MEMORANDUM

DATE: September 2, 2014

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SUBJECT: Antitrust laws' applicability to the Electric Reliability Council of Texas, Inc.

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I. Introduction

This memorandum provides an overview of how the federal and state antitrust laws may apply to the Electric Reliability Council of Texas, Inc. (ERCOT). Evaluation of the antitrust laws' applicability requires consideration of two basic questions. First, which ERCOT activities fall within the scope of the antitrust laws and which are exempt? Second, for activities subject to the antitrust laws, what are the applicable standards that determine which activities are permissible and which would be unlawful?

The purpose of this analysis is to provide a framework for guidelines that will allow ERCOT Board Directors, officers, employees, and members to do their work without undue concerns about potential antitrust violations or liability. Guidelines by definition cannot anticipate all issues that may arise. This is especially true for antitrust because the governing statutes are worded in very general terms that leave the courts to determine the laws' scope and application on case-by-case, fact-specific grounds.[1] This memorandum sets out applicable principles and indicates how they are likely to be applied. The analysis does not purport to determine whether any specific conduct would be subject to antitrust challenge and if so whether that challenge would succeed. Legal counsel should always be consulted whenever specific questions arise.

II. Executive Summary

The basic purpose of the federal and state antitrust laws is to protect competition in our market-based economy. The laws' premise and policy are that free market competition will produce lower priced and higher quality products and services, promote innovation, and efficiently allocate economic resources. To that end, the antitrust laws prohibit business practices found to unreasonably restrain and harm competition.

The antitrust statutes are framed in general terms and applied by the courts case-by-case. Most relevant to ERCOT is Section 1 of the federal Sherman Act, which broadly prohibits "[e]very contract, combination . . . , or conspiracy in restraint of trade." Also relevant are Section 5 of the Federal Trade Commission Act and Section 15.05(a) of the Texas Free Enterprise and Antitrust Act. These provisions overlap with and are similar in application to Section 1 of the Sherman Act. Other antitrust provisions address anticompetitive conduct by a single business, such as monopolization, and anticompetitive mergers and acquisitions. These provisions have less relevance because ERCOT for the most part is a market regulator rather than market participant.

ERCOT activities should not raise antitrust concerns when undertaken in the normal course to discharge ERCOT's responsibilities pursuant to the Public Utility Regulatory Act (PURA)[2] and Public Utility Commission of Texas (Commission) rules. This is so for three reasons.

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[1] *See Cantor v. Detroit Edison Co.*, 428 U.S. 579, 603 (1976) (affirming that "the Court should adhere to its settled policy of giving concrete meaning to the general language of the Sherman [antitrust] Act by a process of case-by-case adjudication of specific controversies.").

[2] TEX. UTIL. CODE §§ 11.001 - 66.016.

First, a core function of ERCOT as independent system operator is to oversee and facilitate competition in the production and sale of electricity. To the extent that they facilitate competition, ERCOT activities fundamentally comport with the antitrust laws.

Second, the antitrust laws likely do not apply to ERCOT in the exercise of its statutory responsibilities even when the result is to restrict competition. The courts have construed Section 1 of the Sherman Act not to apply to actions by the States in their sovereign capacity. This "State Action" exemption provides antitrust immunity for competitive restrictions adopted by a governmental entity that are a reasonably foreseeable result of the statutory authority granted to the governmental entity. The State Action exemption also immunizes private parties acting pursuant to a state scheme that displaces competition provided that the private actions are subject to active state supervision.

Although ERCOT is not a governmental entity *per se*, the State Action exemption likely applies because the State of Texas has granted ERCOT powers the exercise of which may restrict competition in ways reasonably foreseen from the legislative grant of authority. As an "Essential Organization" certified by the Commission, ERCOT has a duty under PURA and Commission rules to establish and enforce requirements to ensure the reliability and adequacy of the ERCOT electrical grid. ERCOT also has a statutory responsibility to establish and enforce requirements for the operation and oversight of the competitive market for production and sales of electricity. In addition, ERCOT engages in transmission planning, an area that remains subject to traditional utility regulation under PURA.

ERCOT's discharge of responsibilities in each of these areas constrains unfettered competition in some respects, but they are the types of constraints either explicitly or implicitly endorsed by statute. Thus, they may be said to be acts of the State. Moreover, because ERCOT activities are subject to active and comprehensive supervision by the Commission, State Action immunity would likely attach regardless of whether ERCOT is viewed as a governmental entity or a private entity.

This conclusion regarding State Action immunity applies to actions of ERCOT Directors, committee members, and officers and other employees in the execution of their official ERCOT responsibilities, such as adoption of Protocols and other market rules. It also applies to actions by private market participants to comply with ERCOT requirements where compliance is subject to active ERCOT and Commission oversight. Conversely, market participants, including individuals serving as Board Directors or committee members, would not be entitled to State Action antitrust immunity for conduct outside the scope of their ERCOT duties.

A corollary to the State Action exemption, known as the *Noerr* exemption, recognizes the right of private parties to petition for the adoption of governmental regulations that restrict competition. The *Noerr* exemption likely applies to the activities of market participants, including those serving on ERCOT committees, and other private parties in supporting or opposing adoption of ERCOT Protocols and other regulatory requirements. The exemption does not apply to petitioning that employs clearly illegal practices such as bribes or a separate agreement to fix prices. Neither does it shield abuses of the process or other "sham" petitioning

that directly harms competitors. *Noerr* also would not immunize non-petitioning activities of private market participants that may take place at ERCOT.

Third and finally, even if no antitrust exemption applies, the courts will not quickly or lightly condemn business agreements and other activities in a complex market where market participants' interdependence requires coordinated action. The courts have recognized that some activities must be carried out jointly with agreed upon rules that both restrain and facilitate competition. Under a "Rule of Reason" analysis, such activities will not be found to violate the antitrust laws without detailed examination of the business and the nature, purpose, and effect of the activities.

The courts would likely apply the Rule of Reason to the vast majority of ERCOT activities. The production and sale of electricity in ERCOT is a unique and highly complex market requiring coordination among market participants. ERCOT plays a central role in coordinating activities of generators, transmission and distribution utilities, wholesale and retail providers, and customers. To the extent that adoption of ERCOT Protocols and other requirements may be characterized as agreements that restrain trade, they could be justified under a Rule of Reason analysis by demonstrating that their procompetitive market aspects outweigh or counterbalance any anticompetitive impact.

III. Overview of the Antitrust Laws

The antitrust laws principally include the federal Sherman Act,[3] the Clayton Act,[4] the Federal Trade Commission Act,[5] and, in Texas, the Texas Free Enterprise and Antitrust Act.[6] From ERCOT's perspective, the most important of these statutes is the Sherman Act. Enacted in 1890, the Sherman Act "was designed to be a comprehensive charter of economic liberty aimed a preserving free and unfettered competition as the rule of trade."[7] The Act's premise and policy are that competition "will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress" in a manner "conducive to the preservation of our democratic political and social institutions."[8]

The Sherman Act has two main provisions. Section 1 prohibits contracts, combinations, and conspiracies that unreasonably restrain trade or commerce. Section 2 prohibits monopolization, attempts to monopolize, and conspiracies to monopolize trade or commerce. Violating these provisions can have severe consequences. A violation constitutes a felony that can result in a fine of up to $1 million and imprisonment up to 10 years. Enforcement occurs through criminal and civil lawsuits filed by the Antitrust Division of the United States Department of Justice and

[3] 15 U.S.C. §§ 1 - 7.

[4] 15 U.S.C. §§ 12 - 27.

[5] 15 U.S.C. § 45.

[6] TEX. BUS. & COMM. CODE §§ 15.01 - 15.26.

[7] *Northern Pac. R. Co. v. United States*, 356 U.S. 1, 4 (1958).

