UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, Plaintiff,	)	
-vs-	)	97-CV-6294T
ROCHESTER GAS & ELECTRIC CORPORATION, Defendant.	)	

PLAINTIFF UNITED STATES' MEMORANDUM OF LAW IN REPLY TO DEFENDANT'S OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

INTRODUCTION

In July of 1993, the University of Rochester ("UR") authorized construction of a new power plant that would have replaced its existing steam plant and supplied all of its electricity needs, and then some. The electricity from that cogeneration plant posed a competitive threat to RG&E -- the plant would have first taken UR's electrical load off of RG&E's system, and the excess power could have helped to satisfy the requirements of other RG&E customers. Rather than building the plant, contracted with RG&E for its electricity supply at an attractive price. But RG&E was not content solely to lock-up UR's electricity needs -- it wanted to prevent UR, and anyone working with UR, from building a steam plant that would generate electricity in competition with RG&E.

RG&E could have responded to the threat posed by UR by simply, and lawfully, offering UR a discounted rate of electricity, thereby altering UR's incentive to build the proposed cogeneration plant. A conventional supply contract would have been enough to keep UR's load on the system. But RG&E did more. It extracted UR's promise not to interfere with the load of

other customers, a promise not to compete that violates the antitrust laws. That promise should not be complicated by unnecessary digressions into whether RG&E was justified in giving UR a rate discount, or whether the electric industry is particularly complex. And neither should that simple promise be confused with the electricity supply contract between RG&E and UR, a contract which treats UR as a buyer (not a potential seller) of electricity. Nor, finally, should it be thought that the State of New York, by encouraging competition in the electric generation industry, has somehow authorized anticompetitive behavior in that same industry. RG&E entered into a naked restraint of trade, subject to the per se rule, that is not protected by the state action doctrine, and injunctive relief is the appropriate remedy.

I. REPLY ARGUMENT

A. The Uncontested Facts Make Clear That RG&E's Agreement With UR Is Illegal Per Se, and RG&E's Arguments For Avoiding the Per Se Rule Are Unpersuasive.

Section 6.3 of the Individual Service Agreement ("ISA") explicitly precludes UR from competing with RG&E in the retail electric power market.[1] RG&E acknowledges that the "main purpose" of the ISA was "to provide the university with discounted electric rates *in exchange for the University's promise to forego the construction of a cogeneration plant* and remain a customer of RG&E . . .," and § 6.3 was necessary "to ensure that RG&E would receive the benefit of its bargain." (Def. Rep. Mem. at 23 (emphasis added).) Without § 6.3, and in spite of the supply contract, RG&E would have faced the very real possibility of a competing supplier of electricity. RG&E might be faced with "'everybody in town demand[ing] some kind of discount,'" which is not what RG&E "'paid for.'" (Def. Rep. Mem. at 6 (quoting Thomas

[1] UR will not "solicit or join with other customers of RG&E to participate in any plan to provide them with electric power and/or thermal energy from any source other than RG&E." ISA § 6.3.

Richards, President and Chief Operating Officer of RG&E).) As explained in detail in the United States' opening brief, such an agreement is a naked restraint of trade that is subject to per se condemnation. *See, e.g.*, *Palmer v. BRG of Georgia, Inc*., 498 U.S. 46, 49-50 (1990); *United States v. Topco Assocs. Inc. ,* 405 U.S. 596, 608 (1972); *Engine Specialties, Inc. v. Bombardier Ltd*., 605 F.2d 1, 9 (1st Cir. 1979), *cert. denied*, 449 U.S. 890 (1980).

In response, RG&E argues that the per se rule does not apply in this case because (1) the electric industry is unique, (2) RG&E and UR were not potential competitors, and (3) § 6.3 is "ancillary" to the ISA.[2] In support of its first argument, RG&E accurately cites the Supreme Court's recent decision in *State Oil Co. v. Khan*, 1997 U.S. Lexis 6705, at *10-11. But *Khan* requires experience with a particular type of restraint prior to application of the per se rule, and RG&E confuses that requirement with a requirement of experience with a particular industry. To the contrary, the Supreme Court has unequivocally rejected the argument that per se rules should not be applied in complicated or heavily regulated industries with which the courts have limited experience:

> "[T]he argument that the per se rule must be rejustified for every industry that has not been subject to significant antitrust litigation ignores the rationale for per se rules, which in part is to avoid 'the necessity for an incredibly prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable -- an inquiry so often wholly fruitless when undertaken.'"

Arizona v. Maricopa County Medical Soc'y, 457 U.S. 332, 350-51 (1982) (quoting *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 5 (1958)); *accord Addino v. Genesee Valley*

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[2] These arguments are not necessarily consistent. According to RG&E, § 6.3 is at once "ambiguous on its face" (Def. Rep. Mem. at 5), "meaningless for antitrust purposes" (Def. Rep. Mem. at 20), "ancillary" -- and thus by definition necessary -- to the ISA (Def. Rep. Mem. at 22), and so insignificant as to permit its removal from the ISA (Def. Rep. Mem. at 23). In effect, RG&E claims "we do not know what it means, it does not do anything, we need it, and we just got rid of it."

