IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 07-2499

FEDERAL TRADE COMMISSION,

Plaintiff - Appellant,

v.

EQUITABLE RESOURCES, INC., DOMINION RESOURCES, INC.,
CONSOLIDATED NATURAL GAS COMPANY, and
THE PEOPLES NATURAL GAS COMPANY,

Defendants - Appellees.

ON APPEAL FROM A FINAL ORDER OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA DISMISSING PLAINTIFF'S COMPLAINT

BRIEF OF PLAINTIFF - APPELLANT FEDERAL TRADE COMMISSION

* * PUBLIC VERSION * *

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JURISDICTION

The Federal Trade Commission ("FTC"), an agency of the United States government, initiated this action in the United States District Court for the Western District of Pennsylvania seeking a preliminary injunction, pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b). The FTC sought the injunction to prevent defendant Equitable Resources, Inc. ("Equitable"), from acquiring The Peoples Natural Gas Company ("Peoples") from the Consolidated Natural Gas Co., which is a wholly-owned subsidiary of Dominion Resources, Inc. ("Dominion"). The FTC requested the injunction to prevent the acquisition pending resolution of an administrative complaint filed on March 14, 2007. The district court's jurisdiction over this matter derives from 15 U.S.C. § 53(b), and from 28 U.S.C. §§ 1337 and 1345.

The FTC seeks review of the district court's Order of May 14, 2007, which granted defendants' motion to dismiss. That order is final and is appealable pursuant to 28 U.S.C. § 1291. The FTC filed its Notice of Appeal on May 16, 2007, and that notice was timely under Fed. R. App. P. 4(a)(1)(B).

STATEMENT OF THE ISSUES PRESENTED

1. Whether the district court correctly held that the state action doctrine exempts Equitable's acquisition of Peoples from federal antitrust scrutiny. Appendix ("Appx.") 1.

2. Whether, if this Court overturns the district court's dismissal of the FTC's complaint, it should enter relief sufficient to enjoin the acquisition pending the district court's resolution on remand of the issues raised by the FTC's complaint.

STATEMENT OF RELATED CASE

This case is related to the FTC's administrative challenge to defendants' acquisition, *In the matter of Equitable Resources, Inc., et al.*, FTC Docket No. 9322.

STATEMENT OF THE CASE

A. Nature of the Case, the Course of Proceedings, and the Disposition Below

The FTC seeks review of a district court order that dismissed its complaint for a preliminary injunction in aid of an FTC administrative proceeding. In the administrative proceeding, the FTC alleged that Equitable's acquisition of Peoples would result in a monopoly, thereby eliminating the benefits of competition enjoyed by numerous customers (who, in turn, serve thousands of consumers), and violating the antitrust laws. The FTC sought the injunction to prohibit the acquisition pending resolution of the administrative proceedings, both to prevent interim harm to consumers and to ensure the availability of effective relief at the end of those proceedings.

Defendants filed a motion to dismiss, pursuant to Fed. R. Civ. P. 12(b)(6), alleging that their conduct was exempt from the antitrust laws, pursuant to the antitrust state action doctrine. The district court held that the state action doctrine applied because Pennsylvania's regulatory regime was "pervasive," and because the acquisition was, in the court's opinion, in the public interest. The court made no mention of the fact that Pennsylvania law specifically prohibits anticompetitive acquisitions. On the basis of its understanding and application of the state action doctrine, the district court dismissed the FTC's complaint.

B. Facts and Proceedings Below

1. Background

On March 31, 2006, Equitable and Dominion sought approval from Pennsylvania's Public Utility Commission ("PUC") for Equitable to acquire Peoples. PUC Opin. at 2. At the same time, they also provided the FTC with notification of the acquisition, pursuant to the Hart-Scott-Rodino Antitrust Improvements Act, 15 U.S.C. § 18a. Equitable distributes natural gas through pipelines directly to residential, commercial, and industrial customers in ten counties in western Pennsylvania. Appx. 162 (PUC Initial Decision ("ID") at 9). Peoples also distributes natural gas to customers in western Pennsylvania. *Id.* Their service areas overlap so that in some areas, both companies have pipelines and customers may choose between the two companies for gas distribution service. Appx. 211 (ID at 58). As defendants have recognized, this distribution competition affects approximately "500 geographically advantaged customers who are uniquely positioned to leverage discounts." D.5 at 1.[1] Equitable and Peoples compete for these customers by offering discounts from the maximum rates authorized by the PUC. *See* D.5 at 2. As a result of this competition, those customers are currently able to obtain better deals for natural gas distribution service.

Although the number of customers who can take advantage of competition is relatively small, their number greatly understates their significance because these customers are large commercial, industrial, and institutional customers. These

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[1] Items in the district court's record are referred to by their docket number ("D. xx").

customers, who face the possible loss of discounts if the acquisition is consummated, include schools, hospitals, churches, and other organizations (such as Mercy Hospital, Duquesne University, Forbes Nursing Center, and the Animal Rescue League of Western Pennsylvania). Appx. 380, 390 (PX0024, PX0047).[2] They provide a variety of services to thousands of people in western Pennsylvania. An example is Crossgates Management, Inc. It manages four apartment buildings (with more than 450 units of rent-subsidized housing) for which Equitable and Peoples currently compete. Dominion has provided discounts to attract Crossgates' business. Crossgates believes it will lose those discounts if the acquisition is consummated, and, because it cannot pass on price increases to its rent-subsidized tenants, it will have to forgo necessary updates to the buildings. Appx.49 (PX0049).

Duquesne University also currently benefits from competition. Duquesne has an enrollment of approximately 10,000 students, 20% of whom come from outside Pennsylvania. *See* http://www.irp.duq.edu/pdf/2006_Fact_Book.pdf, p. 20. At present, Duquesne obtains natural gas distribution services from Equitable, although in the past, it has also received such services from Dominion. As a result of competition,

[REDACTED]

Appx. 388 (PX0045).

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[2] Exhibits submitted by the FTC in support of its Motion for a Preliminary Injunction (D.3) are referred to as "PX xxxx."

Pursuant to Pennsylvania law, public utilities may not consummate an acquisition of property unless they first obtain a certificate of public convenience from the PUC. 66 Pa. Cons. Stat. § 1102(a)(3).[3] The PUC will grant a certificate only if it determines that the acquisition "is necessary or proper for the service, accommodation, convenience, or safety of the public." 66 Pa. Cons. Stat. § 1103. Pennsylvania law specifically prohibits the PUC from granting approval, however, if the acquisition is "likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power * * *." 66 Pa. Cons. Stat. § 2210(b).

During the proceedings that the PUC held in connection with defendants' acquisition, a wide variety of parties intervened or filed objections, including customers who would be adversely affected. Appx. 154-155 (ID at 1-2). A PUC administrative law judge ("ALJ") held hearings, and on February 5, 2007, he issued an initial decision approving the acquisition. He recognized that the acquisition would eliminate the benefits of gas distribution competition, but he concluded that the "public interest" favored such a result because other customers might benefit from the acquisition. Appx. 220-221 (ID at 67-68). As a result, he concluded that the acquisition complied with Pa. Cons. Stat. § 2210.

On April 13, 2007, the PUC affirmed the ALJ's initial decision with a few minor modifications. Appx. 52.

2. The FTC's administrative proceeding

The FTC conducted its own investigation into the economic impact of the

[3] Relevant statutory sections are included in an Addendum bound with this Brief.

proposed acquisition. That investigation showed that, among other things, Equitable projected that, [REDACTED] eliminating discounts and raising prices charged to customers that currently benefit from competition between the two companies. Appx. 380 (PX0024). Such projections were not qualified by any indication that there would be a concomitant decrease in revenues received from other customers. The FTC's investigation also showed that defendants' customers are already feeling these anticompetitive effects because the defendants -- in anticipation of the acquisition -- have begun to pull back on competing with each other. Appx. 386, 49, 392 (PX0039 at ¶ 4; PX0049 at ¶ 5; PX0051 at ¶¶ 3-4).