[8] *Id.* at 4-5.

through civil lawsuits filed by the United States Federal Trade Commission.[9] In addition, private parties alleging injury by an antitrust violation can file lawsuits to recover treble damages.[10]

Section 1 of the Sherman Act is most pertinent to ERCOT because it broadly addresses agreements that restrict competition. In the normal course of business, ERCOT activities involve continuous interaction resulting in myriad formal and informal agreements between and among ERCOT personnel and market participants. Section 2, by contrast, primarily addresses unilateral actions by a business that monopolizes or attempts to monopolize a defined market.[11] Section 2 therefore could apply mainly to actions by an electric market participant. ERCOT and ERCOT personnel are not private market participants but instead perform the functions of an independent system operator pursuant to PURA.[12]

The Federal Trade Commission Act also is relevant. Section 5 of the Act prohibits, among other things, "unfair methods of competition in or affecting commerce."[13] The courts have held that this prohibition "overlaps the scope of Section 1 of the Sherman Act aimed at prohibiting restraints of trade."[14]

The Texas Free Enterprise and Antitrust Act should be noted as well because it is patterned on the federal laws. Section 15.05(a) tracks the language of Section 1 of the Sherman Act.[15] The Texas Act's stated purpose is to "maintain and promote economic competition in trade and commerce occurring wholly or partly within the State of Texas and to provide the benefits of that competition to consumers in the state." The Act directs that its provisions "shall be construed in harmony with federal judicial interpretations of comparable federal antitrust statutes to the extent consistent with this purpose."[16] The Texas Attorney General enforces the Texas Act.[17] In

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[9] According to U.S. Department of Justice statistics, the Antitrust Division in fiscal year 2012 obtained $1.14 billion in criminal fines, and courts imposed 45 prison terms with an average sentence of approximately two years per defendant. *See* U.S. Dep't of Justice Antitrust Division Update Spring 2013 (available at http://www.justice.gov/atr/public/division-update/2013/criminal-program.html).

[10] *See* 15 U.S.C. § 15(a).

[11] As noted, Section 2 also prohibits persons from "combining or conspiring" with other persons to monopolize trade or commerce. This prohibition partly overlaps the general prohibition in Section 1 against anticompetitive combinations and conspiracies. A Section 2 conspiracy requires proof of the parties' specific intent to monopolize. The Supreme Court has described a Section 1 conspiracy as one "in restraint of trade that may stop short of monopoly" and a Section 2 conspiracy as one "that may not be content with restraint short of monopoly." *See American Tobacco Co. v. U.S.*, 328 U.S. 781, 788, 809 (1946).

[12] PURA § 39.151.

[13] 15 U.S.C. § 45(a)(1).

[14] *California Dental Ass'n v. FTC*, 526 U.S. 756, 762 n. 3 (1999) (citing *FTC v. Indiana Fed. of Dentists*, 476 U.S. 447, 454-55 (1986) (internal citations omitted).

[15] TEX. BUS. & COM. CODE § 15.05(a). Section 15.05(b) tracks Section 2 of the Sherman Act.

[16] *Id.* §15.04.

[17] *Id.* § 15.20.

addition, similar to federal law, private parties can file lawsuits for treble damages.[18]

IV. Applicability of the Antitrust Laws to ERCOT

The courts have construed the Sherman Act not to apply to two general categories of activity. First, the Act does not apply to actions taken by the States in a sovereign capacity that regulate their economies and restrict competition. This exemption is known as the "State Action" doctrine.[19] Second, the Act does not apply to private parties exercising their constitutional right to petition the government to adopt laws that restrict competition. This exemption is known as the *Noerr* doctrine.[20] Persons are immune from antitrust liability for conduct falling within either the State Action doctrine or the *Noerr* doctrine.

Because these two antitrust exemptions are judicial interpretations developed on a case-by-case basis, their contours are not always precise and they continue to evolve. By illustration, the United States Supreme Court in its October 2014 term will consider whether certain actions by the North Carolina Board of Dental Examiners, most of whose members are elected by dentists in the state, qualify for State Action antitrust immunity.[21] Although not altogether precise, existing case law is extensive and provides a reasonable basis for judging whether and which types of ERCOT activities are likely to be found exempt from the antitrust laws under State Action or *Noerr* principles.

A. The State Action Exemption

The State Action exemption rests on the courts' interpretation that, in light of our system of federalism, Congress did not intend the Sherman Act "to prohibit anticompetitive actions by the States in their governmental capacities as sovereign regulators."[22] Rate regulation is a prime example. The State Action exemption applies when a state statute displaces competition by authorizing a state agency to set "just and reasonable" rates that businesses may charge the

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[18] *Id*. § 15.21. The federal Clayton Act, noted above, is less pertinent to ERCOT. The Clayton Act prohibits, among other things, mergers or acquisitions that are likely to lessen competition and anticompetitive "tying" arrangements in which a seller or buyer conditions the sale or purchase of a product or service on the other party's agreement not to sell to or purchase from a third party. ERCOT is not a party to mergers or acquisitions, nor does it have jurisdiction to review such transactions between private market participants. Tying arrangements have potential relevance to ERCOT procurement activities. Procurement is not the focus of this memorandum.

[19] *Parker v. Brown*, 317 U.S. 341 (1943), is the seminal Supreme Court decision that recognized an antitrust exemption for "State Action."

[20] "*Noerr*" refers to the Supreme Court's decision in *Eastern R.R. Presidents Conference v. Noerr Motor Freight Inc.*, 365 U.S. 127 (1961). The doctrine is sometimes referred to as the *Noerr-Pennington* doctrine to acknowledge the Court's decision in *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

[21] *See North Carolina Bd. of Dental Exam'rs v. F.T.C.*, No. 13-534, 134 S.Ct. 1491 (*cert. granted* Mar. 3, 2014).

[22] *City of Columbia v. Omni Outdoor Advertising, Inc.* 499 U.S. 365, 374 (1991).

public pursuant to a regulatory scheme.[23] Disputes over the applicability of the exemption have centered on whether the sovereign "State" itself has truly "acted" to displace competition when the action is that of a "sub-state" governmental entity or a private party acting pursuant to a state regulatory scheme.

1. "Sub-state" governmental entities

"Sub-state" governmental entities such as municipalities and other political subdivisions do not automatically qualify for State Action antitrust immunity because these entities are not themselves the sovereign State.[24] Instead, sub-state governmental entities receive immunity when their activities "are undertaken pursuant to a 'clearly articulated and affirmatively expressed' state policy to displace competition."[25] This "clear articulation" test does not require that a statute or its legislative history expressly state an intent for the governmental entity's delegated action to have anticompetitive effects.[26] It is sufficient, instead, if the anticompetitive effect of the action "was 'the foreseeable result' of what the State authorized."[27] That is, "the State must have foreseen and implicitly endorsed the anticompetitive effects as consistent with its policy goals."[28] A policy of "mere neutrality" is not enough; there must be some indication that the State contemplated that the governmental entity could act or regulate anticompetitively.[29]

Once the "clear articulation" standard is met, it need not be shown that state officials oversee and supervise the sub-state governmental entity's exercise of delegated authority. This additional requirement, which applies to actions by private parties as discussed below, does not apply to governmental entities because they "have less incentive to pursue their own self-interest under the guise of implementing state policies."[30]

2. Private parties

Actions by private parties pursuant to a regulatory scheme can also be considered "State Action" entitled to antitrust immunity. A two-part test applies. The first is the "clear articulation" requirement that suffices for sub-state governmental entities. In addition, a private party's participation in the regulatory scheme to displace competition must be "'actively supervised' by the State."[31] State officials must "have and exercise power to review particular anticompetitive

[23] *See Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48, 63-65 (1985).

[24] *F.T.C. v. Phoebe Putney Health Sys., Inc.*, 133 U.S. 1003, 1010 (2013).

[25] *Id.* (quoting *Community Communications v. Boulder*, 455 U.S. 40, 52 (1982)).

[26] *Id.* at 1011.

[27] *Id.* (quoting *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 43 (1985)).

[28] *Id.* at 1013.

[29] *Id.* at 1012.

[30] *Id.* at 1011.

[31] *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980).

acts of private parties and disapprove those that fail to accord with [the clearly articulated] state policy."[32] Active supervision does not mean that the state officials must have reviewed and approved every action of the private party.[33] But "hands-off" regulatory programs do not suffice.[34] This active supervision requirement gives assurance that the private party's anticompetitive actions genuinely reflect implementation of the State's policy to displace competition, not merely the private party's individual interest.[35]

3. The Public Utility Commission of Texas

Although the matter is not entirely settled, state agencies like the Commission are very likely entitled to antitrust immunity under the State Action doctrine on at least the same basis as sub-state governmental entities. The Supreme Court has indicated that "[i]n cases in which the actor is a state agency, it is likely that active state supervision would not be required [as it is for private parties]."[36] Accordingly, Commission actions that regulate and restrict competition should raise no antitrust issue when the restriction is a reasonably foreseeable result of what the Texas Legislature authorized in PURA.

