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ARTICLE

CITY OF CLEVELAND V. CEI: A CASE STUDY IN ATTEMPTS TO MONOPOLIZE BY REGULATED UTILITIES

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IN CLEVELAND, OHIO, A LEGAL CONTROVERSY HAS DEVELOPED which compels the judiciary to evaluate the limits of competition.[1] Seventy years of head-to-head combat between a large investor-owned electric system and a smaller city-owned company has entered the federal courts as an issue to be resolved under section two of the Sherman Act.[2] The precise issue is whether a refusal by the larger utility to sell or wheel power to the smaller utility constitutes an illegal act of monopolization. To resolve this issue, the judiciary must superimpose upon a stormy political dispute[3] an abstract formulation of proper and

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[1] City of Cleveland v. Cleveland Electric Illuminating Co., No. C75-560 (N.D. Ohio, filed July 1, 1975) [hereinafter cited as Cleveland v. CEI].

[2] Monopolies and Combinations in Restraint of Trade (Sherman Anti-Trust Act), 15 U.S.C. §§ 1-7 (1974).

[3] The political war between MUNY Light and CEI began upon MUNY Light's creation by populist Mayor Thomas L. Johnson and continues today. While the controversy over the years has produced memorable moments, two recent events stand out as indicators of the magnitude and intensity of the MUNY Light issue. First, upon receiving a judgment against MUNY Light in Federal court, CEI began attaching City property in February of 1978 in an attempt to collect a past debt for electricity sold to Cleveland. How Will Cleveland's Light Bill Be Paid?, BUSINESS WEEK, Mar. 13, 1978, at 30. Second, the City chose to default on its notes rather than sell MUNY Light to CEI. *The Cleveland Story: How the Banks Foreclosed Dennis Kucinich*, THE NATION, Jan. 20, 1979, at 44; *Cleveland Woes*, SATURDAY REVIEW MAGAZINE, Feb. 12, 1979, at 11-12.

A congressional report on the issue as to whether there was foul play by the Cleveland banks which foreclosed on the City in December of 1978, concluded that "the deep animosities and political cross currents in which some bank officers become involved [rather than] pure hard-nosed credit judgments" influenced their decisions as to Cleveland's default. The Washington Post, July 17, 1979, at A-1, col. 1. While the report found that political influence was a factor in the default decision by the banks, it did not conclude that the banks acted from a desire to assist CEI's acquisition and/or destruction of MUNY Light. While the six banks and CEI had eight common directors, the committee did not conclude improper business conduct. That this type of dispute should be resolved by such a process is a matter of some curiosity, but that is not the subject of this Article. This Article is simply a dramatization in three parts: the plaintiff's factual case, the defendant's affirmative defense as to the legal merits of the plaintiff's case, and a suggested analysis and resolution.[4]

I. PLAINTIFF'S CASE

This is a case about a necessity of life, electricity, and how that necessity should be distributed.[5]

A. *The Parties*

The Cleveland Electric Illuminating Company (hereinafter referred to as CEI) is an investor-owned utility in northeast Ohio serving the entire City of Cleveland and surrounding areas. CEI produces and distributes over 18,159,754,000 kilowatt-hours (kwh) of electricity annually to over 700,000 residential and commercial customers and over 7,000 industrial facilities.[6] Within its service area, CEI provides over 94% of all generation capacity and over 96% of all transmission facilities, wholesale sales,

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that the decision as to default was unrelated to proper economic considerations by the bankers. Although MUNY Light's sale to CEI was made a condition for default, MUNY Light's poor financial condition could be a sound business factor for the bankers to use in their decision as to reviewing the city's indebtedness. *See Staff of the House Subcommittee on Financial Institutions, Supervision, Regulation and Insurance, The Role of Commercial Banks in the Finances of the City of Cleveland,* 96th Cong., 1st Sess. (Comm. Print, 1979).

The City had a special election on February 27, 1979 to decide whether MUNY Light should be sold to CEI. The Plain Dealer, Feb. 12, 1979, at A-1, col. 1. The City of Cleveland voted to keep the municipal plant by a wide margin. Clev. Plain Dealer, Feb. 28, 1979, at A-1, col. 5.

[4] In summarizing and restating both plaintiffs and defendant's arguments, numerous decisions had to be made in matters of interpretation and phrasing. Each party's trial briefs exceeded 200 pages, thus requiring deletion of large quantities of material. Furthermore, a constant dilemma was posed by the desire to restate precisely the arguments made by counsel and the need to draw sharply into focus the legal issue at stake in this controversy. Averments of fact are based on evidence presented at the first trial by the parties as well as supplementary research by the authors. Within the limits of space and understanding, every effort has been made to present the position of each party as forcefully and convincingly as possible.

[5] William B. Norris' opening statement in his closing argument to the jury for MUNY Light, Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), Proceedings of Oct., 1980.

[6] CLEVELAND ELECTRIC ILLUMINATING COMPANY, FACTS ABOUT THE ILLUMINATING COMPANY (1981). *See also* I. MOODY, MOODY'S PUBLIC UTILITY MANUAL 333 (1980).

and retail sales.[7] The Cleveland Municipal Electric System (hereinafter referred to as MUNY Light), wholly owned and operated by the City of Cleveland, transmits electricity to retail customers.[8] It sells power entirely within CEI's service area. While MUNY Light did at one time generate its own power, its generating capacity is now negligible.[9]

Throughout much of Cleveland, MUNY Light and CEI compete street-by-street and house-by-house for the same customers.[10] In only nine communities in the United States is there direct competition in the retail distribution of electricity; Cleveland is the only major city where this situation exists.[11]

In 1967, CEI became a member of the Central Area Power Coordination Organization (hereinafter referred to as CAPCO), a pooling group of five privately owned utility companies in Ohio and Pennsylvania.[12] By the terms of the agreement, the utilities work together to coordinate electric service; by means of interconnection, CAPCO members can take advantage of scale economies thereby reducing needless duplication of facilities. CAPCO members do not compete with each other, and each is the dominant electric utility within its service area.[13]

B. *A Chronology of the Predamage Period*

1. 1906-1960

CEI, in existence since 1892, operated without competition until 1906 when the City of Cleveland annexed the community of South Brooklyn's electric generating and distribution system.[14] In 1910, Cleveland expanded its generating capacity when it acquired the Village of Collinwood facility again through annexation.[15] In 1914, Cleveland began operating its

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[7] For a full discussion of CEI's position in the relevant market, see The Toledo Edison Company (Davis-Besse Nuclear Power Station Units 1, 2, and 3), The Cleveland Electric Illuminating Company *et al.* (Perry Nuclear Power Plant Units 1 and 2) [hereinafter cited as CEI *et al.*], 5 NRC 133, 153 (1977).

[8] *Id.* at 166.

[9] The Plain Dealer, Feb. 12, 1979, at A-1, col. 3.

[10] CEI *et al.*, 5 NRC at 166.

[11] Brief for Defendant, filed Sept. 2, 1980, at 1, City of Cleveland v. Cleveland Electric Illuminating Company, No. C75-560 (N.D. Ohio, filed July 1, 1975) [hereinafter cited as Brief for Defendant].