In light of this and other evidence, the FTC found reason to believe that the proposed acquisition would substantially lessen competition in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the FTC Act, 15 U.S.C. § 45. On March 14, 2007, the FTC issued an administrative complaint challenging the acquisition. Defendants asserted various affirmative defenses in the FTC action, including the contention that the acquisition is exempt from federal antitrust review pursuant to the state action doctrine. The FTC's complaint counsel moved to strike the state action defense, arguing that Pennsylvania had not clearly articulated a policy to permit Equitable and Dominion to effectuate an anticompetitive acquisition, and that Pennsylvania would not actively supervise Equitable's postmerger anticompetitive conduct. On April 16, 2007, the FTC stayed all further briefing on this issue, pending resolution of defendants' motion to dismiss filed before the district court in this case.

3. Proceedings below

On April 13, 2007, the day that the PUC approved the acquisition, the FTC filed its complaint in this case, pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b).[4] The complaint seeks a preliminary injunction to prevent Equitable and Dominion from consummating the acquisition pending the resolution of the FTC's administrative proceeding. Appx. 34 (D.1). Equitable and Dominion filed a motion to dismiss before the district court, arguing that the state action doctrine renders Equitable's acquisition of Peoples exempt from the federal antitrust laws. D.18. The FTC filed its opposition to the motion to dismiss on April 27. D.44.[5]

On May 14, 2007, the district court granted the motion to dismiss. Appx. 20 (D.71). In its Opinion, D.70 (hereinafter, "Opin."), the court first recognized that, for defendants' state action defense to prevail, they must show that both parts of the test set forth in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), are satisfied. Appx. 12 (Opin. at 12). With respect to the first part of the test, whether Pennsylvania had clearly articulated a policy to displace competition with regulation, the court held that the standard had been met because, in connection with the approval of acquisitions, Pennsylvania had enacted a "comprehensive and pervasive governmental regulatory scheme." Appx. 13 (Opin.

[4] Section 13(b) provides that the FTC is entitled to a preliminary injunction "[u]pon a proper showing that, weighing the equities and considering the [FTC]'s likelihood of ultimate success, such action would be in the public interest."

[5] The PUC filed three *amicus* briefs in support of the motion to dismiss, D.24, D.53, D.65, and the Commonwealth of Pennsylvania, represented by the attorney general, filed a brief in support of the FTC, D.39.

at 13). The court noted the various factors that the PUC was required to address, and observed that the PUC considered the impact of the acquisition on competition. Appx. 14 (Opin. at 14). The court then conceded that "on some theoretical level," PUC review "is not in conflict with the policy of the federal antitrust laws." Appx. 15 (Opin. at 15). However, the court found it significant that "the FTC is attempting to stop a transaction which the PUC has found to be in the overall public interest of the citizens of the Commonwealth of Pennsylvania." *Id.* The court thus advised that, if the FTC disagreed with the outcome approved by the PUC, the FTC should challenge the PUC's decision directly in Pennsylvania state courts. Appx. 14-15 (Opin. at 14-15).

Next, the court held that the second part of the *Midcal* test, active supervision, was also satisfied because, after the acquisition, the defendants would be required to report to the PUC regarding a list of specific matters such as accounting methodology, supply contracts, and data interface system. Appx. 17-18 (Opin. at 17-18). Based on thise observation, the court concluded that it was "obvious" that the PUC would monitor the transaction, and, in its view, this was sufficient to satisfy the second part of the test. Appx. 18 (Opin. at 18). Accordingly, the court dismissed the FTC's complaint.

On June 1, 2007, this Court granted the FTC's motion for an injunction of defendants' acquisition pending appeal.

STANDARD OF REVIEW

Because the district court dismissed the FTC's complaint pursuant to Fed. R. Civ. P. 12(b)(6), this Court exercises *de novo* review. *A.D. Bedell Wholesale Co. v.*

Philip Morris Inc., 263 F.3d 239, 249 n.25 (3d Cir. 2001).

SUMMARY OF ARGUMENT

The district court misapplied the state action doctrine, and as a result, it improperly dismissed the FTC's complaint. That doctrine recognizes that the federal antitrust laws do not necessarily apply to anticompetitive conduct of the states, and that states may effectuate their goals through the acts of private parties. Such private conduct is exempt from the antitrust laws, however, only if both parts of the exacting two-part test of *Midcal* are satisfied. Under *Midcal*, a state wishing to shield anticompetitive private conduct from the antitrust laws must first clearly articulate a policy to displace those laws with a regulatory regime. This part of the *Midcal* test requires the antitrust defendant to show that, with respect to the allegedly anticompetitive consequences of its conduct, the state was not merely neutral, but that those consequences were clearly contemplated. Second, to assure that the state's regulatory policy is truly a policy of the state, *Midcal* also requires the antitrust defendant to show that the state actively supervises the anticompetitive consequences of the conduct in question. Without such supervision, a state could simply confer antitrust immunity on private parties without any assurance that the state's policies were being effectuated. (Part I.A, *infra.*)

The district court's opinion fails to address the core criteria of *Midcal*. The court should have assessed whether the Pennsylvania legislature had clearly articulated any policy to displace the antitrust laws with respect to anticompetitive acquisitions by public utilities. Instead, having observed that Pennsylvania law subjects public utilities to generally pervasive regulation, it stopped its analysis and held that the first part of the *Midcal* test had been satisfied. But the statutory requirements on which the court focused -- that acquisitions of property require PUC approval, that the PUC may not grant such approval until it receives assurances regarding labor interests, service reliability, and service to low-income customers -- come nowhere close to satisfying the first part of the *Midcal* test. *Midcal* requires a showing that the state has authorized the specific anticompetitive conduct that has been challenged. Thus, anticompetitive acquisitions are not shielded from the antitrust laws merely because Pennsylvania has determined that other aspects of public utility conduct will be governed by regulation. Were the law otherwise, any regulation of an entity would deprive consumers of the protections of the antitrust laws with respect to all of the entity's conduct. The court below recognized that the PUC's review of such acquisitions does not conflict with the antitrust laws, yet inexplicably concluded that defendants satisfied the first part of the *Midcal* test. (Part I.B.1, *infra*.)

The district court's opinion discusses various provisions of Pennsylvania law that have no relevance to the *Midcal* test, but overlooks the critical significance of 66 Pa. Cons. Stat. § 2210(b). The court misreads that section to *authorize* the PUC to reject an anticompetitive acquisition. Even if the subsection upon which the court focused (§ 2210(a)) were viewed in isolation, it would not be enough to support a state action defense because the mere fact that Pennsylvania requires the PUC to consider competition does not indicate that Pennsylvania has displaced competition. In any event, § 2210(b) does not just authorize the PUC to consider competition; it specifically *precludes* the PUC from approving any anticompetitive acquisitions. A state action exemption cannot apply to conduct that a state prohibits. (Part I.B.2, *infra.*)

The court also improperly focused on the merits of the PUC's decision approving defendants' acquisition. But only the state legislature, not a subordinate state agency such as the PUC, can provide the clear articulation required by the first part of the *Midcal* test. Moreover, the state action defense is an antecedent issue that must be addressed before a court conducts any review at all of the merits of the challenged conduct. The merits of the PUC's decision are irrelevant to the court's evaluation of the state action defense, and the possibility of further proceedings under state regulatory law is no ground for displacing the federal antitrust laws. (Part I.B.3, *infra.*)