4. ERCOT

ERCOT is neither a state agency nor a private party in the traditional sense, but has attributes of both. ERCOT, Inc. is a Texas tax-exempt, non-stock, non-profit organization[37] that exercises regulatory powers expressly granted by PURA and delegated by the Commission pursuant to PURA. A review of PURA, Commission rules, and ERCOT's Articles of Incorporation and Bylaws indicates that, like the Commission, ERCOT would likely be found exempt from antitrust scrutiny under the State Action doctrine as long as the activities in question are a reasonably foreseeable result of the authority granted to ERCOT under PURA. Whether ERCOT should instead be considered a private party also subject to the "active supervision" requirement can be debated. As a practical matter, however, the question is probably moot because ERCOT activities are, in fact, subject to active and comprehensive supervision by the Commission.

a. ERCOT is an independent entity with statutory authority to regulate, similar to state agencies.

ERCOT actions would likely be analyzed for State Action immunity on the same basis as actions

[32] *Patrick v. Burget*, 486 U.S. 94, 101 (1988).

[33] *F.T.C. v. Ticor Title Ins. Co.*, 504 U.S. 621, 640 (1992) (noting that active supervision may include "a regulatory regime in which sampling techniques or a specified rate of return allow state regulators to provide comprehensive supervision without complete control, or in which there was an infrequent lapse of state supervision").

[34] *See id.* at 639; *Cantor v. Detroit Edison Co.*, 428 U.S. at 594.

[35] *Id.* at 100-01. *See also Ticor Title Ins.*, 504 U.S. at 633-40.

[36] *Town of Hallie*, 471 U.S. at 46, n.10.

[37] *See Amended and Restated Articles of Incorporation of Electric Reliability Council of Texas, Inc.* (filed Jan. 4, 2001 in the Office of the Secretary of the State of Texas).

by state or sub-state governmental entities because ERCOT is an "essential organization" granted broad authority by the State of Texas pursuant to PURA and Commission rules. PURA § 39.151 charges ERCOT to perform the following functions:

- ensure the reliability and adequacy of the ERCOT electrical network;
- ensure that all buyers and sellers of electricity have access to the ERCOT transmission and distribution systems on nondiscriminatory terms;
- ensure that the production and delivery of electricity are accurately accounted for among the generators and wholesale buyers and sellers in the ERCOT region; and
- ensure that information relating to a customer's choice of retail electric provider is timely conveyed to those who need the information.[38]

Supplementing these express statutory duties, PURA authorizes the Commission to delegate to ERCOT the authority to:

- establish and enforce rules relating to the reliability of the ERCOT network and the accounting for production and delivery of electricity over the network;[39] and
- enforce operating standards within the ERCOT network and establish and oversee utility dispatch functions and transaction settlement procedures.[40]

The Commission has adopted detailed rules delegating such authority to ERCOT.[41]

Pursuant to the foregoing grants of authority, ERCOT has adopted an extensive set of Protocols, Market Guides, and Other Binding Documents.[42] These rules have the force of law. PURA § 39.151(j) requires market participants to "observe all scheduling, operating, planning, reliability, and settlement policies, rules, guidelines, and procedures" adopted by ERCOT.

In addition to performing statutorily prescribed functions like those of state agencies, ERCOT conducts meetings in public in a manner similar to state agencies. In accordance with PURA § 39.1511 and ERCOT's Bylaws, meetings of the ERCOT Board of Directors and Board subcommittees are open to the public except for confidential or sensitive matters which may be addressed in a closed, executive session.[43] ERCOT must provide public notice of a meeting,

[38] PURA §§ 39.151(a), (b).

[39] *Id.* § 39.151(d).

[40] *Id.* § 39.151(i).

[41] *See* P.U.C. SUBST. R. 25.361, 25.362, 25.501, 25.502, and 25.503.

[42] ERCOT market rules are available at http://ercot.com/mktrules.

[43] PURA § 39.1511(a); *Amended and Restated Bylaws of Electric Reliability Council of Texas, Inc.* ("ERCOT Amended Bylaws") § 4.6(e).

including the planned meeting agenda, at least seven days in advance of the meeting.[44] The public may attend the meetings or view them live, without charge, over the Internet.[45] Those attending have the right to comment on the matters under discussion.[46] This right of the public to comment actually exceeds the requirements of the Texas Open Meetings Act that govern most state agencies.[47]

Unlike the Commission but similar to some licensing agencies, the ERCOT Board and ERCOT committees include individuals affiliated with private market participants representing various industry segments. PURA specifies the Board's composition to ensure that ERCOT as an "independent organization" performs its functions in a manner "sufficiently independent of any producer or seller of electricity that its decisions will not be unduly influenced by any producer or seller."[48] Of the Board's 16 members, only six can have private market affiliation.[49] Five members must be unaffiliated with any market segment, and three others must represent various consumer interests.[50] The remaining two members are ERCOT's Chief Executive Officer and the Commission's Chairman.[51] Moreover, of the six market participant members, each must represent a different market segment: independent generators, investor-owned utilities, power marketers, retail electric providers, municipally owned utilities, and electric cooperatives.[52] The statute further safeguards independent decision making by requiring a member to recuse himself or herself if the member either has a direct interest in a matter or a substantial financial interest in a person who has a direct interest.[53] The Commission's rules additionally require that ERCOT adopt policies to ensure that its operations are not affected by conflicts of interest involving its employees or the organization's contractual relationships with other businesses.[54]

These provisions for independent decision making contrast with those governing the North Carolina State Board of Dental Examiners recently reviewed by the United States Court of Appeals for the Fourth Circuit.[55] The North Carolina Board consists of six licensed dentists elected by dentists, one dental hygienist elected by dental hygienists, and one consumer member appointed by the Governor. Because a "decisive coalition" of the North Carolina Board "is made

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[44] PURA § 39.1511(b); ERCOT Amended Bylaws § 4.6(b).

[45] PURA § 39.1511(c); P.U.C. SUBST. R. 25.366.

[46] PURA § 39.1511(b); ERCOT Amended Bylaws § 4.6(d).

[47] *See* TEX. GOV'T CODE § 551.001, *et seq.*

[48] PURA § 39.151(b).

[49] PURA § 39.151(g).

[50] *Id.*

[51] *Id.* The Chairman of the Commission is an ex officio nonvoting member.

[52] *Id.*

[53] PURA § 39.1512.

[54] P.U.C. SUBST. R. 25.362(f).

[55] *See North Carolina State Bd. of Dental Exam'rs v F.T.C.*, 717 F.3d 359 (4th Cir. 2013), *cert. granted* No. 13-534, 134 S.Ct. 1491 (Mar. 3, 2014).

up of participants in the regulated market, who are chosen by and accountable to their fellow market participants," the court ruled that the Board members are in reality "private actors" who must meet both the "clear articulation" and "active supervision" tests to qualify for State Action immunity.[56] ERCOT is plainly distinguishable. ERCOT Board Directors elected by market participants are not a "decisive coalition" and even among themselves represent different market segments with often diverging interests.

The foregoing supports the conclusion that ERCOT, as an independent entity with statutory powers and public interest responsibilities, should be found immune from the antitrust laws in the same manner as state agencies and sub-state governmental entities. ERCOT's structure and procedures provide assurance that ERCOT as a body does not engage in decision making that reflects the self-interest of individual private parties. Accordingly, ERCOT activities insofar as they may restrict competition should be found exempt from antitrust scrutiny under the State Action doctrine as long as the activities are a reasonably foreseeable result of the authority granted to ERCOT under PURA. Section IV.A.6. below identifies types of ERCOT activities that may restrict competition in some respects but nonetheless may be viewed as a reasonably foreseeable result of ERCOT's responsibilities under PURA and Commission rules.

b. ERCOT is actively supervised by the Commission.