Medical Care, Inc., 593 F. Supp. 892, 900 (W.D.N.Y. 1984) ("apply[ing] general per se principles to the unique facts" of the health care industry). The per se rules apply in the electric industry just like they apply in any other. *See, e.g., Columbia Steel Casting Co. v. Portland General Elec. Co.*, 111 F.3d 1427, 1444 (9th Cir.), *petition for cert. filed*, 66 U.S.L.W. 3085 (U.S. Sup. Ct. July 2, 1997); *Yeager's Fuel, Inc. v. Pennsylvania Power & Light Co*., 953 F. Supp. 617, 653 (E.D. Pa. 1997).[3]

RG&E next argues that the per se rule is inapplicable because UR was not a potential competitor. To establish whether a party is a potential competitor, courts look to objective factors, such as the concrete steps taken towards entry, *see Engine Specialties*, 605 F.2d at 9, available means to enter, *see Yamaha Motor Co., Ltd. v. FTC*, 657 F.2d 971, 978 (8th Cir. 1981), *cert. denied*, 456 U.S. 915 (1982), and, most tellingly, an agreement which has the purpose of keeping the party from entering, *see United States v. Sargent Elec. Co*., 785 F.2d 1123, 1127 (3rd Cir.), *cert. denied*, 479 U.S. 819 (1986). Here, RG&E's own evidence establishes that UR was a potential competitor. The affidavit of Richard Greene, Executive Vice President and Treasurer of the University, makes clear that (1) the University Board of Trustees had approved a proposal to develop a cogeneration facility, (2) the facility would have generated more electricity than the University could use, and (3) the excess output could have been sold.

The uncontroverted evidence is that the University had not committed that excess output to any particular customer. RG&E did not wait to find out what the University would do with it. Instead, it negotiated § 6.3 of the ISA, a clause that deals with UR as a seller of electricity to

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[3] *Town of Concord v. Boston Edison*, 915 F.2d 17 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991), cited by Defendant, stands for the unremarkable proposition that an evaluation of anticompetitive effects -- which is wholly irrelevant to a per se case such as this -- must take into account the industry in which the effects are alleged. *See id.* at 22.

RG&E's customers in competition with RG&E. RG&E would have the Court believe that § 6.3 is not evidence that UR was a potential competitor, but it does not offer any other intelligible explanation for what it sought to accomplish with that language. *Cf. In re Columbus Park Corp.*, 598 N.E.2d 702, 708 (N.Y. 1992) (contracts are not interpreted to render a provision meaningless).

To counter this uncontested, objective evidence, RG&E relies primarily on Mr. Greene's subjective statement of his and others' "expectations" regarding who would be the first customer of the proposed plant. That evidence is legally and factually insufficient to establish that UR and RG&E were not in potential competition. First, it is inherently subjective -- the uncorroborated post hoc rationalizations of an official "with an incentive to minimize the probability of [the potential competitor's] independent entry." *Yamaha Motor*, 657 F.2d at 979 n.9. Second, it is far too limited -- it purports to account only for the three month period after approval of the plant and before the Memorandum of Understanding cut off any further deliberation regarding what might be done with the excess output. And third, it is only the "expectation" of a single University official, not a final decision.[4]

As for the claim that UR could not compete because the PSC would have withheld the necessary permits to sell the plant's output, RG&E relies on two orders in which the PSC approved generating facilities under the "at or near" standard. (Def. Rep. Mem. at 21.) Those

[4] In its Reply Memorandum, RG&E argues that its evidence of UR's "intent" entitles it to summary judgment under the rule of reason. (Def. Rep. Mem. at 14.) This argument ignores the fact that the United States disputes RG&E's assertion of the University's "intent" as to who would be the first customer of UR's cogeneration plant. *See* Plaintiff's Statement Setting Forth Specific Facts as to Which There Is a Genuine Issue In Opposition To Defendant's Motion for Summary Judgment, ¶ 70, at 35.

orders show only that, when asked, the PSC *has* granted approval, at least twice. RG&E's agreement, not the PSC, prevented UR from competing with RG&E.

Finally, RG&E argues that per se treatment is unwarranted because § 6.3 is "ancillary." All horizontal restraints have anticompetitive effects, but not all are subject to the per se rule. In limited circumstances, where the restraint is "collateral to but necessary for the implementation of a lawful agreement," a horizontal restraint will be judged according to its reasonableness. *Tower Air, Inc. v. Federal Express Corp*., 956 F. Supp. 270, 283 (E.D.N.Y. 1996); *see generally United States v. Addyston Pipe & Steel Co*., 85 F. 271, 281 (6th Cir. 1898), *modified and aff'd*, 175 U.S. 211 (1899). But to be deemed ancillary, a restraint must be "part of a larger endeavor whose success [it] promote[s]," *Polk Bros., Inc. v. Forest City Enters., Inc*., 776 F.2d 185, 189 (7th Cir. 1985), and it must be "no broader in scope than necessary to accomplish the purpose of the agreement." *Tower Air*, 956 F.2d at 283.