The district court also erred in its analysis of the second part of the *Midcal* test, active supervision. It observed that, post-acquisition, the PUC will set maximum rates and establish minimum service requirements, and that Equitable will submit reports to the PUC regarding various aspects of its operational practices. But the second part of the *Midcal* test is satisfied only if Pennsylvania will actually monitor the anticompetitive consequences of the acquisition. The FTC's complaint alleges that, as a result of the acquisition, consumers will lose the benefits of the competition that currently exist, including discounts from maximum rates, long-term contracts, and guaranteed terms and conditions. The limited record available at this stage of this proceeding provides no indication that Pennsylvania will monitor any of these consequences. (Part I.C, *infra.*)

Finally, if the FTC prevails on this appeal, this Court should enjoin defendants' acquisition until the district court has completed its proceedings. Defendants' acquisition is a merger to monopoly. Even defendants do not dispute that this will lead to higher prices for affected consumers. Instead, they argue that depriving these consumers of the benefits of competition will result in benefits to other consumers outside the area of competition. It is far from clear that such benefits will occur, but even if they do, anticompetitive conduct in one market cannot be justified by benefits to consumers in another market. Further, if defendants are permitted to consummate their acquisition, it will be difficult, if not impossible, for the district court or for the FTC in its administrative proceedings to implement effective relief. Thus, unless this Court issues an injunction, a decision in favor of the FTC on the state action issue will be hollow indeed. (Part II, *infra*.)

ARGUMENT

I. THE DISTRICT COURT INCORRECTLY HELD THAT THE STATE ACTION DEFENSE EXEMPTS DEFENDANTS' ACQUISITION FROM ANTITRUST SCRUTINY

A. The Antitrust State Action Doctrine

The state action doctrine stems from the Supreme Court's decision in *Parker v. Brown*, 317 U.S. 341 (1943). In that case, the Court upheld California's Agricultural Prorate Act against a Sherman Act challenge. The Court examined the Sherman Act and its legislative history, and concluded that Congress had given no indication that it intended the Sherman Act to apply to the states acting as sovereigns. *Id.* at 350-51. Accordingly, the Court held that, when a "state in adopting and enforcing [a] program * * *, as sovereign, imposed the restraint [on competition] as an act of government," the Sherman Act does not prohibit the restraint. *Id.* at 352.

In *Midcal*, the Supreme Court held that, in certain circumstances, the doctrine may extend to the conduct of private parties. Under *Midcal*, the anticompetitive conduct of private parties is exempt from the antitrust laws only if 1) the parties are acting pursuant to a "clearly articulated and affirmatively expressed" state policy to displace competition, and 2) the conduct is "actively supervised" by the state. 445 U.S. at 105. In *FTC v. Ticor Title Insurance Co.*, 504 U.S. 621 (1992), the Court explained that "while a State may not confer antitrust immunity on private persons by fiat, it may displace competition with active state supervision if the displacement is both intended by the State and implemented in its specific details." *Id.* at 633. Thus, the *Midcal* test is "directed at ensuring that particular anticompetitive mechanisms operate because of a deliberate and intended state policy." *Id.* at 636. The state statute need not explicitly provide for the displacement of competition. However, that displacement must be, at least, "the 'foreseeable result' of what the statute authorizes." *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 373 (1991) (quoting *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 42 (1985)). That is, the state must "clearly contemplate" the anticompetitive conduct. *Town of Hallie*, 471 U.S. at 42.

To qualify for the state action exemption from antitrust liability, private parties' anticompetitive conduct must not only be in accordance with a clearly articulated state policy to displace competition, but must also must be actively supervised by the state. *Midcal*, 445 U.S. at 105. The second part of the *Midcal* test "stems from the recognition that '[w]here a private party is engaging in the anticompetitive activity, there is a real danger that he is acting to further his own interests, rather than the governmental interests of the State.'" *Patrick v. Burget*, 486 U.S. 94, 100 (1988) (quoting *Town of Hallie*, 471 U.S. at 47). The Supreme Court has made clear that the standard for active state supervision is a rigorous one. It is not enough that state officials have the authority to review the private activity at issue. Instead, active supervision "requires that state officials have *and exercise* power to review particular anticompetitive acts of private parties and *disapprove those that fail to accord with state policy*." *Patrick*, 486 U.S. at 101 (emphasis added).

Because the state action doctrine provides an exemption from the antitrust laws, it is disfavored. *Ticor*, 504 U.S. at 636. The doctrine must be narrowly interpreted so that states do not "act in the shadow of state-action immunity whenever they enter the realm of economic regulation." *Id.* at 635. That is, states should feel free to implement economic regulations without the concern that every regulation will allow the regulated parties to engage in anticompetitive conduct. Finally, because the state action doctrine is an affirmative defense, the burden of proof is on the defendants to show that both parts of the *Midcal* test have been met. *Yeager's Fuel, Inc. v. Pennsylvania Power & Light Co.*, 22 F.3d 1260, 1266 (3d Cir. 1994).

B. The District Court Erred With Respect to the First Part of the *Midcal* Test

A key aspect of the balance of federal and state interests that the state action doctrine strikes is that a state may displace the federal antitrust laws with respect to specific conduct only if it clearly articulates its decision to displace the application of the antitrust laws with a regulatory regime. Thus, in this case, the state action doctrine required the defendants to identify a state policy to allow acquisitions by public utilities that are harmful to competition. Neither the defendants, nor the district court, has identified such a state policy.

The court's fundamental error, an error that infects every part of its decision, was to equate an ostensibly "comprehensive" state regulatory scheme (*see* Appx. 13 (Opin. at 13)) with a state policy to displace the type of competition that is at issue here, *i.e.*, competition among natural gas companies to provide gas distribution services to consumers. The court repeatedly referred to the "pervasive" nature of Pennsylvania's regulation of utilities, as if that were a talisman authorizing all anticompetitive effects. *See, e.g.*, Appx. 4-5 (Opin. at 4-5) (PUC regulates across a "broad spectrum of activities"); Appx. 7 (Opin. at 7) ("detailed and comprehensive statutory scheme"); Appx. at 9, 13 (Opin. at 9, 13) ("pervasive"); Appx. 10 (Opin. at 10) ("thorough and substantive"); Appx. 14 (Opin. at 14) ("*many* statutory factors" (emphasis in original)). But the court failed to identify any policy to displace the antitrust laws with respect to acquisitions. Indeed, the court ignored a crucial provision of Pennsylvania's regulatory regime, which precludes the PUC from approving anticompetitive acquisitions. Far from clearly articulating any sort of policy to permit anticompetitive acquisitions by utilities, Pennsylvania has specifically prohibited them.

1. Nothing in Pennsylvania law clearly contemplates anticompetitive public utility acquisitions

The state action defense would apply here only if it could be shown that anticompetitive acquisitions involving utilities are "clearly contemplate[d]" by Pennsylvania's regulatory regime. *See Town of Hallie*, 471 U.S. at 42. Although the district court concluded that Pennsylvania intended to displace competition in connection with this acquisition, it identified no statutory basis to support this conclusion. Little wonder, because there is no provision of Pennsylvania's Public Utility Code that either authorizes anticompetitive acquisitions of the sort challenged in this case, or that even clearly contemplates such a result.

The PUC's authority over defendants' acquisition comes from 66 Pa. Cons. Stat. § 1102, which requires that public utilities obtain approval from the PUC, evidenced by a "certificate of public convenience," before they may consummate an acquisition of property. Section 1103 governs PUC approval: "A certificate of public convenience shall be granted by order of the [PUC], only if the [PUC] shall find or determine that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public." In *City of York v. Pennsylvania Public Utility Commission*, 295 A.2d 825, 828 (Pa. 1972), Pennsylvania's Supreme Court explained that § 1103 "requires that those seeking approval of a utility merger demonstrate more than the mere absence of any adverse effect upon the public. [Section 1103] requires that the proponents of the merger demonstrate that the merger will affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some substantial way."