Even if ERCOT were deemed a private party subject to the State Action "active supervision" requirement, the result would likely be the same. Under PURA, ERCOT is subject to active and comprehensive supervision by the Commission. ERCOT must be certified by the Commission as an independent organization to perform the statutory duties of independent system operator.[57] As a certified organization, ERCOT "is directly responsible and accountable to the Commission."[58] The Commission "has complete authority to oversee and investigate the organization's finances, budget, and operations as necessary to ensure the organization's accountability and to ensure that the organization adequately performs the organizations functions and duties."[59] ERCOT must "fully cooperate with the Commission in the Commission's oversight and investigatory functions."[60] Should the organization "not adequately perform" its functions and duties," the Commission may take "appropriate action" against ERCOT, including assessing administrative penalties or decertification.[61]

Other PURA provisions and the Commission's rules underscore the active and detailed nature of this supervision related to both finances and operations:

[56] 717 F.3d at 368-70. As noted above, the Supreme Court recently granted certiorari to review this ruling.

[57] PURA § 39.151(c).

[58] *Id.* § 39.151(d).

[59] *Id.*

[60] *Id.*

[61] *Id. See also* P.U.C. SUBST. R. 25.364 (relating to "Decertification of an Independent Organization").

- ERCOT must prepare and submit for Commission review the organization's "entire proposed annual budget."[62] The Commission must review the budget annually or biennially, and may approve, disapprove, or modify any line item.[63] The Commission also may review and approve, disapprove, or modify any ERCOT proposals for debt financing or refinancing.[64] The Commission prescribes the system of accounts and financial and other reporting requirements for ERCOT.[65] The Commission may inspect and conduct audits of ERCOT's records, accounts, and facilities.[66]

- ERCOT must prepare and submit for Commission review a detailed strategic plan and a detailed operations report and plan.[67] ERCOT must file quarterly reports with the Commission that include, among other things, a report on performance measures.[68]

- The Commission has the power to resolve disputes that may arise between ERCOT and affected persons. Any affected person may file a formal complaint and the Commission may hold a hearing to determine whether any ERCOT conduct violated any law, Commission order or rule, or ERCOT protocol or procedure within the Commission's jurisdiction.[69]

These extensive and detailed provisions for Commission oversight and review of ERCOT activities support the conclusion that the State Action "active supervision" requirement will be satisfied in the vast majority of situations involving ERCOT's performance of functions as an independent system operator. This conclusion applies to conduct by ERCOT Board Directors, ERCOT officers, ERCOT employees, and ERCOT committee members in the performance of statutorily authorized ERCOT functions. Such conduct, insofar as it may allegedly restrict competition, would likely be considered exempt from the antitrust laws because of the State's active supervision, assuming that the conduct was a reasonably foreseeable result of the State's grant of authority under PURA.[70]

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[62] PURA § 39.151(d-1).

[63] *Id.* *See also* P.U.C. SUBST. R. 25.363 (providing detailed requirements for the preparation and review of ERCOT's budget and all fees levied by the organization).

[64] PURA § 39.151(d-2).

[65] *Id.* § 39.151(d-4); P.U.C. SUBST. R. 25.362(i), 25.363.

[66] PURA § 39.151(d-4).

[67] P.U.C. SUBST. R. 25.362(i). *See* PURA § 39.151(d-4)(1).

[68] P.U.C. SUBST. R. 25.362(i)(3).

[69] *Id.* § 25.251. *See* PURA § 39.151(d-4)(6).

[70] Many ERCOT committees, subcommittees, and working groups do not approve measures but merely make recommendations for consideration by another committee and, ultimately, the ERCOT Board. In addition to State Action immunity, member participation in these lower level committees and groups may also have antitrust immunity under the *Noerr* doctrine, discussed below, inasmuch as participation at these levels constitutes advocacy or petitioning for a decision rather than decision making itself.

5. Market participants as private parties

Private parties are entitled to State Action antitrust immunity for activities that meet both the "clear articulation" and "active supervision" requirements. Actions by market participants in their private capacities (*i.e.*, not under official ERCOT auspices) ordinarily should meet both requirements when undertaken to comply with ERCOT Protocols and other regulatory rules. Conversely, no immunity would attach to actions by private market participants that are not necessary to implement or comply with adopted ERCOT regulatory requirements.[71]

6. Certain types of ERCOT activities likely meet the "clear articulation" test for State Action immunity

The "clear articulation" test for State Action immunity requires that the conduct in question be taken pursuant to a clearly articulated and affirmatively expressed State policy to displace or limit competition. PURA reflects the State of Texas's policy to displace or limit competition in three relevant areas: ensuring the safety and reliability of the electric grid; regulating transmission and distribution rates and services; and imposing restrictions incidental to the oversight and operation of a competitive market for the production and sale of electricity. A court would likely conclude that ERCOT activities in these areas fall within the State Action exemption from the antitrust laws.

a. Ensuring the reliability and adequacy of the ERCOT grid

Enacted in 1999, Chapter 39 of PURA mandated a basic restructuring of the electric utility industry. The Legislature found that the production and sale of electricity should no longer be considered a monopoly warranting traditional utility regulation of rates and services.[72] Chapter 39 accordingly was "enacted to protect the public interest in the transition to and in the establishment of a fully competitive electric power industry."[73] As part of this restructuring to enable competition, however, the Legislature made clear that the public interest also included ensuring the reliability and adequacy of the electricity grid. PURA § 39.151(a) decreed that "essential organizations" such as ERCOT be established and certified by the Commission to "ensure the reliability and adequacy of the regional electrical network." PURA § 39.151(d) directed the Commission to adopt and enforce rules related to the reliability of the network, and also authorized the Commission to delegate such authority to the essential organization subject to Commission oversight and review.

Thus, PURA does not sanction or contemplate unfettered competition in the production and sale of electricity, but rather competition tempered by the imperative to ensure the reliability and

[71] As discussed above, the "active supervision" requirement may not be applicable to actions by a market participant taken as a member of the ERCOT Board or an ERCOT committee. Also as discussed, the requirement is likely to be satisfied in any event by virtue of the Commission's comprehensive supervision of ERCOT. Board or committee membership would provide no shield, however, for activities beyond the scope of ERCOT's authority under PURA.

[72] PURA § 39.001(a).

[73] *Id.*

adequacy of the electrical system. The statute empowers the Commission and ERCOT to take reasonable measures to safeguard system reliability and adequacy. This does not mean that regulatory restrictions can be imposed *carte blanche* without regard to whether they substantially obstruct or interfere with competition. PURA § 39.001(c) cautions that regulatory authorities, and by implication ERCOT, may not impose restrictions or conditions on competition "except as authorized in this title." PURA § 39.001(d) specifically instructs that regulatory authorities should choose "competitive rather than regulatory methods . . . to the greatest extent feasible" and adopt rules and orders that are "practical and limited so as to impose the least impact on competition."

ERCOT has adopted a multitude of Protocols, Market Guides, and other rules and requirements that function to protect the reliability and adequacy of the electrical system. A prime example is the procurement and deployment of ancillary services needed to comply with National Electric Reliability Corporation (NERC) standards.[74] PURA § 35.004(c) explicitly recognizes the need for ancillary services and empowers ERCOT to procure them. ERCOT does so through a competitive market process when appropriate.[75] Other reliability examples include technical requirements that must be met before generation facilities will be permitted to interconnect to the electrical grid.[76] These and other provisions relating to system reliability and adequacy inarguably restrict unfettered market competition in some respects. At the same time, however, they are a reasonably foreseeable result of a clearly articulated State policy to provide for competition under a system that is reliable and adequate to serve the public. ERCOT's consideration, adoption, implementation, and enforcement of rules to maintain system reliability and adequacy accordingly should satisfy the "clear articulation" standard for State Action antitrust immunity.

b. Regulating transmission and distribution services

PURA also reflects a State policy to displace competition with regulation of transmission and distribution services. Chapter 39 contains the legislative finding that that competitive electric markets are in the public interest "except for transmission and distribution services."[77] Such services are regulated pursuant to other chapters of PURA. Chapters 35 and 36 authorize the Commission to set wholesale rates for the transmission and distribution services of transmission and distribution utilities (TDUs) including transmission service providers (TSPs).[78] Chapter 37 restricts which entities are permitted to provide transmission and distribution service to the public. Under Chapter 37, no utility may provide such service without first obtaining a certificate of public convenience of necessity (CCN) authorizing the installation and operation of

[74] *See generally* ERCOT Nodal Protocols § 6 (Ancillary Services).

[75] *See, e.g., id.* §§ 4.5.1(d), 4.5.2, 3.14.2(3), 3.14.3.1(19), 6.4.9.2.

[76] *See generally* ERCOT Protocols § 16.5(3).