[12] CAPCO was formed in September of 1967, pursuant to an agreement by which The Toledo Edison Co., the Cleveland Electric Illuminating Co., The Duquesne Light Co., The Ohio Edison Co. and the Pennyslvania Power Co. agreed to coordinate the generation and transmission of electricity to further their reliability and enhance the benefits from economies of scale. CEI *et al.*, 5 NRC at 151-53.

[13] CEI *et al.*, 5 NRC at 153-54.

[14] Brief for Defendant, *supra* note 11, at 52-54.

[15] *Id.*

own generating facility which was interconnected with the two previously acquired plants, thereby creating the Cleveland Municipal Light System.[16] For the next twenty years, MUNY Light grew quickly and made dramatic inroads into what had previously been CEI's exclusive service area.[17] By 1937, MUNY Light served a twenty-eight square mile area in direct competition with CEI.[18] From 1937 to 1958, MUNY Light went through its "yardstick era."[19] Instead of attempting to expand its market, MUNY Light sought only to meet the new demand of existing customers.[20] The purported reason for this policy was that MUNY Light should function primarily as a check on CEI's retail electric rates.[21]

In 1958, MUNY Light re-asserted competition for the retail electric market. New plants and equipment were put in operation while MUNY Light embarked on a bold merchandising effort to gain new customers.[22] This change in posture did not go unnoticed. By 1959, Elmer Lindseth, president of CEI, was on record as intending to eliminate MUNY Light as a competitor.[23] At this point, MUNY Light's problems in generating sufficient power to meet demand came to the fore, and accordingly came MUNY Light's need to interconnect with CEI or other utilities.[24]

2. 1960-1970

That CEI has had, since 1960, a corporate objective to eliminate MUNY Light from the marketplace is a key element in MUNY Light's suit. This corporate objective was to be accomplished by preventing MUNY Light from expanding facilities, improving reliability, or having the financial wherewithal to compete.

MUNY Light is completely surrounded by CEI's service area and hence must have access to the benefits of parallel interconnection with

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[16] *Id.*

[17] *Id.*, citing E. KENEALY, THE CLEVELAND MUNICIPAL LIGHT PLANT 8-12 (1935).

[18] *Id.* at 56.

[19] *See* note 157 *infra* and accompanying text.

[20] *Id.* at 57-60.

[21] *Id.*

[22] *Id.* at 58-59.

[23] The Plain Dealer, Sept. 24, 1980, at B-1, col. 1. A CEI memo written by Elmer L. Lindseth, former CEI board chairman and president in 1959, stated:

> [C]aution would have to be exercised in any efforts we might make to hasten the financial and service decline of the Municipal Operation, and this was so in order not to alert Municipal Management and their many friends of the extent of the financial difficulty MUNY was getting into.

Id.

[24] CEI *et al.*, 5 NRC at 167-69.

other utilities in order to meet the peak demands of its customers.[25] As a general matter, interconnection is critical to the reliability of modern electric power systems. During emergencies, equipment maintenance periods and peak-load times, interconnected utilities can exchange electric power as required to maintain service reliability. Furthermore, interconnection protects customers against the effects of an unscheduled outage as loads will be picked up by other power sources.[26] Because of its uniquely insular position, MUNY Light began in the late 1950's to consider three courses of conduct: 1) interconnect with CEI; 2) interconnect with utilities other than CEI; or 3) expand generation and transmission capabilities.

At the same time, CEI recognized that private utilities across the country had failed to acquire municipal electric companies in those instances where the rates of the municipal systems were lower than the rates charged by the private company.[27] MUNY Light's rates in the early 1960's were lower than CEI's.[28] MUNY Light, pursuant to a contract with the City of Cleveland, provided street light service at disproportionately high rates. The excess revenues from this street light service were used to cross-subsidize lower rates to other customers who, unlike the City of Cleveland, could switch to CEI.[29] CEI concluded that as long as this pattern of cross-subsidization continued, elimination or acquisi-

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[25] *Id.* at 173. MUNY Light was not interconnected to another electric utility. *See* The Plain Dealer, Sept. 24, 1980, at B-1, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 23, 1980. CEI has for a number of years been interconnected with other electric untilites including the Ohio Edison Co., with which CEI is in direct competition for customers along their mutual service territories which is CEI's southern boundary.

[26] Fairman and Scott, *Transmission, Power Pools, and Competition in the Electric Utility Industry*, 28 HASTINGS L. REV. 1159, 1168-70 (1977).

[27] CEI *et al.*, 5 NRC at 166. A CEI memo from the early 1960's showed that CEI had performed a study on the ability of private power companies to acquire municipal systems. The study showed that when the rates of the municipal system were less than the rates of a private utility, the continued existence of the municipal system was almost certain. In such event, the memo went on: "[I]t would be necessary to use extreme measures to acquire the plant." The Plain Dealer, Sept. 24, 1980, at B-1, col. 1, 2; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 23 1980.

[28] *See* KENEALY, *supra* note 17, at 8-12.

[29] Cross-subsidization is the process by which a firm uses financial resources gained in one market to enhance its competitive position in a second market. Antitrust issues may be raised if cross-subsidization is used to implement a predatory pricing scheme, whereby a firm lowers its prices in one market to a level below their marginal cost using profits from another market to balance against those competitive losses. *See* California Computer Products, Inc. v. Int'l Bus. Machines, 613 F.2d 727, 739 (9th Cir. 1979); III AREEDA & TURNER, ANTITRUST LAW 150-54 (1978)[hereinafter cited as AREEDA & TURNER].

tion of MUNY Light would be extremely difficult. Therefore, CEI tried to exploit MUNY Light's need for an interconnection by opposing MUNY Light's rate policy and its plans for plant expansion. This strategy was first used in 1962 when CEI offered to interconnect with MUNY Light on the two-fold condition that MUNY Light reduce its rates charged to the city for street light service and correspondingly raise its rates for all other service equal to CEI's rates.[30] This proposal was considered to be an unwarranted interference with the authority of the elected officials of Cleveland and was rejected.[31]

MUNY Light began in 1968 to explore the possibility of interconnection with the municipal plants of neighboring Painesville and Orrville.[32] MUNY Light also proposed to add to its own generation and transmission facilities.[33] CEI publicly opposed any such interconnection and expansion, and both proposals were subsequently abandoned.[34] In late 1965

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[30] CEI *et al.*, 5 NRC at 167. The NRC found that CEI offered to interconnect with MUNY Light only if MUNY Light would increase its rates to its retail customers and decrease its charges to the city for street light service. The NRC found CEI's attempt to fix MUNY's rates to be a price fixing scheme and thereby per se illegal under § 1 of the Sherman Act.

While testifying before the Nuclear Regulatory Commission, Mr. Lindseth stated that CEI requested a change in MUNY Light's rates only because "CEI [wanted] . . . to utilize the tax exemption of the Municipal Light plant for the benefit of all the taxpayers of Cleveland instead of those who were customers of the Municipal Light Plant." At trial, Mr. Lindseth testified that CEI feared a permanent interconnection would give MUNY Light the system dependability it needed. Dependability, in conjunction with MUNY Light's lower rates, would give MUNY Light a competitive advantage that CEI could not tolerate. The Plain Dealer, Sept. 24, 1980, at B-1, col. 3; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 23, 1980.

