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The Continuing Role For Antitrust Enforcement In the Electricity Sector

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By William H. Stallings[1]

Regulated industries present challenges for antitrust enforcement, including complex products and fact patterns, difficult theories of liability, and, at times, limited remedial options.

I. INTRODUCTION

One of the more demanding challenges involves the question of when regulation may displace the antitrust laws. The debate on this issue is as old as the Sherman Act itself and continues to this day, with recent Supreme Court cases refining the contours of the relationship between antitrust and sectoral regulation.

The Antitrust Division of the United States Department of Justice has a long history of enforcing the antitrust laws in regulated industries, complementing regulatory structures to protect against anticompetitive conduct that harms consumers. This history is particularly evident in the highly-regulated electricity sector[2], in which the Antitrust Division has asserted – and the courts have recognized – an important role for governmental enforcement of the competition laws.

Recent enforcement activity builds on this history, demonstrating the Antitrust Division's continued willingness to pursue novel liability theories and unprecedented remedies to address anticompetitive harm in the electricity sector.

In the "New York Capacity" cases[3], the Antitrust Division sued a large power generator and a financial services firm for entering into a financial swap agreement[4] that caused an anticompetitive effect on a regulated energy product called "capacity." The theory of harm was that the swap – in conjunction with a hedge agreement that the financial services firm entered into with the generator's direct competitor – acted to transfer a significant economic interest in the output of one of the competitors to the other, much like a merger or acquisition would have done. The New York Capacity cases reflect the first time that the United States based a Sherman Act Section 1 complaint on the use of a financial derivative agreement to cause harm in an underlying market.

THE NEW YORK CAPACITY CASES REFLECT THE FIRST TIME THAT THE UNITED STATES BASED A SHERMAN ACT SECTION 1 COMPLAINT ON THE USE OF A FINANCIAL DERIVATIVE AGREEMENT TO CAUSE HARM IN AN UNDERLYING MARKET.

The remedy was equally unprecedented. The parties settled the charges, with each defendant agreeing to disgorge profits earned under the swap agreement. These cases marked the first time in the history of the Sherman Act that the United States has sought and obtained disgorgement for a violation of the antitrust laws. This remedial option is likely to play an im-

portant role when dealing with antitrust claims arising against regulated firms. In many such circumstances – including in the New York Capacity cases – private antitrust plaintiffs can be legally foreclosed from seeking monetary damages. Accordingly, government antitrust enforcement – and the remedy of disgorgement – can be particularly meaningful to address anticompetitive harm.

This article focuses on the Antitrust Division's activity in the electricity sector, as set in the larger context of enforcing the antitrust laws in regulated industries.

II. ANTITRUST ENFORCEMENT AND SECTORAL REGULATION

The legal landscape governing application of the antitrust laws to regulated entities requires careful analysis to ensure an appropriate balance between antitrust enforcement and sectoral regulation.

There is a rich history of caselaw addressing this issue that dates back to the enactment of the federal antitrust laws.[5] In 1892, two years after the adoption of the Sherman Act, the United States sued to dissolve a joint rate-setting organization among the defendant railroads. In *United States v. Trans-Missouri Freight Ass'n*,[6] the Supreme Court considered the defendants' argument that the recently-enacted Sherman Act could not apply to their conduct given that the defendants were subject to the specific "system of regulations" set forth in the pre-existing Interstate Commerce Act.[7]

The Court, wrestling with arguments that still resonate in today's cases, scrutinized the terms of the Commerce Act, finding that no provision of the regulation "authorized" an agreement such as the one to form the organization at issue.[8] The Court held that there was "no repeal" and that antitrust and regulation could co-exist in that "both statutes [the Sherman Act and the Commerce Act] may stand, as neither is inconsistent with the other."[9] The Court further found that the railroads were properly subject to both the general proscriptions of the antitrust laws as well as the specific regulatory provisions of the Commerce Act.[10] The vigorous dissent considered the antitrust laws inapplicable as the conduct at issue was "sanctioned," "impliedly authorized" by, "in accord with" and "in harmony with" the regulatory construct under the Commerce Act.[11]

Trans-Missouri was only the beginning.[12] As the Supreme Court frequently has considered the application of competition laws to regulated entities,[13] several general principles have emerged. In the most straightforward circumstance, Congress expressly declares the antitrust laws inapplicable to a particular regulated industry or specific practice subject to regulation.[14] In such situations, there is no question about preemption of the antitrust laws provided that the conduct in question falls within the scope of the statutory exemption.[15]

Where regulatory statutes are silent, however, courts must determine whether the regulatory scheme implicitly precludes application of the antitrust laws to the specific claim at issue. The implied immunity analysis depends "upon the relation between the antitrust laws and the regulatory program set forth in the particular statute, and the relation of the specific conduct at issue to both sets of laws."[16] In the 2007 *Credit Suisse* case, the Supreme Court employed the

following factors to determine "whether there is sufficient incompatibility to warrant an implication of preclusion":

> "(1) the existence of regulatory authority under the [regulatory] law to supervise the activities in question; (2) evidence that the responsible regulatory entities exercise that authority; ... (3) a resulting risk that the [regulatory] and antitrust laws, if both applicable, would produce conflicting guidance, requirements, duties, privileges, or standards of conduct [, and] (4) ... the possible conflict affect[s] practices that lie squarely within an area of ... activity that the [regulatory] law seeks to regulate."