[77] PURA § 39.001(a). Also excepted is "the recovery of stranded costs" by electric utilities that "unbundled" their generation and retail facilities from their transmission and distribution facilities as required by Chapter 39. *Id*. *See id.* § 39.051 (requiring unbundling).

[78] *See, e.g.,* PURA §§ 35.004(d), 36.003, 36.051. *See also id.*§§ 31.002(6), (19) (defining "electric utility" and TDU).

facilities for that purpose.[79] The statute specifically authorizes the Commission to grant a CCN to a utility or other person "for a facility used as part of the transmission system serving the ERCOT power region solely for the transmission of electricity."[80] The Commission has broad discretion under Chapter 37 to grant or deny a TSP's CCN application based on a determination of whether the requested certificate "is necessary for the service, accommodation, convenience, or safety of the public." Finally, Chapter 38 authorizes the Commission to adopt reasonable standards, classifications, rules, and practices that an electric utility must follow in furnishing service.[81]

ERCOT supports the Commission in the exercise of these regulatory duties. ERCOT engages in transmission planning to evaluate the need for transmission system improvements for the electrical grid.[82] Proposed transmission projects undergo review through the ERCOT Regional Planning process and may result in a recommendation that a project is needed with a designation of TSPs for the project.[83] The Commission considers ERCOT's recommendation of need in CCN proceedings.[84] To the extent that these transmission planning activities by ERCOT have the effect of limiting competition in the provision of transmission services, they would likely qualify for State Action antitrust immunity because the statutory scheme contemplates regulatory review and approval prior to construction and operation of transmission facilities.[85]

c. Imposing requirements related to operation and oversight of the competitive market for the production and sale of electricity

The market for the production and sale of electricity in ERCOT is not one of *laissez faire* competition. Pursuant to PURA's directive to transition to and establish a competitive market, the Commission has adopted a "Wholesale Market Design" for ERCOT. Commission Rule 25.501 outlines that market design and delegates authority to ERCOT to implement it. Inherent in any market design are ground rules that establish conditions and requirements for participating

[79] PURA § 37.051(a).

[80] *Id.* § 37.051(d)

[81] *Id.* § 38.002.

[82] *See* ERCOT Protocol § 3.11 (Transmission Planning).

[83] *See* ERCOT Planning Guide § 3.

[84] *See* P.U.C. SUBST. R. 25. 10 1 (b)(3)(A)(ii)(I) (affording "great weight" to an Independent System Operator's recommendation of need for transmission facilities).

[85] It should be noted that PURA does not in all aspects fully displace competition with regulation of transmission and distribution services. For example, under PURA § 39.904 and Commission rules, no showing of need is required for transmission facilities that are part of a Commission-approved Competitive Renewable Energy Zone (CREZ) transmission plan, and TSPs are selected for CREZ projects through a competitive process. *See* PURA § 39.904(g), (h); P.U.C. SUBST. R. 25.174(d)(2), 25.216. An agreement between TSPs to allocate CREZ projects among themselves and not submit competing proposals could well raise antitrust concerns. *Cf. U.S. v. Topco Assoc, Inc.*, 405 U.S. 596, 608-10 (1972) (holding that competitors' agreement to allocate geographic markets is *per se* illegal under Section 1 of the Sherman Act).

in the market.[86] This is true of Rule 25.501 which establishes the framework for ERCOT's adoption of Protocols and other rules and requirements governing the operation of the electricity grid. Rule 25.501 includes the general directive that "ERCOT shall determine the market clearing prices of energy and other ancillary services that it procures through auctions and the congestion rents that it charges or credits, using economic concepts and principles such as: shadow price of a constraint, marginal cost pricing, and maximizing the sum of consumer and producer surplus." Key specific directives include, among others:

- ERCOT shall permit market participants to self-schedule or bilaterally contract for energy and ancillary capacity services, except to the extent that doing so would adversely impact ERCOT's ability to maintain reliability.

- ERCOT shall operate a voluntary day-ahead energy market.

- ERCOT shall require resource-specific bid curves for energy and ancillary capacity services that it competitively procures in the day-ahead or operating day, and ERCOT shall use these bid curves or ex-ante mitigated bid curves to address market failure, as appropriate, in its operational decisions and financial settlements.

- ERCOT shall operate a security-constrained, economic dispatch (SCED) system that uses nodal energy prices for resources equal to the locational marginal prices that assign congestion rents to the resources that caused the congestion.

In addition, ERCOT shares responsibility with the Commission to ensure that Retail Electric Providers (REPs) have the "technical and managerial resources and ability to provide continuous and reliable retail electric service to customers."[87]

Pursuant to these directives, ERCOT has adopted a multitude of Protocols and other market rules. All market participants have a duty to be knowledgeable about and comply with the rules.[88] Market participants must register with ERCOT and demonstrate their qualifications before being permitted to participate in ERCOT market transactions.[89] A generator through its Qualified Scheduling Entity (QSE) cannot simply produce electric energy for dispatch to the electricity grid at any time and in any amount the generator chooses. Generators and load cannot avoid the costs of congestion related to their use of the electric grid. Rather, SCED calculates locational marginal prices including congestion costs that generators may charge and that load must pay, and dispatches generation resources accordingly. To the extent that market

[86] At a fundamental level, the law of contracts sets ground rules for "the enforceability of commercial agreements [that] enabl[e] competitive markets . . . to function effectively." *Nat'l Soc. of Prof. Engin. v. U.S.*, 435 U.S. 679, 688 (1978).

[87] P.U.C. SUBST. R. 25.107(g). *See* PURA § 39.352; *AEP Tex. Comm.& Ind. Retail Ltd. Ptrshp v. Pub. Util. Comm'n*, No. 3-13-00358, 2014 WL 3558763 at *4 (Tex. App.—Austin July 17, 2014) (observing that Legislature "imposed some barriers to [market] entry" by requiring certification of REPs).

[88] *Id.* § 25.503(f).

[89] *See* ERCOT Nodal Protocols § 16.

participants are restricted from competing in the market by having to comply with SCED and other competitive market ground rules, the competitive restrictions are a reasonably foreseeable result of the market system established under PURA. As such, the restriction would likely be exempt from antitrust scrutiny under the State Action doctrine.[90]

It bears emphasis that this category of activities, market ground rules, represents an exception to the general rule of competition and antitrust applicability that pervades Chapter 39 of PURA. Chapter 39 is replete with provisions designed to facilitate and promote competitive generation and sales of electricity. The Commission has broad statutory powers to safeguard competition by assessing and addressing market power.[91] One provision, PURA § 39.158, grants the Commission authority to consider market impact before approving proposed mergers and consolidations of owners of electric generation facilities. Subsection 39.158(b) includes a statement that the chapter "shall not be construed to confer antitrust immunity" but instead "is intended to complement other state and federal antitrust provisions."[92] Chapter 39 thus confers no additional immunities itself, and any remedies available under PURA complement and do not preclude "antitrust remedies [that] may also be sought in state or federal court to remedy anticompetitive activities."[93]

Finally, it is important to remember that State Action immunity would not extend to actions by ERCOT Board Directors and committee members that are outside the scope of ERCOT's statutory charge or those individuals' official duties. Board and committee meetings and other gatherings at ERCOT, like any meeting or conference involving industry members, present opportunities for off-topic conversations. Conversations can lead to agreements, and agreements that restrict or impair competition are subject to antitrust liability. Such extra-curricular activities would not be shielded by the fact that they occurred at ERCOT.[94]

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[90] Even if not exempt, such market-enabling and operational activities would be difficult to challenge on the merits in an antitrust lawsuit. *See* Section V.B. below.

[91] *See* PURA §§ 39.155, 39.156, 39.157, and 39.158.

[92] PURA § 39.158(b). *See also id.* § 39.157(a) ("The possession of a high market share in a market open to competition may not, of itself, be deemed to be an abuse of market power; however this sentence shall not affect the application of state and federal antitrust laws.")

[93] *Id.* In *Texas Commercial Energy v. TXU Energy, Inc.*, 413 F.3d 503 (5th Cir. 2005), the Fifth Circuit recognized the complementarity of PURA Chapter 39 and the antitrust laws. The court rejected the argument that PURA § 39.158(b) operated to deny an antitrust defendant the right to assert the "filed rate" doctrine as a common law defense to a private party's antitrust claim for damages. The filed rate doctrine generally precludes recovery of damages based on rates that are "filed" with a regulatory agency but does not confer immunity from antitrust enforcement actions. *See Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 422 (2005).