[31] CEI *et al.*, 5 NRC at 168. "Though Cleveland had 'long desired an interconnection between [MELP] and CEI,' it could not accept CEI's interconnection offers 'with this coercive limitation' [rate equalization] but remained interested 'in an interconnection of the two systems in the interest of public welfare and the mutual benefit of the two systems' and was 'willing to consider an interconnection on a business basis without unfair strings attached.'" *Id.*, *citing* Feb. 17, 1965, letter of then Cleveland Mayor Locher to CEI President Besse.

[32] CEI *et al.*, 5 NRC at 168.

[33] *Id.* In 1962, the city had publicly proposed to add to MUNY Light's generation facilities. The proposal, which would have added a 75 megawatt (mw) boiler and and 985 mw steam turbine generating unit, was never implemented. In 1968, the city again publicly proposed addition to MUNY Light's plant and equipment, and those proposals also were carried out.

[34] *Id.* CEI publicly renewed its offer of a conditional interconnection each time the city proposed to add to MUNY Light's transmission and/or generating capacity. The NRC found that this caused the proposed projects to fail. Further, the NRC found such activity constituted destructive competition, given that CEI acted from a desire to hinder MUNY Light's ability to serve its customers with reliable power. *See* Brief for Plaintiff, filed Sept. 2, 1980, at 29, Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975) [hereinafter cited as Brief for Plaintiff].

The City offered into evidence CEI communications to show CEI's attempt to and into 1966, CEI adopted an aggressive promotional allowance and free-wiring program intended to entice MUNY Light customers to switch to CEI.[35] This program was accompanied by a more entrenched position regarding interconnection. By early 1968, CEI was no longer willing to interconnect with MUNY Light under any conditions.[36]

In the summer of 1969, MUNY Light requested that CEI provide it with 30,000 kilowatts (kw) of standby power in order to enable MUNY Light to install air pollution control devices in its plant.[37] CEI refused this request but offered to provide a temporary nonsynchronous[38] 11 kv

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modify and defeat a bond levy for MUNY Light. The CEI memo suggested that CEI assisted in its defeat. Further evidence showed that Donald H. Hauser, CEI general counsel, prepared an amendment to the MUNY Light legislation which blocked the sale of the bond issues. A Cleveland City Councilman subsequently proposed amendments to the MUNY Light levy similar to those prepared by CEI. The Plain Dealer, Oct. 3, 1980, at A-17, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Oct. 2, 1980.

[35] At trial, Theodore L. Tsevdos, President of the Pentagon Plating Industries, testified that CEI offered his company $18,000 to $21,000 worth of free wiring as an incentive to switch from MUNY Light to CEI service. Further, CEI paid twenty-seven other contractors $707,656 to convert 1,883 commercial customers to CEI service. The Plain Dealer, Oct. 8, 1980, at A-23, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Oct. 7, 1980.

The City's expert, Mr. Weiss, testified that CEI's free wiring program constituted "cut-throat" competition and was predatory in nature. Mr. Weiss also testified that free wiring was prohibited under CEI's operating license as issued by the Public Utilities Commission of Ohio. The Plain Dealer, Oct. 8, 1980, at A-23, col. 1 (proceedings of Oct. 7, 1980). The NRC found CEI's free wiring program constituted cut-throat competition. CEI *et al.*, 5 NRC at 166.

[36] Brief for Plaintiff, *supra* note 34, at 31. Clement T. Lashing, CEI treasurer, testified CEI knew a decade ago MUNY Light needed an interconnection and that CEI intentionally avoided it. A 1964 CEI memo (Bingham Memo) stated: "A strong permanent interconnection would give (MUNY Light) the . . . reliability it sorely needs." Mr. Lashing testified that he agreed with Mr. Bingham's statement and advised that CEI should not be interconnected with MUNY Light. The Plain Dealer, Sept. 25, 1980, at A-23, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975) proceedings of Sept. 24, 1980. *See* CEI *et al.*, 5 NRC at 168-69.

[37] CEI *et al.*, 5 NRC at 169.

[38] Electricity in the form of AC current has uneven waves which when looked at from a side view have a series of alternating high points and low points. When two generators are producing AC current, the alternating high and low points from one generator will not necessarily correspond to the alternating high and low points of the other. When two generators are producing electricity which does not have matching AC currents, the two generators are nonsynchronous. A nonsynchronous interconnection or load transfer system, is an interconnection between two utilities where the power which is being sent over the interconnection has AC waves which do not match the AC waves of the electricity being produced by the firm which is accepting the current.

A firm which is being supplied electricity over a nonsynchronous interconnecload transfer system without parallel operation.[39] CEI made no effort to implement the 11 kv system until after MUNY Light suffered a major power outage during Christmas Week of 1969, leaving customers without service for an extended period of time.[40] Although the 11 kv system was eventually placed into operation, it provided MUNY Light with little help for its long-range production problems. CEI placed heavy procedural burdens upon its use. When power was needed, MUNY officials had to telephone CEI plant personnel who, in turn, had to contact higher officials for their approval to furnish power. This procedure often caused hours of delay.[41]

As a consequence of MUNY Light's inability to obtain a dependable and immediate source of back-up power, MUNY Light suffered numerous shortages and curtailments and consequently developed a poor service reputation.[42] MUNY Light's financial position simultaneously deteriorated. CEI did not hesitate to use these developments to encourage MUNY Light customers to switch service.[43]

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tion cannot use the power which it generates to supply the same grid or distribution system; parallel operation is thereby precluded. O. ELGERD, BASIC ELECTRIC POWER ENGINEERING 245-94 (1977); *see also* A. GUILE & W. PATERSON, ELECTRICAL POWER SYSTEMS 60 (2d ed. 1978); P. SPORN, TECHNOLOGY, ENGINEERING AND ECONOMICS 123 (1964).

[39] CEI *et al.*, 5 NRC at 170-71.

[40] *Id.* at 170.

[41] *Id.* at 169-70. The NRC found CEI's procedural delays to be far below industry standards and that they were used by CEI to knowingly strip MUNY Light of any benefits the 11 kv load transfer system might have provided. Further, the NRC found that CEI's offer for interconnection and final connection of the 11 kv load transfer system came from fear that the Public Utility Commission of Ohio would force an interconnection upon less favorable terms.

At trial, the City offered evidence that CEI employees were dispatched to watch the smoke stacks at MUNY Light to insure that MUNY Light was using all its generating capacity before allowing power to pass to MUNY Light over the 11 kv system. The Plain Dealer, Sept. 30, 1980, at A-17, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 29, 1980.

[42] CEI *et al.*, 5 NRC at 173.

At trial, Sesler Titus, a MUNY Light employee, testified that CEI's outdated 11 kv transfer system caused frequent power curtailments and failures at MUNY Light which resulted in bad publicity for MUNY Light. He added that a permanent interconnection would have avoided these problems. The Plain Dealer, Sept. 30, 1980, at A-17, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 29, 1980.

[43] CEI *et al.*, 5 NRC at 166-67.