In applying these factors[17] to the private plaintiff's antitrust claims about certain securities underwriting practices, the Court found the securities laws to be "clearly incompatible" with the application of the antitrust laws "in this context," especially as the specific antitrust action would be accompanied by "a substantial risk of injury to the securities markets and by a diminished need for antitrust enforcement to address anticompetitive conduct."[18]

The Supreme Court's most recent case applying the antitrust laws to a regulated firm involved a state – not federal – regulatory scheme. The state action immunity doctrine serves to preempt application of the antitrust laws when anticompetitive activity occurs pursuant to a state regulatory program.[19] The courts, though, impose strict tests to ensure that only appropriate state action displaces the competition laws.[20] In the 2013 *Phoebe Putney* decision, the Court considered whether a Federal Trade Commission challenge to a hospital merger was precluded by a state law creating hospital authorities and giving those authorities general corporate powers. The Court unanimously held that the law did not "clearly articulate" and affirmatively express a policy "to use those powers anticompetitively."[21] As such, the state regulation did not preclude the FTC's antitrust claims.

Even when implied immunity does not apply (such as if the regulatory statute contains an antitrust-specific savings clause), antitrust claims arising in the context of a regulated industry still may be barred. In *Trinko*, the Supreme Court dismissed a monopolization claim by a private plaintiff alleging that a phone company violated Section 2 of the Sherman Act by refusing to supply competing local exchange carriers with the network elements they needed to provide service to customers.[22] The Court determined that the implied immunity doctrine did not apply because of an antitrust-specific savings clause in the relevant statute. In evaluating the specific refusal to deal claim (which did not fit within an established theory of antitrust liability), the Court nevertheless declined to apply the antitrust laws. It found that the applicable regulatory framework "significantly diminishes the likelihood of major antitrust harm"[23] arising from the conduct at issue, especially given the "existence of a regulatory structure designed to deter and remedy anticompetitive harm."[24]

There is continuing debate about the impact of *Credit Suisse* and *Trinko*.[25] One leading commentator has expressed his concern for the potential for *Trinko* and *Credit Suisse* to adversely impact the role of competition laws when dealing with regulated firms[26]:

> "As the law stands today, antitrust will play a diminished role in regulated industries compared to that which it played before 2004. The Supreme Court's decisions in *Trinko* and *Credit Suisse* interpreted the implicit immunizing effect of regulation broadly and read express savings clauses narrowly. This is a change from the past, which the Court disfavored immunity and antitrust often worked as a constructive complement to regulation in the absence of any express statutory savings provision."

The plaintiffs in both *Credit Suisse* and *Trinko* were private firms seeking substantial damages. The opinions, however, do not explicitly exclude government antitrust enforcement actions from their reach.[27] An argument exists, however, that since one factor affecting the immunity analysis is the claim and remedy at issue; as such, a government antitrust claim for equitable relief may be entitled to more deference than a private claim for monetary damages.[28]

IT IS PARTICULARLY NOTEWORTHY, HOWEVER, THAT IN THE RECENT UNANIMOUS PHOEBE PUTNEY OPINION, THE SUPREME COURT'S REITERATED THE PRESUMPTION AGAINST FINDING THAT A REGULATORY SCHEME CREATES AN IMPLIED IMMUNITY FROM COVERAGE OF THE ANTITRUST LAWS.

Credit Suisse and *Trinko* both favored reliance on the regulatory schemes at issue over application of the antitrust laws. It is particularly noteworthy, however, that in the recent unanimous *Phoebe Putney* opinion, the Supreme Court's reiterated the presumption against finding that a regulatory scheme creates an implied immunity from coverage of the antitrust laws. The Court stressed that the antitrust laws reflect the "fundamental national values of free enterprise and economic competition;"[29] as such, immunities – i.e., state-action immunity or immunity based on "repeals by implication" – are "disfavored."[30]

III. GOVERNMENT ANTITRUST ENFORCEMENT IN THE REGULATED ENERGY SECTOR

The Supreme Court repeatedly has recognized the ability of the government to seek redress for antitrust violations committed by regulated entities.[31] In doing so, the Court has endorsed antitrust enforcement actions brought by the United States against firms in regulated industries as diverse as railroads[32], banks[33], radio stations[34], and natural gas distribution[35].

The energy sector – one of the most critical sectors of the economy, affecting every business and consumer in the United States – is no different. Although energy markets are subject to extensive regulatory structures pursuant to the Federal Power Act and related statutes[36], the United States has long played an important role in protecting competition in energy through antitrust enforcement actions.

In the seminal case of *Otter Tail Power Co. v. United States*, the United States brought an action under Section 2 of the Sherman Act to stop *Otter Tail* Power Company from monopolizing the retail distribution of power in its service area by, among other things, refusing to distribute wholesale power to municipally owned distribution systems.[37] The Supreme Court upheld

the lower court's order requiring the defendant to transmit power to the municipal utilities despite the defendant's argument that immunity should apply due to Federal Power Commission regulation.[38] The Court scrutinized the regulatory scheme and found no general legislative "purpose to insulate electric power companies from the operation of the antitrust laws."[39] The Court further found that any general remedial powers that the regulator had pursuant to the Federal Power Act would not serve to displace the reach of the antitrust laws: "There is no basis for concluding that the limited authority of the Federal Power Commission to order interconnection was intended as a substitute for, or to immunize *Otter Tail* from, antitrust regulation for refusing to deal with municipal corporations."[40]

In the 1997 *Rochester Gas & Electric* case, the United States filed a civil antitrust complaint alleging that defendant Rochester Gas and Electric ("RG&E") entered into a contract with the University of Rochester ("University"), in which RG&E promised the University a number of benefits, including electricity at reduced rates, in exchange for the University's promise not to compete against RG&E in the sale of electricity to consumers.[41] The case had its origin in the highly regulated electricity rates in New York in the early 1990s. The University, a major customer of RG&E, had decided to build an efficient new power plant to replace a decades-old steam plant used to heat and cool its buildings. The new plant would also produce more electricity than the University needed. The University considered selling the plant's excess electricity to other users, in competition with RG&E. The new plant, however, was never built. Instead, RG&E and the University entered into a supply agreement that also prevented the University from participating in any projects that would provide other current RG&E customers with energy from anyone other than RG&E.[42]

The district court considered and rejected RG&E's claim that the contract with the University was immune under the state action doctrine, finding nothing in the New York Public Service Law to support RG&E's contention that the regulatory scheme authorized it to impose in supply contracts anticompetitive conditions on potential competitors.[43] Moreover, the court, on summary judgment, rejected the defendant's argument that pervasive regulation, including "rigorous review" and acceptance of the contract at issue by the regulator (the Public Service Commission), conferred antitrust immunity[44]:

> "The Public Service Commission, however, is not charged with enforcing federal antitrust law, and did not review the contract to determine whether or not it violates that law. The fact that the New York Public Service Commission has approved the contract at issue does not mean that the State has authorized, and shielded from federal law, allegedly anticompetitive behavior."