[94] Nor would the State Action exemption apply to procurement and other activities by ERCOT in the normal course of business as a non-profit corporation.

B. The *Noerr* Exemption

The *Noerr* antitrust exemption is a corollary to the State Action exemption.[95] Whereas the State Action exemption "recognize[s] the States' freedom to engage in anticompetitive regulation," *Noerr* recognizes that the antitrust laws also do not apply to "the conduct of private individuals in seeking anticompetitive action by the government."[96]

The *Noerr* exemption respects the First Amendment right of private parties to petition the government for the redress of grievances.[97] In general, private parties enjoy absolute immunity from antitrust liability for individual or concerted efforts to persuade the government to take action that restricts competition.[98] This immunity extends to both anticompetitive restraints that result from the governmental action and to anticompetitive restraints directly caused by and "incidental" to legitimate efforts to influence and obtain government action.[99] That the private parties may have selfish motives is irrelevant: "*Noerr* shields from the Sherman Act a concerted effort to influence public officials regardless of intent or purpose."[100]

1. The "sham" exception

While "genuine petitioning is immune from antitrust liability, sham petitioning is not."[101] *Noerr* does not protect lobbying, litigation, or other petitioning that is "ostensibly directed toward governmental action [but] is a mere sham to cover what is actually nothing more than an attempt to interfere directly with the business relationships of a competitor."[102] Sham petitioning involves abuse of the governmental process through conduct that is "not genuinely aimed at procuring favorable governmental action" and instead seeks to inflict competitive harm directly.[103] Examples include filing baseless lawsuits against a competitor and frivolous objections to a competitor's application for a governmental license to operate.[104] *Noerr* does not

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[95] *City of Columbia v. Omni Outdoor Advertising, Inc.* 499 U.S. 365, 379-380 (1991).

[96] *Id.*

[97] *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 134 S.Ct. 1749, 1757 (2014). The First Amendment to the United States Constitution provides:

> Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances.

[98] *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 499 (1988) (citing *Noerr* and *Pennington*).

[99] *Id.* As discussed below, the *Noerr* case itself involved petitioning that caused incidental anticompetitive injury.

[100] *Omni Outdoor Advertising*, 499 U.S. at 380 (quoting *Pennington*, 381 U.S. at 670).

[101] *BE&K Constr. Co. v. N.L.R.B.*, 536 U.S. 516, 525-26 (2002).

[102] *Prof. Real Estate Investors v. Columbia Pictures Indus., Inc.*, 508 U.S. 49, 56 (1993).

[103] *Omni Outdoor Advertising*, 499 U.S. at 380 (quoting in part *Allied Tube & Conduit*).

[104] *Id.*, 499 U.S. at 380.

apply in such situations where the actions are taken in "bad faith" and directly harm competitors.[105]

2. Non-sham activities that directly restrain competition or employ illegal means to influence government action

Certain types of activities are not entitled to *Noerr* immunity even though they might be genuine attempts to influence governmental action. Competitors cannot enter into a price-fixing agreement as a way of advocating for governmental ratemaking that sets prices at the agreed-upon level.[106] As discussed below, price-fixing by competitors is a classic example of conduct deemed illegal *per se* under the antitrust laws. *Noerr* does not immunize private party activities that by themselves have blatantly illegal anticompetitive impact. Similarly, *Noerr* does not protect petitioning through other illegal means such as bribing government officials.[107]

3. Activities that take place in a primarily commercial rather than political arena

Noerr's basic rationale is to safeguard constitutionally protected *political* activity as beyond the scope of the antitrust laws which are intended to address *commercial* business activity.[108] The *Noerr* decision itself involved classic political activity. A group of long-distance trucking companies filed an antitrust suit against an association of railroad companies for conducting a publicity campaign aimed at influencing the passage and enforcement of legislation that placed trucking companies at a competitive disadvantage. The Supreme Court held that the publicity campaign constituted political activity that lay outside the scope of antitrust laws, irrespective of its anticompetitive purpose and notwithstanding any incidental injury to the trucking companies.[109]

Noerr thus stands for the proposition that anticompetitive political activity is not be subject to antitrust liability even when it has some commercial impact. In later decisions, the Supreme Court recognized the converse principle: anticompetitive commercial activity can be subject to the antitrust laws even though the activity may have an ultimate political aim and impact. The Court drew this distinction between primarily political activity and primarily commercial activity in *Allied Tube & Conduit Corporation v. Indian Head*.[110] The distinction is important and bears discussion because it points to *Noerr*'s applicability to private party advocacy at ERCOT.

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[105] *Octane Fitness*, 134 S.Ct. at 1757.

[106] *See Allied Tube*, 486 U.S. at 503-04.

[107] *Id.*

[108] *California Motor Transp.*, 404 U.S. at 510.

[109] *Eastern R.R. Presidents Conference v. Noerr Motor Freight Inc.*, 365 U.S. 127 (1961). The Court found it "inevitable, whenever an attempt is made to influence legislation by a campaign of publicity, that an incidental effect of that campaign may be the infliction of some direct injury upon the interests of the party against whom the campaign is directed." *Id.* at 143.

[110] 486 U.S. 492 (1988).

Allied Tube involved an antitrust challenge to activities that took place before and during an annual meeting of the National Fire Protection Association (NFPA). The NFPA is a private, voluntary organization that publishes the National Electrical Code (Code) and other fire protection codes and standards.[111] The Code is "the most influential electrical code in the nation."[112] State and local governments "routinely adopt the Code into law," and "private certification laboratories, such as Underwriter Laboratories, normally will not list and label an electrical product that does no meet Code standards."[113]

The NFPA annual meeting in question involved consideration of a proposal to approve polyvinyl chloride as an acceptable type of conduit for inclusion in the Code. At the time, almost all electrical conduit was made of steel. Concerned about the prospect of new competition, members of the steel and steel conduit industries collectively agreed to pack the NFPA meeting with new association members for the sole purpose of voting against the polyvinyl chloride proposal. The plan succeeded; the proposal was rejected. In response, the company that had submitted the polyvinyl chloride proposal filed a lawsuit alleging that the steel companies' agreement violated Section 1 of the Sherman Act.

The Supreme Court held that the steel companies' activities were not entitled to *Noerr* immunity. The Court emphasized that "the relevant context" was "the standard-setting process of a private association" where members "often have economic incentives to restrain trade" and where product standards "have a serious potential for anticompetitive harm."[114] The Court observed that the antitrust laws have traditionally applied to such associations' decisions about which products are acceptable to be sold and which are not.[115]

The steel companies had argued that *Noerr* applied because they were petitioning a quasi-legislative body, not a purely private organization. They pointed out that legislatures routinely adopt the Code after it is published by the NFPA. The Court rejected this characterization because, despite its influence, the NFPA itself had no official authority conferred on it by any government, and its decision making involved private persons with economic interests to suppress competition.[116] The steel companies' activities therefore were not comparable to legislative lobbying that enjoys *Noerr* immunity.[117] In the Court's view, the challenged conduct was foremost commercial activity that had a political impact, not political activity with only secondary commercial impact.[118]

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[111] *Id*. at 495.

[112] *Id.*

[113] *Id.*

[114] *Id.* at 500.

[115] *Id.* The Court recognized that product standards, if based on objective expert judgments through procedures that safeguard against members' economic biases, can be procompetitive and upheld on the merits under the antitrust laws. *Id.* at 500-01.

[116] *Id.* at 501-02.

[117] *Id*. at 504.

[118] *Id.* at 507.

4. The Public Utility Commission of Texas

Noerr immunity clearly applies to private party advocacy before the Commission. The Commission is a state governmental entity, and "the right to petition extends to all departments of the Government."[119] This includes "administrative agencies which are both creatures of the legislature, and arms of the executive."[120] Accordingly, a power generation company, electric utility, industrial or commercial electric customer, and other private market participants can freely participate in Commission rulemaking proceedings and contested cases to advocate for decisions that impose costs or restrictions on competitors. Such advocacy will generally be entitled to *Noerr* antitrust immunity unless the activities are a sham or involve clearly unlawful means.