An acquisition is not exempt from antitrust scrutiny simply because Pennsylvania's utility code mentions acquisitions and requires advance PUC approval. *See Community Commc'ns Co. v. City of Boulder*, 455 U.S. 40, 56 (1982) (clear articulation is not satisfied by mere neutrality with respect to the actions in question). Section 1102 merely provides general authorization for the utilities to acquire property by a range of legal mechanisms including mergers. It is silent as to the elimination of competition. As other courts have recognized, the "courts will not infer such a policy to displace competition from naked grants of authority." *Surgical Care Ctr. of Hammond, L.C. v. Hospital Serv. Dist. No. 1 of Tangipahoa Parish*, 171 F.3d 231, 236 (5th Cir. 1999) (en banc); *see McCaw Personal Comm., Inc. v. Pacific Telesis Gp.*, 645 F. Supp. 1166, 1172 (N.D. Cal. 1986) (state utility commission approval of an acquisition is insufficient to demonstrate that the state intended to insulate the acquisition from the antitrust laws). In *Surgical Care Ctr. of Hammond*, for example, state law specifically authorized the defendant hospital district to enter into joint ventures with others to provide hospital services. 171 F.3d at 233. The *en banc* Fifth Circuit, however, denied state action protection, recognizing that "[n]ot all joint ventures are anticompetitive. Thus, it is not the foreseeable result of allowing a hospital service district to form joint ventures that it will engage in anticompetitive conduct." *Id.* at 235. Here, it similarly cannot be concluded that, simply because Pennsylvania generally authorized utility companies to acquire property, it contemplated anticompetitive acquisitions.

Indeed, if mere mention were equated with clear articulation, then any time that a state implemented any regulation regarding any aspect of a subject, every aspect of that subject would be exempt from the antitrust laws. But the Supreme Court specifically cautioned against such result:

> If the States must act in the shadow of state-action immunity whenever they enter the realm of economic regulation, then our doctrine will impede their freedom of action, not advance it. The fact of the matter is that the States regulate their economies in many ways not inconsistent with the antitrust laws.

Ticor, 504 U.S. at 635-36; *see A.D. Bedell*, 263 F.3d at 255 (the state action exemption "relies heavily on the clarity of the State's goals and actions").

Nor does the fact that such approval is linked to "service, accommodation, convenience, or safety," *i.e.*, the public interest, *see City of York*, 295 A.2d at 828, give any indication that the Pennsylvania legislature intended approval of anticompetitive acquisitions. The imposition of a regulatory structure is insufficient to displace the antitrust laws unless such displacement is authorized by that structure. *Cost Mgmt. Srvs., Inc. v. Washington Nat. Gas Co.*, 99 F3d 937, 942 (9th Cir. 1996); *see also First Am. Title Co. v. Devaugh*, 480 F.3d 438, 456 (6th Cir. 2007) (state gave registers of deeds the power to contract, but this did not demonstrate that the state intended to authorize anticompetitive contracts). As the Supreme Court has explained, public interest review by a state utility commission and antitrust review are not necessarily incompatible. *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 595 (1976).

The district court's decision, which is based on the mistaken notion that public interest review conflicts with the antitrust laws, is directly at odds with *Detroit Edison*. In that case, an electric utility asserted state action in defense of a marketing program whereby it distributed light bulbs to its customers. The Michigan Public Service Commission "pervasively" regulated the distribution of electricity pursuant to a statute that gave the Commission the authority "to regulate all rates, fares, fees, charges, services, rules, conditions of service, and all other matters pertaining to the formation, operation, or direction of such public utilities." *Id.* at 584, *quoting* Mich.

Comp. Laws § 460.6 (1970).[6] The Commission had approved the light bulb distribution program after finding that the program was in the public interest, and Detroit Edison could not discontinue the program without Commission approval. *Id.* at 582-583.

Nonetheless, the Court rejected the state action defense. *Id.* at 598. The Court observed that Michigan law was silent as to whether Detroit Edison should offer the distribution program, and that no other Michigan utility company distributed light bulbs to its customers. *Id.* at 584-85. Nor did it matter to the Court that the Commission had applied a public interest standard to the program -- "certain conduct may be subject to both state regulation and the federal antitrust laws * * *." *Id.* at 595. The Court concluded that "all economic regulation does not necessarily suppress competition." *Id.* The product-tying in which Detroit Edison engaged was in no way clearly contemplated by a regulatory regime that authorized rate-setting. *See also First Am. Title Co., supra* (state statutes that gave registers of deeds a monopoly on the collection and recordation of deeds did not demonstrate a clear intent to prohibit the resale of property title information); *compare Southern Motor Carriers Rate Conf., Inc. v. United States*, 471 U.S. 48 (1985) (state regulation of rates demonstrates a clear intent to allow collective rate-making by truckers); *City of Columbia v. Omni Outdoor Advertising, supra* (a state law that authorized cities to regulate size, location, and spacing of billboards "necessarily protect[ed]" existing billboards against competition from newcomers).

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[6] Similarly, Pennsylvania regulates the maximum rates that natural gas distribution companies may charge. *See* 66 Pa. Cons. Stat. §§ 1301-1328.

The district court's analysis in this case was also significantly different from the analysis in *Yeager's Fuel*, *supra*. In *Yeager's Fuel*, the plaintiffs alleged that Pennsylvania Power & Light's practice of offering incentives to builders who installed high efficiency electric heating in newly constructed homes was anticompetitive. This Court held that the state action exemption applied. However, it did not base this conclusion on the sort of generalized assessment of the extent of state regulation that the district court employed in this case. Instead, this Court recognized that a Pennsylvania statute that encouraged utilities to offer rebates to promote energy conservation "could easily be foreseen to provide one company with a competitive advantage over another * * *." 22 F.3d at 1268.[7] That is, because Pennsylvania law urged PP&L to offer rebates, that statute satisfied the first part of the *Midcal* test with respect to a challenge directed to the consequences of that rebate program.[8]

To the extent that the district court focused on the specifics of the statutory scheme at all, it relied on provisions that have nothing to do with the rivalry lost here.

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[7] This Court relied on the relevant statute as "permitting" utility companies to offer rebates. *Yeager's Fuel*, 22 F.3d at 1268. In fact, the statute went even further: "Such programs [for promoting energy conservation] *should include*, but not be limited to * * * rebate[s] * * *." 66 Pa. Cons. Stat. § 524(a)(3) (emphasis added).

[8] The defendant in *Yeager's Fuel* conceded, and this Court agreed, that it was not entitled to a state action defense with respect to rebates it provided to developers who entered into "all-electric development agreements." 22 F.3d at 1263. These agreements provided incentives to developers who agreed that every house in a new development would have electric heating, instead of natural gas or fuel oil, regardless of whether that electric heating was high-efficiency. The anticompetitive consequences of such rebates were not contemplated by the Pennsylvania law that encouraged energy conservation rebates.

The court pointed to the fact that the "public interest" analysis that the PUC must undertake includes considerations such as the protection of labor interests, the assurance of service reliability, and the provision of service to low-income households. Appx. 14 (Opin. at 14). Such requirements may have some impact on the vigor of competition. But so do many general purpose laws, such as minimum wage laws and environmental controls. In our economic system, rivals are still expected to compete, within such cost constraints, unless there is a clearly articulated state policy displacing the competition at issue.

Thus, a state "displace[s] competition," *see* Appx. 13 (Opin. at 13), not simply by adding a layer of regulatory requirements with which competitors must abide, but by authorizing conduct that is *inconsistent* with competition. Here the district court points to nothing in Pennsylvania law supporting its contention that, in connection with this acquisition, the General Assembly had, in fact, "replaced free market competition with regulation." *See* Appx. 13-14 (Opin. at 13-14). Indeed, Pa. Cons. Stat. § 1102 is to the contrary. It specifies two prerequisites for defendants' acquisition. First, as discussed above, defendants were required to obtain a certificate of public convenience from the PUC. Second, that section imposes an independent requirement on defendants: that they "compl[y] with existing laws." § 1102(a). That is, merely because they received PUC approval for the acquisition, defendants are not excused from complying with all other laws (including tax laws, securities laws, environmental laws, *and antitrust laws*). PUC approval was only one of the hurdles defendants were required to clear. The antitrust laws are another.