COURTS HAVE LONG RECOGNIZED THE ABILITY OF THE ANTITRUST AGENCIES TO REVIEW MERGERS THAT ARE ALSO SUBJECT TO OTHER REGULATORY REVIEW. IN MOST INSTANCES, THE REGULATORY AGENCY AND THE ANTITRUST AGENCY REACH THE SAME RESULT.

Following the court's rejection of RG&E's motion for summary judgment, the Antitrust Division's lawsuit was resolved by a consent decree that prohibited RG&E from entering into such agreements not to compete.[45]

In addition to conduct cases under Sections 1 and 2 of the Sherman Act, the United States repeatedly

has challenged mergers in the electric power industry under Section 7 of the Clayton Act.[46] The merger review under Section 7's substantial lessening of competition test occurs even though FERC also reviews mergers and acquisitions under its public interest standard. Courts have long recognized the ability of the antitrust agencies to review mergers that are also subject to other regulatory review.[47] In most instances, the regulatory agency and the antitrust agency reach the same result; there can be circumstances, however, when one agency challenges a merger that the other approves[48] or one agency seeks additional remedies than the other.[49]

IV. THE NEW YORK CAPACITY CASES

Following on this history of antitrust enforcement in the electricity sector, the Antitrust Division recently filed two cases with accompanying settlements – the New York Capacity cases – that together demonstrate the Antitrust Division's continuing enforcement activity in matters involving the electricity sector.

A. "Capacity" – A Regulatory Construct

Electrical power is furnished through a grid of interconnected transmission lines and local distribution lines. Retail utilities, frequently called "load serving entities" or "LSEs," must satisfy their customers' power needs ("load") by either generating their own electricity or purchasing power on the wholesale market to re-sell to customers.

Consumer demand for electricity varies widely from season to season, from day to day, and from hour to hour. Demand can be unpredictable (i.e., an unusually hot day could result in electricity needs far above expectations). As electricity cannot be stored in large amounts, generation of electricity must continuously – and instantaneously – match actual demand.

Because the system as a whole is built to protect against the unexpected loss of a generator even at peak demand, a good deal of generating capacity remains idle – and therefore not earning revenues from power sales – for significant periods of time. In other words, having standby capacity costs money to maintain but may rarely, or never, be used. As a result, over the long run, producers may not provide sufficient investment in power plants, leaving the market with inadequate supply.

Regulatory agencies have created "capacity" payments as a means to address this concern.[50] Technically speaking, "capacity" is simply "[t]he capability to generate or transmit electrical power, measured in megawatts."[51] In New York, FERC and the New York Independent System Operator (NYISO), a regional transmission organization operating under FERC authority, require LSEs to procure sufficient capacity from energy suppliers to cover expected load plus a reserve. The capacity payments provide the suppliers a revenue stream independent of actual power sales in order to encourage the construction of adequate generation capacity to cover demand.

Of course, these capacity payments are a cost to LSEs that are ultimately borne by ratepayers. The selection of the amount of capacity that must be purchased has significant consequences both on power prices in the short-run and the development of generation in the long-

run, reflecting a balance between providing enough of a revenue stream to ensure adequate incentives for construction of new generation yet not too high to cause an unnecessary burden to ratepayers.

In New York, the price for capacity is set through FERC-established auctions administered by the NYISO. The auctions match buyers and sellers of capacity using a "clearing price" methodology. Capacity suppliers offer price and quantity bids, which are "stacked" from lowest-priced to highest. The stack is then compared to the amount of demand. The offering price of the last bid in the "stack" needed to meet requisite demand establishes the market price for all capacity sold into that auction.[52] Any capacity bid above this price is unsold, as is any excess capacity bid at the market-clearing price. In this way, suppliers of capacity are competing against each other to sell their capacity to LSEs, thereby forming a capacity market in which market-based rates prevail.

Because of the constrained nature of the transmission system, New York City needs its own local electricity supply to meet all demand (it is a "load pocket"[53]). As a result, regulators require that LSEs in New York City obtain almost all of their capacity requirements (i.e., 80 percent) from suppliers physically located in the city.

During the period at issue in the New York Capacity cases, the New York capacity market was highly concentrated, with three firms – KeySpan, Astoria, and NRG Energy, Inc. (together, the "DGOs"[54]) – controlling a substantial portion of the market's generating capacity. Each DGO was designated as a "pivotal supplier" by FERC, meaning that at least some of each of these three suppliers' capacity was required to satisfy demand. As a result, the DGOs were subject to regulatory caps on the price they could bid their capacity in auctions (known as "mitigation"[55]). The New York capacity market generally cleared at prices at or near the bid caps even though the mitigation bid caps did not apply to other firms or new power plants.

Significant new generation capacity was planning to enter the market in 2006. This additional generation had the potential to impact the auction price for capacity, driving the price below the bid caps as generation firms would need to bid more competitively against each other to ensure sales of their capacity at the auctions.