Warren D. Hinchee, MUNY Light Commissioner during early 1970's, testified that CEI used MUNY Light's bad reputation for dependability to capture MUNY Light customers. The Plain Dealer, Sept. 18, 1980, at A-1, col. 5; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 17, 1980.

Theodore L. Tsendos, President of Pentagon Plating Industries of Cleveland, testified that CEI salesmen used MUNY Light's bad reputation for reliability and

C. *The Damage Period (1970-date)*

By 1970, the option of expanding generation and transmission facilities was no longer available to MUNY Light. Indeed, the serious question facing MUNY Light was how to maintain existing equipment in the face of worsening financial conditions.[44] Only two options remained available: purchase power from CEI, or purchase power from a more distant utility. Since MUNY Light is completely surrounded by CEI's operating territory, either option required CEI's cooperation.

1. Interconnection with CEI

In January, 1970, CEI and MUNY Light agreed to participate in a three-phase interconnection plan. Phases one and two related to load transfer service with phase three contemplating the parallel interconnection long sought after by MUNY Light. Almost two years later, after CEI had refused to pursue implementation of the interconnection plan,[45] MUNY Light sued CEI in a Federal Power Commission (hereinafter referred to as FPC) proceeding seeking an emergency parallel interconnection.[46] CEI responded by filing a notice of termination of the 11 kv load transfer system,[47] but the FPC forced CEI to continue the system

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poor financial situation along with newspaper clippings of MUNY outages to convince him to switch to CEI power. The Plain Dealer, Oct. 8, 1980, at A-23, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Oct. 7, 1980.

[44] CEI *et al.*, 5 NRC at 173.

Irving Daniels, MUNY Light Plant Superintendent, testified that a permanent interconnection with CEI would have been a "godsend." He also testified that a permanent interconnection would have prevented financial ruin for MUNY Light. The Plain Dealer, Sept. 30, 1980, at A-17, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 29, 1980.

[45] CEI *et al.*, 5 NRC at 170.

The NRC found that on September 1, 1970, MUNY Light officials proposed a meeting with CEI officials and engineers to discuss the details of establishing a permanent interconnection between CEI and MUNY Light. No meeting occurred. In early 1971, Mr. Hinchee, MUNY Light Commissioner, again requested a meeting and although consenting to a meeting, CEI was totally unprepared to effectively discuss plans for permanent interconnection. At trial, Mr. Hinchee testified that CEI had intentionally avoided meetings in an effort to delay interconnection. The Plain Dealer, Sept. 18, 1980, at A-1, col. 5; Cleveland v. CEI, No. C75-560 (N.D. Ohio, July 1, 1975), proceedings of Sept. 17, 1980.

The City alleged at trial that "evidence will show that notwithstanding agreements by CEI that it would work with the city to develop a permanent parallel interconnection, CEI employed delaying tactics to stall such construction even though the city had done everything it was to do pursuant to its agreement with CEI." Brief for Plaintiff, *supra* note 34, at 34.

[46] City of Cleveland v. Cleveland Electric Illuminating Co., Docket No. E-7631 (F.P.C., May 13, 1971).

[47] City of Cleveland v. Cleveland Electric Illuminating Co., Docket No. E-7633 (F.P.C., May 21, 1971).

in operation in order to prevent power outages and allow MUNY Light to install air pollution control devices.[48] The FPC's order provided for the temporary interconnection approved by CEI only until such time as MUNY Light was able to repair or replace its generating facilities.[49] Furthermore, the order called for the exact limitations regarding parallel operation which had been sought by CEI.[50]

A 69 kv transfer unit was subsequently constructed, but CEI blocked its use unless all the transfer points of the existing 11 kv system were in operation.[51] MUNY Light was therefore forced to combat the procedural delays of the 11 kv system. Only upon executive clearance requiring twelve hour notice could MUNY Light obtain power from the 69 kv system.[52] In December of 1972, MUNY Light experienced a blackout lasting several hours. CEI attempted to manipulate this situation by

[48] City of Cleveland, Ohio v. Cleveland Electric Illuminating Co., 47 FPC 747 (1972), *rev'd on other grounds sub nom.*, City of Cleveland, Ohio v. FPC, 525 F.2d 845 (D.C. Cir. 1976).

[49] City of Cleveland, Ohio v. Cleveland Electric Illuminating Co., 47 FPC 747, 750 (1972). The Commission ordered, in relevant part, a 69 kv, nonsynchronous interconnection which could at CEI's discretion, in light of its customers' best interests, provide up to 40 mv of emergency power. Before power would be supplied, the City had to first give CEI three hours notice and operate all of its own generating capacity within three hours of obtaining CEI power; second, all facilities were to be constructed by the City; third, the 30 mw load already being served to the City by CEI continued; fourth, the City had to take immediate steps to end the emergency; and finally, the City was forced to keep 15% generating capacity as reserve and required to operate at least two generators.

[50] Commissioner Carver in his dissent believed that the majority's order of March, 1972 "[did] not achieve anything resembling appropriate relief from an electric reliability standpoint." 47 FPC at 751 (Carver, J., dissenting).

The limitations on interconnection which were sought by CEI were the product of a 1969 study by a Mr. Bingham. The findings of the study were offered in evidence by the City in an attempt to show that CEI intentionally precluded MUNY Light from the complete benefits of interconnection. The Plain Dealer, Sept. 25, 1980 at A-23, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 24, 1980. The City offered further evidence of a 1972 CEI memo which stated that "a higher cost burden could be maximized if a two step deal could be clinched." The Plain Dealer, Sept. 30, 1980, at A-17, Col. 1,4; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 29, 1980. The NRC found that the Bingham study called for a two step deal which would minimize the benefits of interconnection for MUNY Light: a temporary 69 kv overhead tie limited to 40 mv, and at some later date, a 138 kv permanent interconnection. CEI *et al.*, 5 NRC at 170.

[51] CEI *et al.*, NRC at 171-72. CEI wanted to be sure that MUNY Light could only draw power from the 69 kv system when the 11 kv system was in full operation. This procedure would insure that MUNY Light would not take excess power from CEI which would enable it to relax its own generating equipment. The 69 kv system therefore offered little help to MUNY's long range problems. *See* City of Cleveland, Ohio v. Cleveland Electric Illuminating Co., 47 FPC 747, 751 (1972) (Carver, J., dissenting).

[52] CEI *et al.*, 5 NRC at 172-73. The NRC found no justifiable reason for such a required delay. *Id.*

refusing to sell power to MUNY Light unless the City of Cleveland would agree to a contract with CEI for the purchase of power for street light service.[53] In response, the FPC in January, 1973, issued a further order requiring the installation of a permanent 138 kv parallel interconnection.[54] However, the interconnection did not become operational until May of 1975, over five years after CEI had originally agreed to provide it.[55]

MUNY Light claims that it suffered serious damage as a result of CEI's refusal to sell power because it was unable to maintain and expand its generating facilities. By 1977, MUNY Light was compelled to cease most of its power generation.