The district court appears to recognize this when it acknowledges that, "on some theoretical level," "the public interest review of proposed utility mergers that the legislature has entrusted to the PUC is not in conflict with the policy of the federal antitrust laws." *See* Appx. 15 (Opin. at 15). Having acknowledged this, the court should have rejected the state action defense and denied the motion to dismiss because, if the PUC's review of the acquisition "is not in conflict with the policy of the federal antitrust laws," then Pennsylvania cannot possibly have articulated a clear policy to displace competition. *See Hancock Industries v. Schaeffer*, 811 F.2d 225, 233 (3d Cir. 1987) (there is clear articulation only where anticompetitive conduct is a logical result of a state-imposed obligation). In light of the court's acknowledgment, its decision to grant the motion to dismiss was a clear error of law.[9]

2. Pennsylvania law specifically precludes the PUC from approving anticompetitive acquisitions

Not only is there no provision of Pennsylvania law that clearly contemplates an anticompetitive acquisition such as the one challenged by the FTC, but, in fact, Pennsylvania law precludes anticompetitive acquisitions. In particular, 66 Pa. Cons. Stat. § 2210(b) provides that:

> If the [PUC] finds, after hearing, that a proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail gas customers from obtaining benefits of a properly functioning and effectively competitive retail natural gas market, the [PUC] *shall not approve such proposed merger, consolidation, acquisition* or disposition except upon such terms and

[9] The Attorney General of Pennsylvania, in his *amicus* brief submitted below in opposition to the motion to dismiss, similarly concluded that "state policy, as expressed in [the state statutes], is in harmony with the goals of the federal antitrust laws." D.39 at 2.

> conditions as it finds necessary to preserve the benefits of a properly functioning and effectively competitive retail natural gas market.

(Emphasis added.) Because Pennsylvania requires the PUC to reject an anticompetitive acquisition (unless the acquisition is modified in some way to protect the affected competition), Pennsylvania has acted to preserve, not displace, competition when the PUC reviews acquisitions. Accordingly, no state action defense can apply. *See Cost Mgmt. Srvs.*, 99 F.3d at 942 (state action exemption cannot apply to conduct that is specifically prohibited by state law).

The district court's failure to recognize the significance of, or to address, § 2210(b) undermines its contention that Pennsylvania "has articulated and affirmatively expressed a state policy to displace competition with pervasive regulation." *See* Appx. 13 (Opin. at 13). Instead, the court focused on 66 Pa. Cons. Stat. § 2210(a)(1), which, as the court repeatedly observed, requires the PUC to "consider" whether an acquisition will have an anticompetitive effect. *See* Appx. 6, 13, 14 (Opin. at 6, 13, 14). But the fact that the PUC must *consider* the anticompetitive impact of a proposed acquisition is, in no sense, a clear expression of a state goal to *displace* competition. *See A.D. Bedell*, 263 F.3d at 255 (state action exemption requires "an affirmative decision by the state itself" to displace competition). The district court failed to draw this distinction because it misconstrued the impact of § 2210(b). According to the court, that section "grants the PUC authority to reject any acquisition, transfer of assets, or merger upon a finding of discriminatory or anti-competitive effects." Appx. 7 (Opin. at 7). In fact, the section does not just authorize the PUC to reject an anticompetitive acquisition;

it requires such a rejection. Thus, not only did the district court fail to identify any clear articulation of a state policy to displace competition with respect to defendants' acquisition, it ignored Pennsylvania's expression of a contrary intent. As this Court has explained, for state action to apply, it must be evident that the challenged restraint is part of the state's policy. *A.D. Bedell*, 263 F.3d at 259. Here, it is plain that, with respect to acquisitions, Pennsylvania has expressed no such policy.

In the court below, defendants mistakenly contended that § 2210(b) should be limited to protecting competition in the market for natural gas supply (as opposed to natural gas distribution) because, in defendants' opinion, the phrase "retail natural gas market" should apply only to the retail market for gas supply. D.19 at 23. However, the defendants ignore that the statute contains and defines a limiting term,"natural gas supply services," which encompasses only the market for natural gas supply. This limiting term is used elsewhere in the statute, *see* § 2202, but not in § 2210(b). As the Pennsylvania Attorney General pointed out, if Pennsylvania had intended to limit the applicability of § 2210(b) to gas supply, it would have used that limiting language. D.36 at 5-6.

Defendants' contention that §§ 2201-2212 have only one purpose: "to open up the commodity gas business to competition," *see* D.19 at 21, is also implausible because § 2210 specifically applies to anticompetitive acquisitions of assets by both "natural gas suppliers" *and* "natural gas distribution companies." *See* § 2210(a). Nothing anywhere in the statute even suggests that, pursuant to § 2210(b), the PUC is to disapprove an anticompetitive acquisition by a natural gas distribution company only if the anticompetitive consequences affect the gas supply market. Finally,

§ 2210(b) makes clear that the PUC is to disapprove anticompetitive acquisitions to assure that "retail gas customers" obtain the benefits of a competitive market. The term "retail gas customer" is defined in § 2202 as "a direct purchaser of natural gas supply services or natural gas distribution services * * *." Thus, in connection with either natural gas supply services, or natural gas distribution services, the PUC is to protect competition.[10] Plainly, § 2210(b) precludes a natural gas distribution company from making an acquisition that has an anticompetitive effect in the market for natural gas distribution services. Therefore, defendants' attempt to cabin the application of § 2210(b) must fail, and the district court's conclusion with respect to the first part of the *Midcal* test is incorrect, as a matter of law.

3. The district court confused the clear articulation inquiry with a consideration of the PUC's decision

As the preceding sections show, the pertinent provisions of Pennsylvania law do not provide the requisite "clear articulation," by the state itself, of a policy to displace the competition for major customers that gas distributors have engaged in for decades in western Pennsylvania. The district court confused the search for a clear articulation of a legislative policy with an assessment of the merits of the PUC's decision. That decision, however, is not the proper focus of this case, and it is not the target of the Commission's complaint. Moreover, the PUC's decision cannot make up for the lack of clear articulation in Pennsylvania law.

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[10] *See also* § 2210(c), which provides that "[n]othing in [§ 2210] shall restrict the right of any party to pursue any other remedy available to it." This subsection, like both § 1102(a) (*see* Part I.B.1, *supra*), reaffirms that Pennsylvania did not intend PUC approval to supplant the protections provided by other laws, such as the antitrust laws.

The court below acknowledged, in passing, that it was not its role to "review the 'correctness' of" the administrative determinations made by the ALJ and the PUC. Appx. 10 (Opin. at 10). Yet the dominant focus of its opinion is the quality of the administrative proceedings and the supposed public benefits of the acquisition that the PUC approved. According to the opinion, the ALJ and the PUC engaged in "substantive and extended" proceedings, employing a process that was "comprehensive," "open," and "thorough," leading to a decision that was "informed and conscientious," as well as "thorough and substantive." Appx. 3, 9, 10 (Opin. 3, 9, 10). The court also repeatedly recounted the ostensible faults of the gas distribution competition that the PUC allowed to be eliminated -- *i.e.*, that it was "inefficient," "wasteful," "duplicat[ive]," "not economical," and of benefit to only "a few customers." Appx. 3, 7, 10, 14 (Opin. 3, 7, 10, 14).