B. The Swap Agreement

The United States' complaints against *KeySpan* and *Morgan Stanley* set forth the background, circumstances and effects of the *KeySpan* Swap. In brief, the complaints alleged that in 2005, *KeySpan*, concerned about the impending market entry, studied various options, including the direct purchase of Astoria (which would have increased *KeySpan*'s market share, thereby securing its incentive to bid its capacity at the bid cap). Such an acquisition, however, would have raised significant market power concerns. *KeySpan* decided instead to approach *Morgan Stanley* to arrange a financial

IN 2005, KEYSPAN, CONCERNED ABOUT THE IMPENDING MARKET ENTRY, STUDIED VARIOUS OPTIONS, INCLUDING THE DIRECT PURCHASE OF ASTORIA. SUCH AN ACQUISITION, HOWEVER, WOULD HAVE RAISED SIGNIFICANT MARKET POWER CONCERNS.

transaction that would provide *KeySpan* an indirect financial interest in Astoria's capacity sales. *Morgan Stanley* informed *KeySpan* that such an agreement between *Morgan Stanley* and *KeySpan* would be contingent on *Morgan Stanley* also entering into an agreement with Astoria, the only other generator with sufficient capacity to offset *Morgan Stanley*'s payments to *KeySpan*.

In January 2006, *KeySpan* and *Morgan Stanley* entered into the *KeySpan* Swap. Under the terms of the *KeySpan* Swap, when the market clearing price for capacity was above the fixed strike price ($7.57 per kW-month), *Morgan Stanley* would pay *KeySpan* the difference between the market price and $7.57 times 1,800 MW (the quantity of capacity established in the agreement); if the market price was below $7.57, *KeySpan* would pay *Morgan Stanley* the difference times 1,800 MW.[56]

Morgan Stanley, which faced significant financial risk if capacity prices settled above the Swap's fixed price, immediately entered into an offsetting agreement with Astoria, *KeySpan*'s largest competitor (the "Astoria Hedge"). Under the Astoria Hedge, if the market price for capacity was above $7.07 per kW-month, Astoria would pay *Morgan Stanley* the difference times 1,800 MW; if the market price was below $7.07, Astoria would be paid the difference times 1,800 MW. *Morgan Stanley* received as revenues the differential between the fixed prices in the *KeySpan* Swap and the Astoria Hedge.

The *KeySpan* Swap itself was a purely financial transaction in that it did not transfer any physical control of capacity. *KeySpan*, however, in effect, was purchasing 1,800 MW-month of capacity from *Morgan Stanley* at the fixed price and selling the same quantity back to *Morgan Stanley* at a value close to the spot auction price.[57] As a result, *KeySpan* profited even more when capacity prices were high, earning revenues on its own capacity and the additional capacity in which it had a financial interest. (The 1,800 MW amount in the *KeySpan* Swap was substantial; in effect, *KeySpan* was nearly doubling its existing capacity levels.)

C. The Antitrust Division's Enforcement Actions

On February 22, 2010, the United States filed suit against *KeySpan* for its role in the *KeySpan* Swap[58] and simultaneously entered into a settlement requiring *KeySpan* to pay to the United States $12 million as disgorgement of ill-gotten gains. The United States subsequently filed suit against *Morgan Stanley* for its role in the Swap,[59] along with a settlement requiring Morgan to disgorge to the United States $4.8 million. The United States District Court for the Southern District of New York entered both judgments following the required Tunney Act public interest review.[60]

THE REVENUES FROM ASTORIA'S CAPACITY SALES THAT KEYSPAN OBTAINED THROUGH THE KEYSPAN SWAP ELIMINATED KEYSPAN'S INCENTIVE TO COMPETE FOR SALES IN THE SAME WAY A PURCHASE OF ASTORIA OR A DIRECT AGREEMENT BETWEEN KEYSPAN AND ASTORIA WOULD HAVE DONE.

The theory of the United States' claims was that the likely effect of the *KeySpan* Swap was to increase prices in the New York City capacity market. The revenues from Astoria's capacity sales that *KeySpan* obtained through the *KeySpan* Swap eliminated *KeySpan*'s incentive to compete for sales in the same way a purchase of Astoria or a direct agreement between *KeySpan* and

Astoria would have done. The agreements effectively transferred to *KeySpan* a financial interest in Astoria's capacity, thereby ensuring that *KeySpan* would "economically withhold"[61] substantial output from the capacity market and increase prices. As a result, *KeySpan* consistently bid its capacity into the capacity auctions at the highest allowed price even though that assured it would sell fewer units in the auction. Despite the addition of significant new generating capacity in New York City, the market price of capacity did not decline.[62]

Following the filing of the government's *KeySpan* complaint, private plaintiffs also filed antitrust actions challenging the *KeySpan* Swap. In 2011, Charles Simon, a retail consumer of electricity in New York City, filed suit against *KeySpan* and *Morgan Stanley*, on behalf of a putative class of similarly-situated consumers, alleging claims that were substantially similar to those in the Antitrust Division's New York Capacity cases.[63] On a motion to dismiss the complaint, the district court found that Simon lacked standing and that his claims for monetary damages resulting from higher capacity prices were barred by a legal doctrine that prohibits antitrust courts from awarding damages based on federally regulated rates (the "filed-rate doctrine"[64]). The Court of Appeals for the Second Circuit affirmed.[65]

In addition to court cases, there was also regulatory scrutiny of the *KeySpan* Swap. In 2008, FERC directed its enforcement staff to evaluate whether *KeySpan*'s conduct violated FERC's market manipulation rule. Staff recommended against enforcement.[66] The FERC staff report did not address application of the antitrust laws.[67]

V. CONTINUING ROLE FOR GOVERNMENT ANTITRUST ENFORCEMENT TO REMEDY ANTICOMPETITIVE CONDUCT IN THE ELECTRICITY SECTOR

A. Use of Antitrust Laws to Challenge Anticompetitive Conduct

The New York Capacity cases demonstrate the Antitrust Division's continuing use of government antitrust enforcement to supplement and complement regulatory oversight.