5. ERCOT

The Supreme Court's analysis in *Allied Tube* strongly suggests that advocacy by market participants and other private parties at ERCOT would also qualify for *Noerr* antitrust immunity. ERCOT—unlike the NFPA—is a quasi-legislative body. As discussed in connection with the State Action doctrine, ERCOT exercises powers expressly conferred by the Texas Legislature and delegated by the Commission. ERCOT Protocols, Market Guides, and Other Binding Documents are adopted through a legislative process. The process typically involves review with recommendations by various technical committees and subcommittees, culminating in a decision by the ERCOT Board. Only a minority of the Board's membership consists of industry representatives with private economic incentives. The process is thus designed to ensure independent decision making. Rules and standards adopted through this process have the force of state law; they are binding and enforceable pursuant to PURA and Commission rules.

These differences between ERCOT and the NFPA support the conclusion that *Noerr* immunity attaches to petitioning by private parties at ERCOT as it would at the Commission. Members of one or more industry segments should be free to collaborate among themselves and their committee representatives to lobby or advocate for adoption of Protocols (*e.g.*, technical requirements for generation interconnection) that would apply to and impose costs on or otherwise disadvantage members of a competing industry segment. That such advocacy may be aimed at securing a competitive advantage is irrelevant. As long as the activities are undertaken in good faith without abusing the process or employing unlawful means, they are unlikely to be subject to antitrust challenge.[121]

An important caveat: ERCOT provides no forum for the protection of anticompetitive collaboration that does not involve petitioning. As discussed above, ERCOT Board and

[119] *Calif. Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508, 510 (1972).

[120] *Id.* (parentheses omitted).

[121] As discussed above, Board Directors as the decision makers would likely have State Action antitrust immunity. The same reasoning applies to members of the ERCOT Technical Advisory Committee (TAC) for TAC actions that are not just recommendations to the Board but take effect upon TAC approval. *See generally* ERCOT Amended Bylaws § 5.2.

committee meetings and other gatherings present opportunities for off-topic conversations and agreements among industry members. Such agreements would be fully subject to antitrust review and potential liability to the extent that they restricted or impaired competition.

V. Sherman Act § 1: Standards and Violations

Section 1 of the Sherman Act broadly states that "[e]very contract, combination . . . , or conspiracy in restraint of trade or commerce . . . is declared to be illegal." As the Supreme Court has observed, the statute "cannot mean what it says" because

> restraint is the very essence of every contract; read literally, § 1 would outlaw the entire body of contract law. Yet it is that body of law that establishes the enforceability of commercial agreements and enables competitive markets – indeed, a competitive economy – to function effectively.[122]

Consequently, consistent with its legislative history, Section 1 has been construed to prohibit only "*unreasonable* restraints on competition."[123] As discussed below, some types of restraints are deemed unreasonable *per se*, while the majority require case-specific evaluation of competitive impact.

A. "contract, combination, or conspiracy"

By its terms Section 1 of the Sherman Act does not apply to actions by a single entity but to "contracts, combinations, or conspiracies" in restraint of trade.[124] "The question whether an arrangement is a contract, combination, or conspiracy is different from and antecedent to the question whether it unreasonably restrains trade."[125]

This antecedent requirement of "concerted action" does not indiscriminately embrace all coordinated actions between individuals or separate legal entities regardless of their relationship. Section 1 does not cover actions taken in combination by the president and vice president of a company, or coordination between a parent corporation and its wholly owned subsidiary.[126] Rather, the statute applies to concerted action between and among separate economic actors "such that the agreement deprives the marketplace of independent centers of decision making

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[122] *Nat'l Soc. Prof. Engin. v. U.S.*, 435 U.S. 679, 687-88 (1978).

[123] *Id.* at 691 (emphasis added). *See id.* at 688. *Accord Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 885 (2007).

[124] As noted above, Section 2 of the Sherman Act primarily addresses anticompetitive unilateral action by prohibiting monopolization and attempts to monopolize. Section 2 also prohibits persons from "combining or conspiring" with other persons to monopolize. This prohibition overlaps in part the general prohibition in Section 1 against anticompetitive combinations and conspiracies but also requires proof of the parties' specific intent to monopolize. *See American Tobacco Co. v. U.S.*, 328 U.S. 781, 788, 809 (1946).

[125] *American Needle, Inc. v. National Football League*, 560 U.S. 183, 186 (2010).

[126] *Id.* at 196.

and therefore of diversity of entrepreneurial interests."[127] This "functional analysis" led the Supreme Court to conclude that Section 1 applied to the National Football League teams as separate economic competitors when they collectively agreed to grant an exclusive license to a single manufacturer to sell trademarked headwear for all of the teams.[128]

Concerted action is not limited to formal, written agreements. A contract, combination, or conspiracy to restrict competition may be express or tacit.[129] Proof may be based on circumstantial evidence.[130]

Applying these principles to ERCOT, coordinated actions between or among ERCOT officers and employees in the performance of their job responsibilities should not be considered concerted action involving separate economic actors under Section 1. ERCOT's Chief Executive Officer and ERCOT Vice Presidents routinely confer and take concerted action but not as separate economic actors capable of conspiring under Section 1. The situation is somewhat less clear in the case of ERCOT Board Directors and committee members who are affiliated with market participants. In the North Carolina dental board case discussed above, the Fourth Circuit upheld the Federal Trade Commission's finding that the individual board members are separate economic actors capable of conspiring under Section 1.[131] The court agreed with the FTC because five of the seven board members are active dentists each of whom has a separate financial interest in the practice of teeth whitening. Under the court's reasoning, at least some of ERCOT's Directors—namely, those representing an industry segment—could be viewed as separate economic actors. As discussed above, however, the dental board's composition and other aspects of the North Carolina statutory scheme are distinguishable from ERCOT and PURA. Moreover, the Fourth Circuit's opinion will not be the last word, as the Supreme Court has granted certiorari.

It is clear in any event that Section 1 would apply to agreements not involving the discharge of, or petitioning related to, official ERCOT business. Board or committee membership is not a license for concerted action between and among market participants on non-ERCOT matters.[132]

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[127] *Id.* at 195.

[128] *See id.* at 197-201.

[129] *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537, 540 (1054); *Interstate Circuit, Inc. v. U.S.*, 306 U.S. 208, 226 (1939).

[130] *Interstate Circuit*, 306 U.S. at 221-26.

[131] *North Carolina State Bd. of Dental Exam'rs*, 717 F.3d 359 (4th Cir. 2013), *cert. granted* No. 13-534, 134 S.Ct. 1491 (Mar. 3, 2014).

[132] Section 1 would also apply to procurement agreements and other concerted activities between ERCOT as a non-profit corporation and other companies in the normal course of business. *See Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of U. Okla.*, 468 U.S. 85, 101, n.22 (1984) (observing that "[t]here is no doubt that" Section 1 applies to non-profit corporations).

B. "in restraint of trade"

Section 1 of the Sherman Act prohibits "unreasonable" restraints on competition. Reasonableness is not an open-ended inquiry but instead "focuses directly on the challenged restraint's competitive impact."[133] Arguments that a restraint serves laudable non-competitive purposes, such as promoting product safety or product quality, are not relevant.[134] Rather, the question is whether the restraint on balance restricts competition or instead has a neutral or even positive impact on competition.[135]

The courts employ one of three levels of analysis, depending on the activity in question, to assess the competitive impact and therefore the reasonableness of a challenged restraint. The general default analysis is the "Rule of Reason."[136] The Rule of Reason provides for full litigation of all factors relating to competitive impact, including information about the relevant market, whether the businesses involved have market power, and the restraint's history, nature, purpose, and effect.[137] The court (either a jury or judge as factfinder) "weighs all of the circumstances of a case" in deciding the restraint imposes an unreasonable restriction on competition.[138]

A second, less detailed method of evaluation is the so-called "quick-look" analysis. This approach is reserved for activities that appear on their face to have an unreasonable anticompetitive effect. Courts employ a quick-look analysis "where an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets."[139] The quick-look approach in effect shifts the burden to the defendants to show empirical evidence of procompetitive effects.[140]

Examples of restraints that have received a quick-look type of analysis include: a National Collegiate Athletic Association (NCAA) television plan that limited the number of televised games and fixed a minimum price for televising;[141] an association of professional engineers' ban on competitive bidding;[142] and an agreement among members of a dentist association not to forward their patients' x-rays to insurance companies with claims forms for use in benefits

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[133] *Nat'l Soc. Prof. Engin. v. U.S.*, 435 U.S. at 688.

[134] *Id.* at 694.

[135] *Id.* at 691.