All of this analysis, however, is based on the administrative determinations of a subordinate state entity, *not* those of the Pennsylvania legislature. As the Supreme Court has repeatedly instructed, the clear articulation needed to invoke the state action doctrine must come from the state itself (*i.e.*, the legislature or the state's highest court), not from a subordinate agency such as the PUC. *See Southern Motor Carriers*, 471 U.S. at 62-63; *City of Boulder*, 455 U.S. at 52-53. As shown above, Pennsylvania's legislature has not articulated a policy displacing gas distribution competition and, despite its general grant of authority to the PUC, "can hardly be said to have 'contemplated' the specific anticompetitive actions" at issue. *City of Boulder*, 455 U.S. at 55.

The court below also misconstrued the FTC's arguments on the state action issue as an attack on the substance of the PUC's decision. For example, the court mistakenly stated that the FTC had argued that the application of the *Midcal* clear articulation standard depends upon whether a specific transaction has an anticompetitive impact. *See* Appx. 15 (Opin. 15 n.5). But the FTC argued nothing of the sort. Clear articulation depends upon the acts of the legislature. If Pennsylvania had a clearly articulated policy to displace competition with respect to acquisitions of public utilities (instead of its actual policy, which prohibits anticompetitive acquisitions), then the acquisition would be exempt from antitrust scrutiny regardless of whether the acquisition has any anticompetitive impact.

The district court went particularly far afield in suggesting that the FTC should be relegated to seeking relief from reviewing state courts, on the premise that the FTC's real disagreement is with the PUC's interpretation of state law. Appx. 15-16 (Opin. 15-16). This suggestion not only mischaracterizes the FTC's arguments, but also reflects a failure to appreciate fundamental differences between federal antitrust analysis and judicial review of a state administrative decision. Where, as here, an antitrust defendant invokes the state action doctrine, the federal antitrust analysis proceeds in two distinct steps. First, the court must ascertain whether the state itself -- *not* the state administrative agency -- has clearly articulated a policy to displace competition, and whether there is the requisite level of state supervision. If the state action doctrine applies, then the federal antitrust claim is dismissed regardless of whether the administrative agency applied state law correctly. *See City of Columbia v. Omni Outdoor Advertising*, 499 U.S. at 372. If the state action doctrine does not apply, then the antitrust case proceeds to the merits, under the standards of the federal antitrust laws.

By contrast, state judicial review proceedings necessarily focus on the decision of the PUC, and are concerned only with the ultimate propriety of that action under state law, in light of whatever standard of review is prescribed. This will often include deference to the administrative body's interpretation of state law. *See generally Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984); *Tool Sales & Service Co. v. Commonwealth*, 637 A.2d 607, 613 (Pa. 1993). Such analysis is appropriate as a matter of administrative law, but would entirely miss the pivotal inquiries under the federal antitrust state action doctrine -- *i.e.*, whether the policy in question was "clearly expressed" by Pennsylvania itself.

C. The District Court Erred With Respect to the Second Part of the *Midcal* Test

The district court also erred with respect to the second part of the test, both as a matter of law, and in its failure to consider pertinent factual issues. This second part of the test seeks to assure that Pennsylvania has not simply enacted a regulatory regime that displaces competition and then abandoned the market to the unsupervised discretion of private parties. As the Supreme Court has explained, a state "may not confer antitrust immunity on private persons by fiat." *Ticor*, 504 U.S. at 633. Instead, "[a]ctual state involvement, not deference to private [anticompetitive] arrangements under the general auspices of state law is the precondition for immunity from federal law." *Id.* Further, state supervision must be "active[]," lest the state "frustrat[e] the national policy in favor of competition by casting a gauzy cloak of state involvement over what is essentially private anticompetitive conduct." *Southern*

Motor Carriers, 471 U.S. at 57 (internal quotation marks omitted).

The need for substantial, continuing state scrutiny is particularly acute in the case of a merger or acquisition. A merger or acquisition eliminates competition between rivals permanently, has the potential to cause ongoing anticompetitive harm, and may have anticompetitive effects that do not become manifest until well after initial approval of the transaction. Thus, in *North Carolina v. P.I.A. Asheville, Inc.*, 740 F.2d 274, 278 (4th Cir. 1984), the court held that a state's issuance of a certificate of need approving a merger of psychiatric hospitals was insufficient to afford state action protection because the state did not have post-acquisition monitoring to ensure the merged hospital's conduct remained "in harmony" with the state's policy goals.[11] As one commentator explains:

> [E]ven mergers justified on grounds of efficiency generate ongoing issues for the state to review. Considerable discretion [by the merged entity] exists about * * * altering the circumstances that might have existed when the merger was initially approved. These situations all involve private choice without the accountability and oversight that *Ticor* would seem to mandate. * * * Ongoing oversight of the implementation of a merger deal therefore would seem to be critical.

James F. Blumstein, *Health Care Reform and Competing Visions of Medical Care: Antitrust and State Provider Cooperation Legislation*, 79 Cornell L. Rev. 1459, 1504-05 (1994).

Although the district court concluded that it was "obvious" that "the PUC is taking an active, hands-on approach to monitoring the transaction on an ongoing

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[11] *See also New York v. Saint Francis Hosp.*, 94 F. Supp. 2d 399, 410 (S.D.N.Y. 2000) (state approval of a hospital joint venture was not entitled to state action protection where, *inter alia*, there was no "continuing state involvement in [the hospitals'] allocation of health care services" after the approval).

basis going forward," *see* Appx. 18 (Opin. at 18), the court provided no adequate support for that conclusion. In fact, its only bases for its conclusion were that "the PUC explicitly retained ongoing oversight authority and control over the merged public utilities," and that the PUC "included conditions in its Order approving the proposed transaction." *See* Appx. 17 (Opin. at 17). But neither of these reasons is sufficient because they do not show -- as they must, to satisfy the active supervision requirement -- that the PUC has the ability to, and actually will, monitor the conduct that may lead to consumer harm. *See, e.g., A.D. Bedell*, 263 F.3d at 262 (state oversight of tobacco settlement agreement insufficient to provide state action immunity "because the States' supervision does not reach the parts of the [agreement] *that are the source of the antitrust injury*" (emphasis added)).[12]

The FTC alleged that defendants' acquisition would result in antitrust injury through the elimination of customer discounts and incentives offered to builders and developers, and through a decline in the quality of customer service. Appx. 34 (D.1). But the Pennsylvania statutes identified by the district court (*see* Appx. 16 (Opin. at 16)) do not reach this competitive harm; they simply set forth the standards and procedures for PUC approval of filed tariffs (*i.e.*, the maximum rates) and establishment of minimum service requirements.[13] Indeed, with respect to many of

[12] Similarly, in *Yeager's Fuel*, this Court did not rely simply on the PUC's general oversight authority to support its conclusion that the active supervision requirement was satisfied. Rather, this Court specifically considered whether the PUC had actually reviewed the rebates that had been challenged. 22 F.3d at 1271.

[13] *See* 66 Pa. Cons. Stat. § 1301 (rates must be just and reasonable and in conformity with regulations or orders of the PUC); § 1302 (public utilities must file

the benefits that will be lost if the acquisition is consummated, Pennsylvania law is simply silent. These are benefits that Equitable and Dominion have provided as a by-product of the competition that has existed between them, not as a result of any requirement of Pennsylvania law. Some of the benefits are improvements upon regulated terms (*i.e.*, discounted rates that are below the rates approved by the PUC), and other benefits are entirely outside the scope of Pennsylvania's regulations (*i.e.*, long-term contracts and guaranteed terms and conditions).

Moreover, the "conditions in its Order" on which the court relied consist solely of requirements that Equitable file reports regarding various aspects of its "operational practices." These have little or nothing to do with the harms the acquisition will cause. This acquisition will have an ongoing impact on customers who currently benefit from competition. Because there is no ongoing monitoring of the impact of the acquisition, there is no active supervision, and the second part of the *Midcal* test cannot be satisfied.