THE NEW YORK CAPACITY CASES AROSE IN THE CONTEXT OF THE HEAVILY REGULATED CAPACITY MARKET, A MARKET THAT WAS IN EFFECT A CONSTRUCT OF REGULATION. THE ISSUE OF WHETHER THIS REGULATORY STRUCTURE WOULD PRECLUDE THE GOVERNMENT'S ANTITRUST ACTION WAS NEVER LITIGATED BY A COURT.

The New York Capacity cases arose in the context of the heavily regulated capacity market, a market that was in effect a construct of regulation. The issue of whether this regulatory structure would preclude the government's antitrust action was never litigated by a court as the parties settled the case prior to contested litigation. In the private Simon case, *KeySpan* and *Morgan Stanley* argued that the antitrust challenge to the *KeySpan* Swap was barred both by the doctrine of implied immunity pursuant to *Credit Suisse* and by *Trinko*'s admonition that antitrust claims should be dismissed if a regulatory framework "significantly diminishes the likelihood of major antitrust harm."[68] The court, however, did not reach the immunity claims.[69]

Accordingly, we do not have a litigated decision regarding the boundary between regulation and antitrust enforcement with regard to the *KeySpan* Swap. That said, the *Otter Tail* decision (finding no implied immunity in the electricity sector) remains good law, and the Supreme Court's recent citations to it in both *Credit Suisse* and *Trinko* strongly suggest that it views this case as rightly decided. It is no surprise then that lower courts are reluctant to find that implied immunity precludes antitrust actions in the energy sector; indeed, it does not appear that any court has applied *Credit Suisse* to do so.[70]

Plainly, the Antitrust Division did not view the underlying regulatory scheme to preclude antitrust enforcement in the New York Capacity cases.

Other recent Antitrust Division activity in the electricity sector similarly demonstrates that it does not view regulation as foreclosing antitrust actions On November 14, 2012, the Antitrust Division issued a public statement regarding its investigation of Entergy Corporation,[71] an integrated energy company engaged primarily in electric power production, transmission and retail distribution operations in a service area covering all or parts of Arkansas, Louisiana, Mississippi and Texas.[72] Entergy operates in a heavily regulated market that has extensive federal, state and local regulatory oversight.[73]

The Antitrust Division's statement noted that it investigated, among other things, whether certain of Entergy's power generation dispatch, transmission planning and power procurement practices constituted exclusionary conduct under Section 2 of the Sherman Act by effectively foreclosing more efficient power suppliers. Entergy's practices allegedly kept these rivals from obtaining certain long-term transmission rights they needed to effectively sell long-term power products to wholesale customers in the Entergy service area. Entergy ultimately publically committed to join an independent regional transmission organization and to divest its transmission assets. Because it was giving up its ability to exclude its power plant competitors, the Antitrust Division decided not to go to court.

The Antitrust Division's statement, without getting into details, specifically noted that it had considered – and rejected "as not persuasive" – regulatory justifications that defendants could have asserted as a defense to the Division's antitrust claims. In short, the Division did not consider the role of antitrust to be foreclosed.

B. Use of Novel Liability Theories and Remedies When Dealing With Regulated Industries

The New York Capacity cases show that the Division is prepared to pursue novel liability theories, as seen by its challenge to financial arrangements that it believed achieved anticompetitive effects analogous to other agreements prohibited by the antitrust laws. In so doing, the fact that an agreement is with a financial intermediary rather than directly with a competitor will not exempt an anticompetitive agreement from scrutiny.[74]

THE ANTITRUST DIVISION ARGUED THAT DISGORGEMENT WAS A MEANINGFUL REMEDY IN *KEYSPAN* IN THAT ANY PRIVATE LAWSUIT FOR DAMAGES FROM INCREASED CAPACITY PRICES WOULD FACE SIGNIFICANT OBSTACLES DUE TO THE FILED-RATE DOCTRINE

The Antitrust Division's pursuit of disgorgement as a remedy was equally novel. The Division argued that disgorgement was a meaningful remedy in *KeySpan* in that any private lawsuit for damages from increased capacity prices would face significant obstacles due to the filed-rate doctrine.[75] That doctrine, annunciated in the 1922 *Keogh* decision, bars a private plaintiff from pursuing an antitrust action seeking treble damages based on rates that have been submitted to and approved by a federal regulatory agency. The Supreme Court held that this "stringent rule" applied in order to protect the "paramount purpose" of Congress in preventing unjust discrimination and ensuring that rates met the requirements of the regulatory structure.[76] The doctrine is a significant hurdle on private plaintiffs seeking damages. Many commentators have called for its modification or repeal, especially in regulated sectors that rely on market-based rates.[77]

The *KeySpan* Court found that disgorgement is available to remedy violations of the Sherman Act.[78] Disgorgement is an equitable remedy designed to deprive the wrong-doer of ill-gotten gains; it is not a substitute for damages.[79] The *KeySpan* Court pointed to the use of this remedy to deter anticompetitive conduct, specifically noting the regulatory context in which the *KeySpan* case arose:

> "Future manipulators of electricity markets or those who seek to leverage derivative products in the restraint of trade now face the prospect of disgorgement in addition to other remedies. This case is an important marker for enforcement agencies and utility regulators alike. Approving disgorgement as part of the Government's arsenal tilts incentives back in favor of competitive bidding and deters the use of derivatives as tools to manipulate a market."[80]

Following the *KeySpan* decision, the United States pursued disgorgement against *Morgan Stanley* for its role in the *KeySpan* Swap.[81] The *Morgan Stanley* Court approved the remedy, noting that its deterrent value on intermediaries who might facilitate anticompetitive conduct: "Approving disgorgement here likely will deter financial services firms from offering derivatives that facilitate anticompetitive behavior. . . . The innovative application of the disgorgement remedy in this action suggests that the settlement will have meaningful deterrent effects."[82]

Disgorgement will be useful in antitrust actions arising in regulated industries as the filed-rate doctrine will commonly apply to limit private damages actions.[83]

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1. The author is Chief of the Transportation, Energy and Agriculture Section of the Antitrust Division of the United States Department of Justice. The views expressed herein do not necessarily reflect those of the United States Department of Justice.