2. Interconnection with Other Utilities

a. *PASNY Power*

The Power Authority of the State of New York (hereinafter referred to as PASNY) generates hydroelectric power from Niagara Falls. Since this water is public property, Congress has determined that 50% of the power generated should be sold to public bodies and non-profit cooperatives, some of which is specifically earmarked for companies outside of New York.[56] In 1971, a group of some forty municipal electric utilities in Ohio formed American Municipal Power-Ohio, Inc. (hereinafter referred to as AMP-O). AMP-O applied for PASNY power in January of 1973, and upon approval allocated twenty-three megawatts (mw) of power to MUNY Light.[57] PASNY agreed to wheel the power to the Pennsylvania border, where the Pennsylvania Electric Company

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[53] *Id.* at 173.

[54] City of Cleveland, Ohio v. Cleveland Electric Illuminating Co., 49 FPC 118, 135-36, 98 P.U.R. 3d 309, 310 (1973).

[55] CEI *et al.*, 5 NRC at 173. The city alleged that CEI attempted in 1972 to delay and/or abate interconnection. On May 9, 1972, CEI secretly paid a third party to file a taxpayer's suit which was aimed at stopping construction of the 69 kv permanent interconnection which had been order by the FPC. Brief for Plaintiff, *supra* note 34, at 35.

At trial, CEI stipulated that it directed an unidentified law firm to contact a Mr. Miller on February 24, 1972. Mr. Miller subsequently attended a meeting with Mr. Hawley, CEI's general counsel, and planned the taxpayer suit. It was further stipulated that Mr. Miller, Mr. Hauser (CEI's corporate counsel), and Mr. Hawley met five times between February 24, 1978 and May 9, 1972, to plan the suit. Other evidence presented by the city showed that while CEI planned the "Miller suit," it represented to the city the desirability of an interconnection. Mr. Miller filed suit on May 9, 1972. The Plain Dealer, Sept. 18, 1980, at A-1, col. 5; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 17, 1980.

[56] Niagara Power Project, 16 U.S.C. § 836 (1974). Congress conveyed to the Power Authority of the State of New York the authority to operate, within the guidelines set forth in 16 U.S.C. § 836, the production and distribution of Niagara Falls Electricity. *Id.*

[57] CEI *et al.*, 5 NRC at 174.

was willing to wheel the power across Pennsylvania to the transmission facilities of CEI.[58]

CEI refused to wheel this power to MUNY Light despite the fact that CEI engaged in the transmission of power daily in cooperation with other privately owned utilities, and despite the fact that CEI's transmission facilities had the necessary and available capacity. CEI explained that since it competed with MUNY Light on a customer-to-customer basis, the transmission of PASNY power would be injurious to CEI's position.[59]

b. *CAPCO Power*

In March of 1971, MUNY Light requested access to the nuclear power generated from Davis-Besse, Perry and Beaver Valley nuclear power plants. This request was refused.[60] Two years later, MUNY Light again requested access to this power and was again refused.[61] CEI claimed that CAPCO controlled the allocation of such power and that all CAPCO members would have to agree to provide service to MUNY Light since CEI could not do so unilaterally.[62] CEI, negotiating on behalf of CAPCO, offered to grant access to nuclear power if MUNY Light complied with three conditions: 1) CEI was to have a right of first refusal on nuclear power which was in excess of MUNY Light's immediate needs; 2) MUNY Light could not sell the power to any customers at a price that was below cost; and 3) MUNY Light must withdraw all formal and informal requests for antitrust review of CEI policies and practices.[63] These conditions were rejected by the City of Cleveland. Shortly thereafter, the Board of the Atomic Energy Commission (hereinafter referred to as AEC) granted petitions of the City of Cleveland to intervene in the licensing proceedings for the Davis-Besse 1 and Perry nuclear power plants.[64] The 1977 decision in that case held:

> These present conditions to nuclear access are an outrageous affront to the policies underlying the antitrust laws. On the basis of these attempts to stifle competition in the use of power from the plants involved in these proceedings we would be delin-

[58] *Id.* at 174-75.

[59] Karl H. Rudolph, CEI President from 1970 through 1977, testified that MUNY Light would have been better off if it had access to PASNY power. He denied that CEI's refusal to wheel power was a method which CEI intended to use to cause MUNY Light's demise. Mr. Rudolph stated that CEI was not trying to take over MUNY Light but rather wanted to eliminate MUNY Light competition. The Plain Dealer, Sept. 16, 1980, at A-5, col. 3; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Sept. 15, 1980.

[60] CEI *et al.*, 5 NRC at 175, 232-33.

[61] *Id.* at 232-33.

[62] *Id.* at 233.

[63] *Id.* at 175-76.

[64] *Id.* at 138-39.

quent in our responsibility were we not to impose license conditions. There is no doubt that activities under the license would be directed to the maintenance and creation of situations wholly antagonistic to the policies of the antitrust laws.[65]

D. *The Complaint*

The City alleged that CEI violated section two of the Sherman Act by monopolizing and attempting to monopolize the retail sale of electricity within CEI's service area and the City of Cleveland,[66] reciting specifically:

(1) That CEI is the dominant electric utility possessing monopoly power in the market it serves;
(2) That CEI had and has as its corporate objective the elimination of all competition by small municipal electric systems located in its service area;
(3) That CEI abused its dominant business position by carrying out its plans of eliminating all municipal competition in its service area, and by committing a number of destructive acts that have injured the ability of MUNY Light to compete with CEI; and
(4) That these destructive acts of CEI have caused injury to the business and property of MUNY Light and the City of Cleveland.[67]

The above policies and practices by CEI can be separated into two categories: exclusionary refusals to deal and predatory practices.

1. Exclusionary Refusals to Deal

The City claims that CEI's refusal to interconnect its transmission system with that of MUNY Light, CEI's refusal to wheel power from PASNY and CEI's refusal to allow MUNY Light access to the power exchange market constitute antitrust violations under section two of the Sherman Act, based on the case of *Otter Tail Power Co. v. United States*.[68] Otter Tail Power Company, a large, vertically integrated electric utility in the Northwest, sold both wholesale power to municipal electric systems and retail power to consumers within its service area. The dispute arose when Otter Tail refused to sell power to certain municipalities which had set up their own distribution systems. Further, Otter Tail refused to wheel power made available to the municipalities by other power producers over its transmission facilities.[69] The United

[65] *Id.* at 176.
[66] Brief for Plaintiff, *supra* note 34, at 56.
[67] *Id.*
[68] 410 U.S. 366 (1973).
[69] *Id.* at 368-71.

States Supreme Court found Otter Tail's refusal to deal with the municipalities constituted illegal monopolization in violation of section two.[70] The fact that Otter Tail was a regulated monopolist did not insulate Otter Tail's illegal conduct from the operation of the antitrust laws.[71]

2. Predatory Practices

Predatory practices refers to unfair conduct designed to induce customers to cease dealing with the perpetrator's competitors.[72] The City cited as unfair business practices CEI's willingness to provide wiring and other electrical equipment and services to customers for little or no charge upon the condition that customers switch to CEI service, and CEI's disparaging statements regarding MUNY Light's ability to provide reliable electric service.[73] Specifically, the City alleged that it was illegal for CEI to cross-subsidize its free wiring program with monopoly profits from another market. Such an arrangement in combination with a strategy to malign MUNY Light demonstrated CEI's intent to eliminate MUNY Light as a competitor and was an unfair trade practice in violation of the law.[74]

In conclusion, the City alleged that: "CEI's activities effectively reduced the net income of MUNY Light from year to year through increasing its costs of operation and decreasing its revenues, and that the effect of such injury will continue in the future."[75] At trial, the City offered expert testimony that, by early 1970, MUNY Light was in serious financial trouble. MUNY Light claims to have suffered loss of revenue, power failures and resulting damage to equipment, loss of customers, increased cost of maintenance and operation, low employee morale, higher costs to customers which decreased MUNY Light's ability to compete, an inability to gain new customers due to its lack of ability to supply reliable power and a lowering of its bond rating.[76] The City alleged damages of $150 million in its action against CEI.[77]

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[70] *Id.* at 377-79.