[136] The Rule of Reason was adopted in *Standard Oil Co. of New Jersey v. U.S.*, 221 U.S. 1 (1911).

[137] *Leegin Creative Leather Products*, 551 U.S. at 885-86.

[138] *Id.* at 886.

[139] *F.T.C. v. Actavis, Inc.*, 133 S.Ct. at 2237 (quoting *Calif. Dental Ass'n*, 526 U.S. at 770).

[140] *Id.*

[141] *Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of U. Okla.*, 468 U.S. at 99-100, 117.

[142] *Nat'l Soc. of Prof. Engin.*, 435 U.S. at 692-99.

determinations.[143] In contrast to these examples, courts will reject the quick-look approach and apply a traditional Rule-of-Reason analysis when complexities about an industry and its practices raise uncertainties regarding a restraint's competitive effects.[144]

The third level of analysis is the *per se* rule of unlawfulness. The courts have determined that certain types of agreements "would always or almost always tend to restrict competition" and thus are "manifestly anticompetitive."[145] These agreements are deemed *per se* violations of Section 1 and require no proof of actual anticompetitive effect. Price-fixing agreements among competitors are *per se* illegal.[146] This is true irrespective of whether the arrangement raises, lowers, or stabilizes prices, or whether pricing formulae are used instead of specific fixed prices.[147] A second type of *per se* violation involves agreements among competitors not to compete with one another by dividing geographic service territories or allocating customers.[148] The *per se* rule also applies to certain "group boycotts" where a group of competitors agrees not to do business with third parties unless those third parties assist in harming others that are in competition with the group.[149]

ERCOT activities, if found not immune from antitrust challenge, would likely be evaluated under the Rule of Reason in the vast majority of cases. Electricity is a unique and highly complex market requiring coordination among many market participants, including generators, transmitters, distributors, wholesalers, retailers, and customers. Generated electricity must be consumed immediately because it cannot be stored in significant quantities. Supply and demand must be kept in balance systemwide at all times. Investment in generation must keep pace with demand over time. Transmission and distribution facilities must be planned, certificated, and constructed. Prices must account for congestion costs and provide market-based signals to investors. Different types of facilities and equipment must be technically compatible and interoperable.

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[143] *Indiana Fed. of Dentists*, 476 U.S. at 459. *See generally Calif. Dental Ass'n*, 526 U.S. at 769-71 (discussing *NCAA*, *Nat'l Soc. of Prof. Engin.*, and *Indiana Fed. of Dentists*).

[144] *E.g., F.T.C. v. Actavis*, 133 S.Ct. at 2239 (holding "quick-look" analysis inappropriate to evaluate whether a "reverse payment' settlement agreement in a patent infringement lawsuit violates Section 1).

[145] *Leegin Creative Leather Products*, 551 U.S. at 886 (quotations omitted).

[146] *Socony-Vacuum Oil Co. v. U.S.*, 310 U.S. 150, 222-23 (1940).

[147] *Id.* At one time "vertical" agreements between a manufacturer and retailer to fix minimum resale prices were considered *per se* illegal. *See Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). In 2007 the Supreme Court overruled *Dr. Miles* and held that such agreements henceforth must be reviewed under the Rule of Reason. *Leegin Creative Leather Prod., Inc. v. PSKS, Inc.*, 551 U.S. 887 (2007).

[148] *U.S. v. Topco Assoc, Inc.*, 405 U.S. 596, 608-10 (1972); *U.S. v. Sealy, Inc.*, 388 U.S. 350 (1967).

[149] *See Fashion Originators' Guild of America, Inc. v. F.T.C.*, 312 U.S. 457, 467-68 (1941); *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207, 213 (1959). Purely "vertical" agreements, such as between a supplier and a customer that deprives the supplier of a potential customer, are subject to Rule-of-Reason analysis. *See NYNEX Corp. v. Discon, Inc.* 525 U.S. 128, 135-37 (1998).

As these and other attributes make clear, the electricity market is one in which "some activities can only be carried out jointly" and in which "a myriad of rules . . . all must be agreed upon" that of necessity "restrain the manner in which [participants] compete."[150] As independent system operator, ERCOT "plays a vital role in enabling" the production, transmission, distribution, and sale of electricity, and for this reason ERCOT's development and implementation of standards that facilitate these functions "can be viewed as procompetitive."[151] Because they typically have procompetitive justification, these ERCOT activities customarily should be reviewed and often exonerated under the Rule of Reason. Only in rare circumstances, where a restraint operates on its face to raise prices and reduce output without apparent market justification, might a quick-look analysis be appropriate.[152] It is difficult to envision such a restraint given ERCOT's charge to "promote economic efficiency in the production and consumption of electricity [and] support wholesale and retail competition."[153]

This conclusion applies to activities by ERCOT and market participants in the discharge and implementation of ERCOT's responsibilities as independent system operator. It does not apply to anticompetitive agreements between private market participants themselves. An agreement among competing generators through their QSEs to fix offers to sell into the Day-Ahead or Real-Time Markets could well be found *per se* illegal under Section 1. An agreement among generators to limit production, if unrelated to compliance with any ERCOT rules, similarly could be found *per se* illegal.[154] An agreement among Retail Electric Providers to divide or allocate geographic areas or customers also would likely be found *per se* illegal.

VI. Conclusion

Activities at ERCOT should not raise an antitrust issue when undertaken in the normal course pursuant to and in accordance with PURA and Commission rules. A core function of ERCOT as independent system operator is to oversee and facilitate competition in the production and sale of electricity. Procompetitive actions comport with the antitrust laws. In addition, Protocols and other ERCOT requirements that establish reasonable ground rules for the operation of the competitive electric market should not present antitrust concerns even though they restrict unbridled competition. Market ground rules adopted and enforced by an independent system operator would likely be upheld under the Rule of Reason or found immune from antitrust scrutiny under the State Action doctrine as reasonably contemplated under PURA.

Similarly, restrictions necessary to ensure the reliability and adequacy of the electricity grid should raise no antitrust issue. Safeguarding the reliability and adequacy of the grid is also a core ERCOT function recognized in PURA. State Action immunity would therefore likely apply

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[150] *Nat'l Collegiate Athletic Ass'n*, 468 U.S. at 101 (quotations omitted) (describing NCAA and how it enables college football games).

[151] *See id.* (discussing role of NCAA).

[152] *See, e.g., Nat'l Collegiate Athletic Ass'n*, 468 U.S. at 105-20.

[153] P.U.C. SUBST. R. 25.501(a).

[154] Withholding of production by a single entity can be evidence of market power abuse under PURA and Commission rules. *See* PURA § 39.157; P.U.C. SUBST. R. 25.504(b), (d).

to such activities. The same is true of ERCOT transmission planning activities that may restrict competition but support the Commission's regulation of electric transmission and distribution services under PURA.

These principles apply to ERCOT Board members, ERCOT officers, ERCOT employees, and ERCOT committee members in the performance of statutorily authorized ERCOT functions. In addition, market participants and other persons acting in their private capacities, including those who serve on ERCOT committee, subcommittees, and working groups that make recommendations, likely have *Noerr* immunity to advocate for the adoption of competitively restrictive ERCOT rules that serve their own private interests.

As emphasized throughout, the conclusion that activities of ERCOT officials are unlikely to raise an antitrust issue presumes that the activities are undertaken pursuant to and in accordance with ERCOT's responsibilities under PURA and Commission rules. Representatives of market participants who serve as Board or committee members should take care to distinguish between actions that they take in their official capacity and actions that are not part of the ERCOT decision making or advocacy process. In addition, when acting in their official decision making capacity on matters that may restrict competition, Board Directors and TAC members should check to ensure that their votes and decision fall within the reasonable scope of PURA and applicable Commission rules. PURA implicitly contemplates that those who represent industry segments may and should take into consideration their segment's interests when voting or advocating for ERCOT action. At the same time, ERCOT decision makers have a statutory responsibility to strive for actions that ensure non-discriminatory access to the transmission and distribution system and that rely on competitive market means to achieve objectives when possible. Board and committee members also have responsibilities to safeguard confidential, competitively sensitive information submitted to ERCOT and to recuse themselves from participating in a matter when unavoidable conflicts of interest arise. With these considerations in mind, those who act diligently to discharge ERCOT's responsibilities in accordance with PURA and Commission rules should not have concerns about the antitrust laws.