2. Electricity and products relating to electricity are extensively regulated. In general, state regulation typically covers the provision of power from retailers to customers, whereas the Federal Power Act provides the Federal Energy Regulatory Commission ("FERC") authority over wholesale energy markets. See 16 U.S.C. § 824(b)(1). FERC has responsibility for regulating the capacity products at issue in the New York Capacity cases described below.

3. United States v. KeySpan Corp., 763 F. Supp. 2d 633 (S.D.N.Y. 2011) & United States v. Morgan Stanley, 881 F. Supp. 2d 563 (S.D.N.Y. 2012).

4. Swaps are common financial derivative agreements used extensively throughout the economy. In typical circumstances, parties use these arrangements to manage exposure to changing prices for items such as interest rates or currency values.

5. In a sense, the issue actually preceded the Sherman Act. See Gibbs v. Baltimore Gas Co., 130 U.S. 396 (1889) (applying antitrust principles to public utilities under the common law).

6. 166 U.S. 290 (1897).

7. Id. at 302.

8. Id. at 314-15.

9. Id. at 315.

10. Id. at 315-16 & 324-25.

11. Id. at 363 & 370-72 (White, J., dissenting). The dissent argued that antitrust liability would "strike a blow" at the beneficial goals sought to be gained under the existing regulatory framework envisioned under the Commerce Act. Id.at 372.

12. In the early years of Sherman Act enforcement, most of the cases involved agreements among or consolidations of railroads. E.g., United States v. Joint Traffic Ass'n, 171 U.S. 505 (1898); Northern Securities Co. v. United States, 193 U.S. 197 (1904); United States v. Terminal Railroad Ass'n, 224 U.S. 383 (1912). Congress ultimately gave a regulatory agency (first the Interstate Commerce Commission and later the Surface Transportation Board) the exclusive ability to decide upon competitive issues raised by mergers and other specified collective railroad actions. As such, the Antitrust Division can provide only an advisory role in such matters.

13. See generally Dennis W. Carlton and Randal C. Picker, Antitrust and Regulation, Nat'l Bureau of Economic Research Working Paper No. 12902 at 2 (2007) (surveying the history of antitrust and industry-specific regulation in the United States, concluding that the Sherman Act "has turned out to be more enduring than regulation").

14. E.g., Capper-Volstead Act, 7 U.S.C. §§ 291-292 (providing immunity for agricultural joint marketing associations) & Ocean Shipping Act, 46 U.S.C. § 40307 (exempting certain ocean shipping agreements from the antitrust laws).

15. See, e.g., Christine A. Varney, "The Capper-Volstead Act, Agricultural Cooperatives, and Antitrust Immunity," The Antitrust Source, December 2010 at 1-9 (discussing the issue of whether production restrictions between and among agricultural cooperatives and their members fall within the antitrust immunity grant in the Capper-Volstead Act).

16. Credit Suisse Secs. (USA) LLC v. Billing, 551 U.S. 264, 271 (2007).

17. See id. at 275-76.

18. Id. at 284-85.

19. Parker v. Brown, 317 U.S. 341, 352 (1943).

20. See Federal Trade Comm'n v. Phoebe Putney Health System, Inc., 133 S. Ct. 1003, 1010-12 (2013).

21. Id. at 1007.

22. Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, 540 U.S. 398 (2004).

23. See Trinko, 540 U.S. at 406 & 412 (internal quotations omitted).

24. Id. at 412. "Where such a structure exists," the Court stated "the additional benefit to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny." Id.

25. See, e.g., Stacey L. Dogan & Mark A. Lemley, Antitrust and Regulatory Gaming, 87 Tex. L. Rev. 685, 685-86 (2009) (Recent Supreme Court cases "have fundamentally altered the relationship between antitrust and regulation, placing antitrust law in a subordinate relationship that, some have argued, requires it to defer not just to regulatory decisions but perhaps even to the silence of regulatory agencies in their areas of expertise."); Richard M. Brunell, In Regulators We Trust: The Supreme Court's New Approach to Implied Antitrust Immunity, 78 Antitrust L.J. 279 (2012); see also ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS 360-62 (2007) ("Trinko should not be read to displace the role of the antitrust laws in regulated industries.") & 358 ("When the government decides to adopt economic regulation, antitrust law should continue to apply to the maximum extent possible, consistent with that regulatory scheme.").

26. Howard A. Shelanski, The Case for Rebalancing Antitrust and Regulation, 109 Mich. L. Rev. 683, 684-85, 708 & 731 (2011) (Credit Suisse "marks the first time in the line of implied-immunity cases that the Court has found regulation to imply immunity from legitimate and nonrepugnant antitrust claims.").

27. E.g., id. at 684-85 & 713-14 ("The Supreme Court's decisions, however, affect public and private actions equally. The Court nowhere confined its holdings to private cases and antitrust doctrine draws no distinction between public and private enforcement.").

28. See 1A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 243g1, at 360 ("To be sure, equity actions can effectively overrule an agency and force it prospectively to change course, but purely equity suits are much less often brought by private parties and—because the rewards are smaller—typically are done with closer attention to competitive merits.").

29. Phoebe-Putney, 133 S. Ct. at 1010. The classic iteration of the "fundamental" aspect of the antitrust laws is found in United States v. Topco Assoc., 405 U.S. 596, 610 (1972): "Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete – to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster."