Even with respect to those provisions of Pennsylvania's regulatory regime that

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tariffs with the PUC); § 1307(f) (allowing natural gas distribution companies to seek rate adjustments reflecting changes in natural gas costs, and requiring the PUC to hold hearings with respect to such requests); § 1308(d) (requiring PUC to conduct an investigation and hold hearings to review tariffs constituting a general rate increase); § 1309(a) (if PUC determines that existing rates are unjust or unreasonable, PUC shall determine and fix just and reasonable rates); § 1317(c) & (d) (requiring natural gas distribution utilities to file reliability plans, and plans for acquisition or receipt of natural gas); § 1318(a), (b) & (e) (requiring PUC to make specific findings regarding whether natural gas distribution utility is pursuing a least cost fuel procurement policy, and requiring utility to file quarterly reports setting forth its actual gas costs); and § 2203(1) (instructing PUC to adopt and enforce standards to ensure safety and reliability of natural gas supply and distribution).

are arguably relevant to the acquisition, it is far from clear that the PUC actually will review post-acquisition conduct in a manner that satisfies *Ticor.*[14] *See, e.g., Yeager's Fuel*, 22 F.3d at 1271 (although the PUC "unquestionably" had the power to review the conduct at issue, the Court was required to decide "whether it actually did so in a manner which satisfies the *Ticor* test"). In particular, defendants contend that 66 Pa. Cons. Stat. § 1304 gives the PUC authority to supervise -- indeed, to prohibit -- discounts of the sort that have, as a result of competition, benefitted consumers. Appellees' Memorandum of Law in Opposition to Emergency Motion for Injunction Pending Appeal, filed before this Court on May 30, 2007 ("Appellees' Memo") at 10. Even assuming that § 1304 actually prohibits discounts, *but see Building Owners and Managers Ass'n v. Pennsylvania Pub. Util. Comm'n,* 470 A. 2d 1092 (Pa. Commw. Ct. 1984) (merely charging different prices to different customers does not establish that a utility is charging unreasonable or discriminatory rates), it is far from clear that the section has actually been enforced by the PUC, since defendants have offered discounts for many years. Given its past history of ignoring discounts, it remains a question of fact whether PUC will, in the future, supervise discounts. It is defendants' burden to adduce facts sufficient to show that the PUC actually will

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[14] The district court erred in suggesting that the "mere fact" that the PUC "retains power" to hear a complaint or review a utility's conduct satisfies the active supervision standard. Appx. 17 (Opin. 17). The court relied on *TEC Cogeneration, Inc. v. Florida Power & Light Co.*, 76 F.3d 1560, 1570 (11th Cir. 1996), but the Eleventh Circuit subsequently modified that opinion, 86 F.3d 1028 (11th Cir. 1996), making it clear that the power to supervise a utility's conduct is not enough; rather, active supervision requires that the state agency *actually exercise* the authority to review and approve the "specifics" of the private anticompetitive conduct at issue. 86 F.3d at 1029.

provide active supervision post-acquisition, *see Yeager's Fuel*, 22 F.3d at 1266, not just "cast[] a 'gauzy cloak of state involvement' over what is essentially private anticompetitive conduct," *Southern Motor Carriers*, 471 U.S. at 57. Defendants have failed to make any such factual showing, relying instead solely on the general authorization of the statute and their own unsworn self-serving predictions. The district court improperly overlooked that failure.

* * * * *

Neither part of the *Midcal* test is satisfied. Pennsylvania has not clearly articulated a policy that, in connection with acquisitions by natural gas distribution companies, displaces competition with a regulatory regime. Also, defendants have not shown that Pennsylvania will actively supervise the anticompetitive consequences of such an acquisition. Accordingly, the state action defense does not apply.

II. THE COURT SHOULD ENJOIN THE ACQUISITION PENDING COMPLETION OF THE DISTRICT COURT PROCEEDINGS

Even if the FTC prevails in this appeal, that victory will be hollow if defendants are free to consummate the proposed acquisition as soon as this appeal is over (and the injunction pending appeal is no longer in effect). As demonstrated above, this Court should reverse and remand to the district court for adjudication of the merits of the FTC's complaint, pursuant to Section 13(b) of the FTC Act, for a preliminary injunction pending resolution of the FTC's administrative proceedings. At the same time, this Court should also order that Equitable's acquisition of Peoples be enjoined until the district court has completed its proceedings. *See ICC v. Cardinal Trucking Corp.*, 308 F.2d 435, 438 (3d Cir. 1962) (court remanded to the district court "with the direction, pending the disposition [of the ICC's motion for an injunction] by it, to issue a temporary restraining order pursuant to the prayer of the plaintiff's complaint").[15]

A. The Standard for Injunctive Relief Under Section 13(b)

Section 13(b) of the FTC Act provides that the FTC is entitled to a temporary restraining order or preliminary injunction "[u]pon a proper showing that, weighing the equities and considering the [FTC]'s likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53(b); *see FTC v. British Oxygen Co., Ltd.*, 529 F.2d 196, 199 (3d Cir. 1976).[16] Under this standard, the FTC is entitled to injunctive relief if it "'raise[s] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." *H.J. Heinz*, 246 F.3d at 714-15 (quoting *FTC v. Beatrice Foods Co.*, 587 F.2d 1225, 1229 (D.C. Cir. 1978)). If the FTC is deemed likely to succeed

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[15] 28 U.S.C. § 2106 provides that, upon review of a district court order, a court of appeals "may affirm, modify, vacate, set aside or reverse any judgment, decree, or order * * * or *require such further proceedings to be had as may be just under the circumstances*" (emphasis added). *See Wiwa v. Royal Dutch Petroleum Co.*, 392 F.3d 812, 819 (5th Cir. 2004) (pursuant to § 2106, "we have power not only to correct error in the judgment under review but to make such disposition of the case as justice requires") (internal quotation marks omitted).

[16] "This standard is broader than the traditional equity standard that is normally applicable to requests for injunctive relief * * *." *FTC v. Libbey, Inc.,* 211 F. Supp. 2d 34, 44 (D.D.C. 2002). In particular, the FTC is not required to show irreparable harm. *See FTC v. H.J. Heinz Co.*, 246 F.3d 708, 714-15 (D.C. Cir. 2001); *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 903 (7th Cir. 1989); *FTC v. Warner Communications, Inc.*, 742 F.2d 1156, 1159-60 (9th Cir. 1984).

on the merits, a presumption arises in favor of granting an injunction. *See, e.g., FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1507 (D.C. Cir. 1986).

Although the FTC's burden is not insubstantial, neither is it overwhelming. In particular, the FTC "need not prove [to the district court] that the proposed merger would in fact violate Section 7 of the Clayton Act," a matter "reserved for the [FTC]." *FTC v. Cardinal Health, Inc.,* 12 F. Supp. 2d 34, 45 (D.D.C. 1998); *see FTC v. University Health, Inc.*, 938 F.2d 1206, 1218 (11th Cir. 1991). Doubts are to be resolved against the transaction and in favor of a preliminary injunction. *Elders Grain*, 868 F.2d at 906 (citing *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 362-63 (1963)).

B. An Injunction is Warranted Here

When the FTC initiated this action, it sought a temporary restraining order to ensure its ability to adjudicate the legality of the proposed acquisition before the closing of the transaction.[17] An injunction is needed here for the same reason. If defendants are allowed to consummate the acquisition, they will entirely eliminate a form of competition that has brought great benefit to western Pennsylvania businesses, institutions, and consumers. It will then be more difficult, if not impossible, for the district court in the preliminary injunction proceedings, or the FTC in its administrative proceedings, to implement effective relief.