[71] *Id.* at 376-77.

[72] Brief for Plaintiff, *supra* note 34, at 67-70.

[73] *Id.*

[74] Brief for Plaintiff, *supra* note 34, at 68-69. *See* City of Mishawaka, Ind. v. American Electric Power Company, 465 F. Supp. 1320, 1329 (N.D. Ind. 1979) (court found that it was illegal for an electric utility to publicize the fact that during a power shortage, it would prefer its retail customers over the municipalities or wholesale customers).

[75] Brief for Plaintiff, *supra* note 34, at 99.

[76] The Plain Dealer, Oct. 15, 1980, at A-17, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Oct. 14, 1980.

[77] City of Cleveland's Amended Complaint filed Sept. 6, 1980, Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975). The City reduced its damage claim from $380 million to $150 million.

II. THE DEFENSE

Defendant CEI presented evidence to dispute MUNY Light's factual allegations, and additionally argued that its conduct was not, as a matter of law, a violation of the Sherman Act.[78] The critical underpinning of this argument is the "fact" that the market for distribution of electric power in Cleveland is a natural monopoly.[79] Hence, competition is inappropriate, and so the Sherman Act should not apply. CEI further argued that MUNY Light must take responsibility for its own failure in the market place, and MUNY's damages are directly the result of managerial incompetence.[80]

A. *The Electrical Power Industry in Cleveland is a Natural Monopoly*

Electricity generation and transmission require extremely high levels of capital investment.[81] Large and sophisticated plants must be built, as must a circulatory network of wires connecting virtually every residence, office, store and factory to those producing plants. Constructing this system is expensive; adding new customers to an already-constructed service network is not.[82] In economic terms, the ratio of capital investment to annual revenues is exceptionally high: about four

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[78] Brief for Defendant, *supra* note 11, at 3-70.

[79] C. KAYSEN & D. TURNER, ANTITRUST POLICY 191 (1959) [hereinafter cited as KAYSEN & TURNER].

A natural monopoly is a monopoly which economists would say results from certain economies of scale "such that one firm of efficient size can produce all or more than the market demand and can expand its capacity at less cost than that of a new firm entering the business." *Id.*

For a legal recognition of the existence of natural monopolies, see United States v. Aluminum Co. of America, 148 F.2d 416, 429-30 (2d Cir. 1945), where the Court recognized that market demand could be so small as to allow the existence of but one competitor. *Accord,* Hecht v. Pro Football, Inc., 570 F.2d 982, 985 (D.C. Cir. 1977); Greenville Publishing Co. v. Daily Reflector, Inc., 496 F.2d 391, 397 (4th Cir. 1974); American Football League v. National Football League, 323 F.2d 124, 126 (4th Cir. 1963); Union Leader Corp. v. Newspapers of New England, 284 F.2d 582 (1st Cir. 1960); North American Soccer League v. National Football League, 465 F. Supp. 665, 676 (S.D.N.Y. 1979); Philadelphia World Hockey Club, Inc. v. Philadelphia Hockey Club, Inc., 351 F. Supp. 457, 511 (E.D. Pa. 1972); Ovitron Corp. v. General Motors Corp., 295 F. Supp. 373, 378 (S.D.N.Y. 1969); United States v. Harte-Hanks Newspapers Inc., 170 F. Supp. 227, 229 (N.D. Tex. 1958).

[80] Brief for Defendant, *supra* note 11, at 1.

[81] M. FARRIS & R. SAMPSON, PUBLIC UTILITIES: REGULATION, MANAGEMENT AND OWNERSHIP 5-6 (1973); *see also* T. MORGAN, ECONOMIC REGULATION OF BUSINESS 5-22 (1976) [hereinafter cited as MORGAN].

[82] *Id. See* Weiss, *Antitrust in the Electric Power Industry,* in PROMOTING COMPETITION IN REGULATED MARKETS 135 (A. Phillips ed. 1975); Primeaux, *A Reexamination of the Monopoly Market Structure for Electric Utilities,* in PROMOTING COMPETITION IN REGULATED MARKETS 136, 175 (A. Phillips ed. 1975).

and one-half times the ratio in the iron and steel industries and over eight times that for most other manufacturing industries.[83]

This characteristic of capital intensity is closely associated with the idea of nearly-perpetual economies of scale. That is, the cost per unit of service declines continuously until a high level of utilization is reached. The greater the number of customers served and units of power consumed, the more widely the fixed capital costs can be spread.[84] This basic relationship is augmented by the fact that the equipment involved in distributing electricity—high capacity lines, sub-stations and transformers—cost less per marginal unit of capacity. Thus, the cost of service for an entire area by a single efficient firm will be lower than if two equally efficient enterprises duplicated capital investment to compete for the same market. For these reasons, the distribution of electric power is widely recognized by economists as a classical example of natural monopoly, and this recognition is accepted by the judiciary.[85]

Most important, the fact that the electrical power industry is a natural monopoly requires, and thereby justifies, state regulation.[86] Once it is understood that each defineable territory should be served by only one firm and that the state has an interest in ensuring that all reasonable demand be immediately met,[87] then the rationale for state regulation is clear. A state commission approves rates sufficient to meet expenses and render a reasonable return on invested capital. It also restricts entry and delineates service territories.[88] In this manner, the protection usually offered by competition is replaced by state regulation. This is a second-best solution dictated by the natural monopoly characteristics of the industry. To not embrace such a solution means that there will be a wasteful duplication of resources. In Cleveland, ap-

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[83] *See generally* M. FARRIS & R. SAMPSON, supra note 81, at 5-6. *See also* Sarikas, *Financial Aspects of Utility Construction Work In Progress*, 105 PUB. UTIL. FORT. 111-12 (1980): "This problem has been accentuated by the rising cost of capital and the adverse effects of inflation which have resulted in an almost continuous round of rate increases by utilities in spite of declining growth rates experienced by most utilities, construction requirements continue to rise rapidly." *Id.*

[84] *See* Hunter, *Long-run Marginal Costs Lower Than Average Costs*, 105 PUB. UTIL. FORT. 17-19 (1980). *See generally* MORGAN, *supra* note 81.

[85] *See* CAVES, MARKET STRUCTURE AND EMBODIED TECHNOLOGICAL CHANGE IN REGULATING THE PRODUCT 125, 131-40 (R. Caves & M. Roberts eds. 1975); Meeks, *Concentration in the Electric Power Industry: The Impact of Antitrust Policy*, 72 COLUM. L. REV. 64, 65 (1972), and authority cited therein.