30. Phoebe-Putney, 133 S. Ct. at 1010 (quoting FTC v. Ticor Title Ins. Co., 504 U.S. 621, 636 (1992)).

31. See Keogh v. Chicago & N.W. Ry. Co., 260 U.S. 156, 161-62 (1922) ("[U]nder the Anti-Trust Act a combination of carriers to fix reasonable and nondiscriminatory rates may be illegal; and, if so, the government may have redress by criminal proceedings . . ., by injunction . . ., and by forfeiture . . . .").

32. E.g., United States v. Pacific & Arctic Railway & Navigation Co., 228 U.S. 87 (1913) (recognizing antitrust violation for attempts by a monopoly carrier to eliminate competition by refusing to deal with other companies).

33. United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

34. United States v. Radio Corp. of America, 358 U.S. 334 (1959) (holding that exchange of radio stations that had been approved by the Federal Communications Commission as in the "public interest" was subject to antitrust review); see also United States v. AT&T Co., 461 F. Supp. 1314, 1324-28 (D.D.C. 1978) (refusing to find that Federal Communications Commission regulation provided immunity for claims made under the antitrust laws).

35. United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964); see also California v. Federal Power Comm'n, 369 U.S. 482, 489 (1962) (holding that Federal Power Commission approval of acquisition of assets of a natural gas company would not bar antitrust challenge).

36. 16 U.S.C. § 824(b).

37. Otter Tail Power Co. v. United States, 410 U.S. 366 (1973).

38. Id. at 373.

39. Id. at 373-74.

40. Id. at 374-75. In Otter Tail, the Federal Power Commission filed an amicus brief with the Supreme Court supporting the position of defendant Otter Tail. Id. at 392 n.8 (White, J., dissenting).

41. Complaint, United States v. Rochester Gas & Elec. Co., No. 97-6294T (W.D.N.Y. filed June 24, 1997).

42. See United States v. Rochester Gas & Elec. Corp., 4 F. Supp. 2d 172, 173-74 (W.D.N.Y. 1998).

43. Id. at 175.

44. Id. at 176.

45. Press Release, March 4, 1998, Rochester Gas & Electric Agrees to Settle Antitrust Suit, U.S. Dep't of Justice., http://www.atrnet.gov/subdocs/212678.htm.

46. E.g., United States v. Enova Corp., 107 F. Supp. 2d 10 (D.D.C. 2000) (entering consent decree relating to challenge to merger of natural gas utility and electric utility).

47. Mergers or sales of assets by federally regulated utilities have been left open to antitrust challenge even though the merger or sale had been explicitly approved by the regulator. See Northeast Utils. Serv. Co. v. FERC, 993 F.2d 937, 947-48 (1st Cir. 1993) ("Petitioners may rest assured that were FERC to approve a merger of utilities which ran afoul of Sherman Act or other antitrust policies, the utilities would be subject to either prosecution by government officials responsible for policing the antitrust laws, or to suit by private citizens meeting the requirements of standing.").

48. In California v. Federal Power Comm'n and United States v. Philadelphia National Bank, the Federal Power Commission and the Comptroller of the Currency had specifically approved acquisitions under their respective regulatory statutes. In both cases, the Court held the government could subsequently challenge the acquisitions in antitrust suits. See Philadelphia Nat'l Bank, 374 U.S. at 350-52; California, 369 U.S. at 484.

49. See generally Tracy Fisher, Electricity Mergers and Department of Justice Antitrust Division Review, The Threshold (Newsletter of the ABA Mergers & Acquisitions Committee), 3-18 (Summer 2012) (describing merger reviews by the two agencies).

50. See generally Central Maine Power Co. v. FERC, 252 F.3d 34, 36-39 (1st Cir. 2001) (describing the use of capacity payments in wholesale electricity markets); Sithe New England Holdings v. FERC, 308 F.3d 71, 73-74 (1st Cir. 2002) (same).

51. New York ISO FERC Electric Tariff, Original Vol. No. 2, Art. 2, Third Revised Sheet No. 29, § 2.18 (defining "capacity"). All operational generation units connected to the grid have capacity regardless of whether they are actually producing power and thereby earning revenues from power sales.

52. Under such "uniform-price" auctions, all suppliers receive the same market-clearing price which is set at the offer price of the most expensive resource chosen to meet supply. NYISO argues that uniform clearing price auctions are advantageous in that they provide a common price for all buyers and sellers, create an incentive for generators to bid competitively, and provide transparency as all participants are aware of the results. See generally http://www.nyiso.com/public/about_nyiso/understanding_the_markets/clearing_price_auctions/index.jsp . NYISO also argues that uniform-price auctions are superior to other types of models, such as "pay-as-bid" auctions, in which prices paid to winning suppliers are based on their actual bids. See http://www.nyiso.com/public/webdocs/media_room/current_issues/uniformpricing_v_payasbid_tierneyschatzkimukerji_2008.pdf .

53. A "load pocket" is an area in which the total electrical import capacity is insufficient to serve the load and, therefore, local generating units within that area are required to meet demand.

54. As part of New York State's market restructuring in 1998, Consolidated Edison Company (ConEd) divested approximately 6,600 MW of its generating capacity located in New York City to independent firms, referred to as the divested generation owners (DGOs).

55. KeySpan had a bid cap of approximately $8.75 per kW-month.

56. The KeySpan Swap agreement is publicly available as an attachment to KeySpan's January 18, 2006 Form 8-K filing with the SEC in which KeySpan announced that it had entered into the transaction, available at http://www.sec.gov/Archives/edgar/data/1062379/000106237906000004/ex101-8kjan2406.txt.

57. In short, based on the terms of the two agreements, if the price of capacity rose above the fixed price, Astoria would pay Morgan Stanley the difference between them, and Morgan Stanley would pay that amount to KeySpan. On the other hand, if the capacity price fell below the fixed price, KeySpan would pay the difference to Morgan Stanley, which, in turn, would pay Astoria that amount.