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[17] The district court never ruled on the FTC's motion for a TRO because defendants stipulated that they would give the FTC three business days notice in advance of closing the transaction. The court noted that this advance notice would give the FTC time to reapply to the court for a TRO, if necessary. Appx. 47-48 (4/13/07 Hearing Tr. at 26-27).

In numerous locales -- principally within central Pittsburgh, but also some other areas of Allegheny County -- the proposed acquisition is a merger to monopoly, reducing the number of competitors in the companies' overlapping service areas from two to one.[18] There is little question that the acquisition will lead to significantly higher prices for affected consumers. Equitable itself projected that [REDACTED] eliminating discounts and raising prices to customers that currently have the option of choosing between Equitable and Peoples for delivery of natural gas. Appx. 355, 380 (PX0008 at 001; PX0024 at 001).[19] Indeed, those customers are already experiencing these anticompetitive effects because, shortly after the public announcement of the transaction, and in anticipation of reduced competition resulting from the transaction, Equitable began raising prices for customers whose contracts had expired. Appx. 394, 415-418 (PX0053 ¶ 4; PX0067 at 006-09). In addition, Equitable and Peoples have begun to refuse customer requests for contracts of longer duration -- a change

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18 Equitable and Peoples are the only options for customers in

[REDACTED]

See Appx. 358, 406-407 (PX0020 at 001; PX0061 at 024-25).

19

[REDACTED]

Appx. 368 (PX0021 at 008).

from their past efforts to win customer business. Appx. 357, 385, 394, 397 (PX0015; PX0033 at 002; PX0053 at 001 ¶ 4; PX0055 at 003¶ 16).

Defendants do not seriously dispute that the acquisition will eliminate competition that has benefitted hundreds of major gas customers -- as well as those customers' clients, lessees, and customers. Rather, as reflected in the discussion above, defendants have focused on the state action doctrine in an effort to avoid antitrust scrutiny. But the very arguments that defendants successfully asserted in support of their state action defense in the court below demonstrate how inimical their position is to the policies of the antitrust laws, once the state action defense is properly put to the side. As reflected in the opinion below, defendants assert that allowing competition for distribution services is "wasteful" and "inefficient," and that, if they were relieved of the burden of having to compete for customers in the areas of overlap, they would be able to provide benefits to others who are outside the area of competition. *See* Appx. 3, 7, 10 (Opin. at 3, 7, 10); *see also* Appellees' Memo at 2 (bemoaning the ability of customers to obtain "discounts by playing one company off against the other"). This is, in short, the "age-old cry of ruinous competition and competitive evils," which federal antitrust law has long rejected. *See Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 346 (1982). On the contrary, "[t]he Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services." *National Soc'y of Prof'l Engineers v. United States*, 435 U.S. 679, 695 (1978).

Defendants accordingly attempt to cast their arguments against competition as "efficiencies." Appellees' Memo at 18, 19. It is doubtful that an efficiencies defense, which has yet to be fully considered by the district court (or in the FTC's administrative litigation) has merit. First, the claimed efficiencies would benefit an entirely different group of consumers than those harmed by the transaction. But the Supreme Court has made it clear that anticompetitive effects in one market cannot be justified by procompetitive consequences in another market. *Philadelphia Nat'l Bank*, 374 U.S. at 370.[20] Second, even if these ostensible efficiencies are cognizable at all, they would be subject to "a rigorous analysis * * * to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior." *H.J. Heinz*, 246 F.3d at 721; *see also University Health*, 938 F.2d at 1223. Under the *Merger Guidelines*, any claimed efficiencies must be "merger-specific." U.S. Dept. of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines*, [4 Trade Reg. Rep. (CCH) ¶ 13,104] (Apr. 8, 1997) ("*Merger Guidelines*"), at § 4. And, given the high market concentration levels present in this case (*i.e.*, defendants' acquisition is essentially a merger to monopoly), defendants must offer proof of "extraordinary efficiencies." *Heinz*, 246 F.3d at 720; *see Merger Guidelines* § 4.

Moreover, there are good reasons to doubt the existence of the "efficiencies" that defendants have advanced. Although defendants contend that the PUC rate-

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[20] *See Larry V. Muko, Inc. v. Southwestern Pa. Bldg. & Constr. Trade Council*, 670 F.2d 421, 439 (3d Cir. 1982) ("antitrust cases have always rejected the premise that a procompetitive effect in one market will excuse an anticompetitive effect in another") (Sloviter, J., dissenting); *RSR Corp. v. FTC*, 602 F.2d 1317, 1325 (9th Cir. 1979) (rejecting defendant's attempt to justify a merger on grounds of procompetitive effects in another market); *Mississippi River Corp. v. FTC*, 454 F.2d 1083, 1089 (8th Cir. 1972) ("the anticompetitive effects of an acquisition in one market cannot be justified by procompetitive effects in another market").

setting structure allows them to subsidize the discounts they offer to customers for whom they compete by increasing rates to "captive" customers, *see* Appx. 409 (PX0062 at 017), they have failed to square this claim with the PUC's declaration that it will no longer permit such subsidization, D.24 at 9, or with the fact that it has been more than 10 years since the defendants have applied to the PUC for any adjustment to base rates. Appx. 401-402, 409 (PX0059 at 12-13; PX0062 at 17).

As weak as defendants' efficiencies arguments appear to be, defendants will have the opportunity to address them in the district court (and, ultimately, in the administrative proceeding) if this Court reverses the dismissal order and remands. But further district court proceedings will be pointless if defendants are allowed to close the transaction now. As this Court implicitly recognized in granting an injunction pending appeal, the FTC and the public would be irreparably deprived of the principal relief Congress envisioned by enacting the premerger notification law, 15 U.S.C. § 18a, and Section 13(b) of the FTC Act -- *i.e.*, a preliminary injunction that allows the adjudication of the merits *before* the parties are allowed to make changes to their businesses (such as a consolidation of staff) that impair the ability of the Commission to achieve fully effective divestiture relief. Further, as noted above, consumers are already suffering from the loss of vigorous competition between the two companies, and this interim consumer harm will only get worse if the acquisition is consummated. *See Heinz*, 246 F.3d at 726 ("Section 13(b) itself embodies congressional recognition of the fact that divestiture is an inadequate and unsatisfactory remedy in a merger case"). Defendants, on the other hand, would not be irreparably harmed by any incremental delay occasioned by the grant of injunctive relief.[21]

CONCLUSION

For the reasons set forth above, this Court should reverse the district court's order dismissing the FTC's complaint, and enjoin defendants' acquisition pending resolution by the district court of the merits of that complaint.

Respectfully submitted,

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[21] We anticipate that the district court proceedings will be completed in relatively short order. As of the date the district court ruled on defendants' motion to dismiss, less than a month remained in the schedule -- agreed to by the parties and entered by the court -- for completion of discovery and the preliminary injunction hearing. D.26.

COMBINED CERTIFICATIONS

1) Bar membership -- Because this brief is filed on behalf of an administrative agency of the United States, there is no bar membership requirement.

2) Word count -- I certify that this brief complies with Fed. R. App. P. 32(a)(7)(B). It is proportionally spaced and contains 11347 words, as counted by the WordPerfect word processing program.

3) Service upon counsel -- I hereby certify that on July 6, 2007, I served the public and sealed version of this brief by e-mail on appellees and on *amicus curiae* Public Utility Commission. I also served two copies of both versions of the brief, the Addendum of Statutes, and the Appendix on appellees and on *amicus curiae* by first-class mail addressed to:

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4) Identical compliance of briefs -- I certify that the text of the electronic brief, which was submitted to this Court, is identical to the paper copies that were served on this Court and on appellants.

5) Virus check -- I certify that I have run a virus check on this brief and no virus was detected. I used Symantec AntiVirus Corporate Edition rev. 24 (updated to July 4, 2007).

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