RG&E's ancillarity argument founders on its inability to identify in the ISA a "larger endeavor" that § 6.3 "promotes." It cannot be the ISA itself, a straightforward supply contract between a buyer and seller of electricity. By its own admission, RG&E has entered into 74 such electricity supply contracts. (Def. Rep. Mem. at 24.) In 73 of those, RG&E apparently believed it could achieve its main purpose without bargaining for a commitment from the buyer that it would not compete as a seller. "[N]o reason has been suggested why" accomplishing the objectives of a simple supply contract "requires that [RG&E and UR] be forbidden to compete with each other." *General Leaseways, Inc. v. National Truck Leasing Ass'n*, 744 F.2d 588, 595 (7th Cir. 1984).

RG&E has attempted to disguise a straightforward contract provision with conflicting interpretations and to cloak it with complex but ultimately tangential regulation. But the fact

remains that UR was poised to generate electricity that it could have sold to RG&E customers. RG&E's response, to pay the University not to compete for those customers, is a per se violation of the Sherman Act.

B. The State Action Doctrine Does Not Shield RG&E's Private Agreement With UR From the Antitrust Laws.

If RG&E fails to show a clearly articulated state policy expressly authorizing its noncompetition agreement, its state action argument fails as a matter of law. The "clear articulation" prong of RG&E's state action defense is based on New York's policy of allowing utilities to negotiate flexible rate contracts with entities capable of generating their own power. But the United States is not challenging the flexible rate policy or the price under which UR bought electricity from RG&E. The United States challenges RG&E's agreement with UR not to sell electricity in competition with UR. That agreement, as explained in the United States' opening brief and in the amicus brief of the State of New York, is fundamentally inconsistent with New York's regulation of the electric industry, and its policy of permitting competition between utilities and cogenerators such as UR.

Even if RG&E prevails on the first, "clear articulation," prong of the state action defense, it must also establish, as a matter of fact, the second prong, that New York actively supervised the anticompetitive agreement. It cannot. RG&E points primarily to the filing of the ISA with the PSC, but mere filing is legally insufficient to establish active supervision, *see Cantor v. Detroit Edison Co.*, 428 U.S. 579, 594-95 & n.31 (1976). At the very most, RG&E has created a question of fact for trial on the active supervision prong of state action, a question of fact that is relevant only if the Court finds that New York clearly articulated a policy expressly authorizing the challenged agreement.

C. Injunctive Relief Is the Appropriate Remedy.

Apparently recognizing that it could not meet the "heavy burden" required to support a forthright claim of mootness, *see, e.g., R.C. Bigelow, Inc. v. Unilever N.V.*, 867 F.2d 102, 106-07 (2d Cir.), *cert. denied sub nom. Thomas J. Lipton, Inc. v. R.C. Bigelow, Inc.*, 493 U.S. 815 (1989), RG&E falls back on the argument that this litigation is a "waste of judicial resources." The United States disagrees.

Where a defendant's cessation of activity is "highly selective" and in response to litigation, *see Soto-Lopez v. New York City Civil Serv. Comm'n*, 840 F.2d 162, 168 (2d Cir. 1988), "injunctive relief remains appropriate so long as future violations of plaintiff's rights are threatened." *Sterling Drug Inc. v. Bayer AG*, 792 F. Supp. 1357, 1375-76 (S.D.N.Y. 1992), *aff'd in part & remanded in part*, 14 F.3d 733 (2d Cir. 1994). RG&E has engaged in a practice that blatantly violates the antitrust laws. Under the threat of pending litigation, RG&E eliminated one manifestation of that practice. The United States has received no assurance that RG&E has ceased the offending conduct, nor, more importantly, has it received any indication that RG&E recognizes the illegality of its behavior. Indeed, RG&E's pleadings in this case demonstrate its belief that paying a competitor to leave its customers alone is perfectly legal and can be done in the future. Especially in light of the increasingly competitive nature of the electric generation industry, an injunction is necessary to ensure that this misunderstanding does not harm consumers in the future. Judicial resources will only be wasted if the United States is forced to return to court the next time RG&E enters into an agreement not to compete with a competitor, and then defends it on the same grounds it has presented to this Court.

III. CONCLUSION

RG&E's agreement not to compete is a per se violation of Section One of the Sherman Act. It was not entered into pursuant to any clearly articulated state policy to displace competition between utilities and cogenerators. Accordingly, the United States' motion for summary judgment should be granted. If the Court determines that summary judgment for the United States is not warranted, trial is necessary, because RG&E cannot show a policy expressly authorizing the anticompetitive agreement, and because the United States disputes the facts on which RG&E relies to claim active supervision under the state action doctrine, as well as those on which it relies to claim a lack of potential competition.

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DEPARTMENT OF JUSTICE
ANTITRUST DIVISION

By: _____
Jade Alice Eaton
Transportation, Energy &
Agriculture Section
325 Seventh Street, N.W.
Washington, D.C. 20530
(202) 307-6316