[86] Kellman, *De-Utilitizing the Energy Industry: Planning the Solar Transition*, 28 UCLA L. REV. 1 (1980). *See also* E. SMEAD, GOVERNMENTAL PROMOTION AND REGULATION OF BUSINESS 438-57 (1969).

[87] Note, *The Duty of a Public Utility to Render Adequate Service: Its Scope and Enforcement*, 62 COLUM. L. REV. 312, 314-23 (1962).

[88] *Id.*

proximately ten million dollars worth of excess transmission lines and equipment exist within the thirty square mile area of MUNY Light's operating territory.[89]

B. *Sherman Act Prohibitions Against Monopolization Are Inappropriate In A Natural Monopoly Market*

CEI contends that MUNY Light's facts at worst allege a corporate policy of CEI to refuse to help MUNY stay afloat.[90] In a natural monopoly market, such refusal is legitimate.[91] Only one firm *should* function in that market. If more than one exists, there will be a battle between them to see which survives. The test of survival is the ability of each firm to allocate resources efficiently and serve the public. In a relatively short period of time, the market will, if left alone, force one firm to leave the market; productive resources will be consolidated into one operating entity, thereby taking maximum advantage of economies of scale,[92] and regulation will ensue to promote the public interest.[93] Thus, competition between two firms in a natural monopoly market is inherently exclusionary. The loss of one firm is natural; there is no injury to the marketplace or consumers.[94]

Should the antitrust laws which were avowedly designed to encourage competition require that one firm support its competitor's ability to do business in a natural monopoly market? Such a requirement seems absurd. To posit that one competitor must support the other is to ignore the nature of that market and replace the law's legitimate goal of efficiently allocating resources with the misguided desire to protect weak firms from the rigors of competition.[95] MUNY Light's territory is

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[89] Brief for Defendant, *supra* note 11, at 3-70. At trial Robert M. Kemper, CEI engineer, testified that the retail electric market in Cleveland was a natural monopoly market where but one firm can survive. Further, Mr. Kemper testified that there exists within the city ten million dollars of excess distribution facilities. The Plain Dealer, Oct. 21, 1980, at 15-A, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Oct. 20, 1980.

[90] Brief for Defendant, *supra* note 11, at 3-70.

[91] *Id.* CEI argued that there is no legal or logical basis for which competition may be protected in a natural monopoly market. Further, because there is no valid competition in a natural monopoly market, such a market cannot constitute a relevant market for Sherman Act purposes. *See* United States v. E. I. du Pont de Nemours Co., 351 U.S. 377, 393 (1956).

[92] *See* MORGAN, *supra* note 81, at 5-22; *contra*, Primeaux, *supra* note 82, at 175.

[93] AREEDA & TURNER, *supra* note 29, at 47-63.

[94] *Id.* "Where the monopoly is known to be inevitable, suit is unfairly burdensome to the defendant . . . ." *Id.*

[95] Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 54-57 (1977). *See also* Kellman, *Vertical Territorial Restrictions and the Limits of Planning*, 46 ANTITRUST L.J. 1107 (1979).

completely subsumed by CEI's service area. The two are direct competitors in a market which would be best served by the more efficient firm. Why then, even if CEI did refuse to deal with MUNY Light, should that raise an antitrust issue? Does CEI have a legal obligation to keep MUNY Light in business?

Section two of the Sherman Act prohibits the deliberate use of market power[96] to acquire or maintain a monopoly position in the marketplace.[97] The mere possession of monopoly power as the result of a superior product, business acumen or historic accident is legal.[98] However, a firm transgresses the limits of the law when it willfully excludes competitors.[99] Such culpability will be found when a firm with monopoly power engages in activity which is intentionally anticompetitive, tortious or a collusive restraint of trade. Thus, if a monopolist agrees to participate in a price fixing agreement[100] or a group boycott,[101] enforces illegal tying arrangements[102] or a resale price

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[96] American Tobacco Co. v. United States, 328 U.S. 781, 809-11 (1946). Market power or monopoly power is the power to control price or exclude competition. *See* Lipson, *Monopolization: Traditional Standards and Future Directions*, 47 ANTITRUST L.J. 1116, 1117 (1978). The power to either control price or exclude competition is sufficient for a finding of monopoly power. The percentage of the market which the alleged monopolist controls is an important factor in determining the existence of monopoly power. United States v. E.I. du Pont De Nemours & Co., 351 U.S. 377, 384 (1956). *See* R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 102-13 (1976).

[97] United States v. Grinnel Corp., 384 U.S. 563, 570 (1966). In *Grinnel*, the Court defined the elements of the monopolization offense under section two as follows: the possession of monopoly power in the relevant market, and the willful acquisition or maintenance of that power in the relevant market. In order to determine the existence of monopoly power under *Grinnel*, one must first find the extent and nature of the relevant geographic and product markets. *See* F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 52-57 (1970). *See also* Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962) (setting forth the legal criteria of a submarket).

[98] United States v. Aluminum Co. of America, 148 F.2d 416, 429-30 (2d Cir. 1945). *See also* Berkey Photo v. Eastman Kodak Co., 603 F.2d 263, 272-74 (2d Cir. 1979); Sargent Welch Scientific Co. v. Ventron Corp., 567 F.2d 701, 712 (7th Cir. 1977); Transamerica Computer Co. v. Int'l Bus. Machines Corp., 481 F. Supp. 965 (N.D. Cal. 1979); Telex Corp. v. Int'l Bus. Machines Corp., 367 F. Supp. 258, 341 (N.D. Okla. 1973); Bailey's Bakery L.T.C. v. Continental Baking Co., 235 F. Supp. 705, 719 (D. Hawaii 1964).

[99] Standard Oil Co. v. United States, 221 U.S. 1 (1911). "[T]he unification of power and control over petroleum . . . which was the inevitable result of . . . aggregating so vast a capital, gives rise . . . to the *prima facie* presumption of intent and purpose to maintain the dominancy over the oil industry . . . with the purpose of excluding others. . . ." *Id.* at 75.

[100] United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 210-18 (1940).

[101] Klor's Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 213 (1959).

[102] Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 608-09 (1953). (1953).

maintenance scheme,[103] impermissibly extends the scope of a patent[104] or commits a business tort in an effort to drive a competitor out of business,[105] then the courts will find such conduct inherently anticompetitive and illegal. Such unilateral conduct by a firm with monopoly power violates section two.[106] But a firm may legally possess monopoly power if it does not engage in anticompetitive conduct.[107] Presumably, the firm's normal conduct of day-to-day business is legal; no one could fault the monopoly firm for being efficient, even if less efficient firms might find it difficult to enter or stay in the market. The case law specifically provides that a firm with monopoly power is encouraged to compete against those who offer similar products.[108] Innovation, efficiency, better foresight and a commitment to work harder are all virtues which a competitive market must reward, regardless of the firm's size.[109] Thus, the sole participant in a market which is "so limited that it is impossible to produce at all except by a plant large enough to supply the whole demand"[110] does not violate the law by pursuing business opportunities, even if other firms find it difficult to compete.[111]

Given this framework, the question becomes how the law treats a refusal to deal by a firm in a natural monopoly market. Refusals to deal are presumptively legal.[112] A business entity may or may not deal with any one it chooses. A small firm in a competitive market may refuse to deal with impunity so long as that refusal is unilateral and an intent to monopolize or restrain trade cannot be inferred from other conduct.[113] A

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[103] Kiefer-Stewart v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211 (1951).