58. See Complaint, United States v. KeySpan Corp., No. 10-1415 (S.D.N.Y. Feb. 22, 2010).

59. See Complaint, United States v. Morgan Stanley, No. 11-6875 (S.D.N.Y. Sep. 30, 2011).

60. United States v. KeySpan Corp., 763 F. Supp. 2d 633 (S.D.N.Y. 2011); United States v. Morgan Stanley, 881 F. Supp. 2d 563 (S.D.N.Y. 2012).

61. "Economic withholding" refers to a firm bidding its capacity at prices high enough that it is not taken at the auction. As a result, market clearing prices are higher in that the market must rely on more expensive generation (i.e., "move up the supply curve") to compensate for the withheld capacity.

62. See United States v. KeySpan complaint. The anticompetitive effects of the KeySpan Swap lasted until March 2008, when regulatory conditions eliminated KeySpan's ability to affect the market price of electricity capacity.

63. Complaint, Simon v. KeySpan Corp. and Morgan Stanley Capital Group, 10 Civ. 04537 (filed July 16, 2010).

64. Simon v. KeySpan, 785 F.Supp.2d 120 (S.D.N.Y. 2011); see also infra Section V.B. (discussing filed-rate doctrine).

65. Simon v. KeySpan, 694 F.3d 196 (2d Cir. 1012). In addition to Simon, other similar cases were filed in state and federal court.

66. Office of Enforcement, FERC, Findings of a Non-Public Investigation of Potential Market Manipulation by Suppliers in the New York Capacity Market (Feb. 28, 2008).

67. The fact that FERC staff did not recommend an enforcement action against the KeySpan Swap under its market manipulation rules does not preclude an antitrust action. See RG&E, 4 F. Supp. 2d at 176 (regulator's approval of the contract at issue did not preclude a subsequent antitrust claim).

68. Memorandum of Law in Support of Defendants' Joint Motion to Dismiss, Simon v. KeySpan, 10-CV-5437 (Docket #14) at 17-22 (quoting Trinko, 540 U.S. at 412).

69. The Simon court found that the private plaintiffs did not have standing and, as discussed below, that their claims were barred by filed rate doctrine. 785 F. Supp. 2d (S.D.N.Y. 2011), aff'd, 694 F.3d 196 (2d Cir. 2012).

70. See Energy Marketing Servs., Inc. v. Columbia Gas Transmission Corp., 639 F. Supp. 2d 643, 650-52 (S.D.W.Va. 2009) (finding that FERC's regulatory authority did not immunize antitrust claims relating to natural gas transmission: "[Defendant] has failed to cite any case applying the Credit Suisse framework outside of the securities context."); see also In re W. States Wholesale Nat. Gas Antitrust Litig., 661 F. Supp. 2d 1172, 1183 (D. Nev. 2009) (regulatory scheme pursuant to Commodities Exchange Act did not entitle natural gas providers to

implied antitrust immunity from consumers' antitrust and unfair competition claims).

71. "Justice Department Statement on Entergy Corp.'s Transmission System Commitments and Acquisition of KGen Power Corp.'s Plants in Arkansas and Mississippi," United States Dep't of Justice, Nov. 14, 2012, available at http://www.justice.gov/atr/public/press_releases/2012/288781.htm.

72. http://www.entergy.com/about_entergy/

73. As Entergy has explained, its practices and policies are subject to review and regulation by FERC, state electric utility regulatory commissions and local regulators. "Entergy Corporation Cooperating with the U.S. Department of Justice on Civil Investigation," Entergy Corporation, October 10, 2010, available at http://www.entergy.com/news_room/newsrelease.aspx?NR_ID=1898

74. As the United States explained, "Financial services firms contemplating the use of such anticompetitive agreements will now recognize the prospect of Sherman Act liability and disgorgement, thereby diminishing their appetite for and deterring this illegal conduct." Response to Public Comments, United States v. Morgan Stanley, at 8.

75. Competitive Impact Statement, United States v. KeySpan, at 9.

76. Keough v. Chicago & N.W. Ry. Co., 260 U.S. 156, 163-64 (1922).

77. There have been calls to restrict application of the filed rate doctrine. For example, the Antitrust Modernization Commission recommended that "Congress should evaluate whether the filed-rate doctrine should continue to apply in regulated industries and consider whether to overrule it legislatively where the regulatory agency no longer specifically reviews proposed rates." AMC Rec. No. 68 at p.362.

78. See United States v. KeySpan Corp., 763 F. Supp. 2d 633, 638–41 (S.D.N.Y. 2011). Disgorgement has long been used to resolve contempt of antitrust decrees. E.g., Final Judgment, United States v. Exelon, No. 11-CV-02276 (D.D.C., entered Nov. 27, 2012) (approving $400,000 disgorgement related to contempt of electricity-related merger consent decree), available at http://www.justice.gov/atr/cases/f291700/291722.pdf.

79. To illustrate this point, the United States sought disgorgement of profits that both KeySpan and Morgan Stanley earned directly from the KeySpan Swap agreement itself, i.e., their ill-gotten gains. On the other hand, the private plaintiffs in the Simon case were seeking monetary damages for the allegedly increased capacity prices that they paid as a result of the effect of the KeySpan Swap on the underlying capacity market.

80. KeySpan, 763 F. Supp. 2d at 642.

81. See United States v. Morgan Stanley, 881 F. Supp. 2d 563 (S.D.N.Y. 2012) (finding proposed final judgment that required Morgan Stanley to disgorge $4.8 million to be in the public interest).

82. Morgan Stanley, 881 F. Supp. 2d at 567-68.

83. In the private case following the government's New York Capacity cases, the Court of Appeals for the Second Circuit found that the filed-rate doctrine did bar the private damages claims. Simon v. KeySpan, 694 F.3d 196, 204-08 (2d Cir. 2012).