[104] Brulotte v. Thys Co., 379 U.S. 29 (1964); Int'l Salt Co. v. United States, 332 U.S. 392 (1947).

[105] Union Leader Corp. v. Newspaper of New England, Inc., 284 F.2d 582, 584 (1st Cir. 1960).

[106] It has long been held that the possession of monopoly power which is acquired or maintained through acts which violate § 1 will constitute a violation of § 2 as well. *See generally* Schine Chain Theatres, Inc. v. United States, 334 U.S. 110, 129-30 (1948).

[107] United States v. United States Steel Corp., 251 U.S. 417 (1920).

[108] United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

[109] Berkey Photo v. Eastman Kodak Co., 603 F.2d 263, 272-74 (2d Cir. 1979).

[110] United States v. Aluminum Co. of America, 148 F.2d 416, 430 (2d Cir. 1945).

[111] AREEDA & TURNER, *supra* note 29, at 47-63.

[112] Annot., 41 A.L.R. FED. 175, 228-33 (1979). "The federal courts have ruled that in the absence of any purpose to create or maintain a monopoly, the Sherman Act . . . does not restrict the right of a trader nor manufacturer engaged in an entirely private business, from freely exercising his own independent discretion as to the parties with whom he will deal." *Id.* at 230. *See also* United States v. Colgate & Co., 250 U.S. 300, 307 (1919).

[113] Daily Press Inc. v. United States Int'l, 412 F.2d 126, 135 (6th Cir. 1969) (where a buyer requests a special deal, it is not a refusal to deal for the seller to reject the buyer's terms).

firm with monopoly power, however, violates the law by refusing to deal in the event that viable competitors are denied access to needed supplies. This refusal may be likened to creating a bottleneck in the free flow of goods and, by that means, unfairly foreclosing the opportunity to compete.[114] Only where the inherent effect of the monopolist's refusal is the foreclosure of competition has section two's prohibition been violated.[115]

The act of refusing to deal with a competitor does not *per se* violate the law; rather, such an act may be evidence of an intent to exclude competition. It is the intent which, if combined with the power to realize the result, threatens competition.[116] However, in the setting of a natural monopoly market, a refusal to supply a competitor is not an act of monopolization—it is a legitimate competitive act regardless of the refuser's large market share.[117] In this market, no competition should exist as competition is itself inefficient. A refusal to help a competitor compete is not an act of monopolization, but is rather a legitimate attempt to respond to the peculiar economic facts of the marketplace. In a market where only one can serve, the policy of section two which pro-

[114] The test as stated in *Colgate* has often been called the "purpose test." Under this test, intent to create or maintain a monopoly is the key to finding a violation of § 2. *See* Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359, 375-76 (1927). In *Kodak*, the Court used the purpose test to find that Kodak's refusal to deal constituted a violation of § 2. *See* Robinson v. Magovern, 456 F. Supp. 1000, 1006 (W.D. Pa. 1978), which held that the Colgate doctrine "is not applicable where the refusal to deal is anti-competitive in purpose or effect, or both, or is in restraint of trade." *Id. See* Note, *Refusals to Deal by Vertically Integrated Monopolists*, 87 HARV. L. REV. 1720, 1740 (1974).

Under the bottleneck theory of monopolization, the monopolist at the supply level is assumed to have a legal monpoly at that level. To violate § 2, the monopolist's refusal to deal must cause the injured competitor to lose its ability to gain supply of the target product. Further, the refusal to deal must give the monopolist a competitive advantage. Note that if the competitive advantage is the result of superior skill or ability and not the result of the refusal to deal, there is no violation of § 2.

[115] Otter Tail Power v. United States, 410 U.S. 366 (1973). *Accord*, Associated Press v. United States, 326 U.S. 1 (1945); United States v. Terminal Railroad Ass'n, 224 U.S. 383 (1912); Helix Milling Co. v. Terminal Flour Mills Co., 523 F.2d 1317 (9th Cir. 1975); Gamco Inc. v. Providence Fruit & Produce Bldg., Inc., 194 F.2d 484 (1st Cir. 1952); United States v. Standard Oil Co., 362 F. Supp. 1331 (N.D. Cal. 1972).

[116] Brief for Defendant, *supra* note 11, at 173-85. *See* Byars v. Bluff City News Co., 609 F.2d 843, 855, (6th Cir. 1979), where the court extended presumptive legality to a refusal to deal by a vertically integrated monopolist. Further, the court found that even the use of unfair methods of competition by a seller would not necessarily result in a violation unless an adverse impact upon the market could be shown. *Accord*, Ace Beer Distributors, Inc. v. Kohn, Inc., 318 F.2d 283, 286-87 (6th Cir. 1963); Industrial Building Materials, Inc. v. Interchemical Corp., 278 F. Supp. 938, 957-60 (C.D. Cal. 1967).

[117] Brief for Defendant, *supra* note 11, at 109-119, 142-48.

hibits monopolization of competitive markets does not apply. The refusal to supply electricity is no more inherently anticompetitive than refusing to lend money to one's competitor. In either event, the competitor may be worse off for the refusal, but the mere refusal is not illegal.[118] The antitrust laws are intended to protect competition, not competitors.[119] Even if the consequence of the refusal is the demise of the competitor, no anticompetitive injury has been suffered since in a natural monopoly market the final outcome of one firm serving the entire market is rational. It follows that, in a natural monopoly market, a firm facing competition can at worst be accused of committing a business tort actionable in the state courts. No antitrust injury within the meaning of section two can thus occur.[120]

CEI has competed against MUNY Light. Both have sought to serve the electric market in Cleveland. The only rational result of this competition should be the success of the more efficient firm (subject, of course, to state utility regulation),[121] and the eventual exit of the loser. MUNY Light has no generation capacity; it can only take power from CEI and re-sell it to the consumer.[122] Only by using city revenues to subsidize its operations could MUNY Light compete.[123] MUNY Light's existence did not result in an increase of power to consumers, nor did it result in an enlarged distribution system. The only tangible result of MUNY Light's existence was that resources were inefficiently duplicated.[124] To sell or wheel power to MUNY Light would further waste the public's resources and only prolong the inevitable. CEI's refusal to supply was not injurious to competition; it was the reasonable exercise of business judgment by utility executives statutorily obligated to provide a public service.[125] A refusal to deal which is not anticompetitive is, as stated above, legal. Therefore, CEI did not violate section two of the Sherman Act.

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[118] *Id.* at 148-65. *See* Watson and Brunner, *Monopolization by Regulated 'Monopolies': The Search for Substantive Standards,* 22 ANTITRUST BULL. 559, 566 (1977); *See also* AREEDA & TURNER, *supra* note 29, at 239.

[119] *See* II E. KINTNER, FEDERAL ANTITRUST LAW 130 (1980).

[120] *See* KAYSEN & TURNER, *supra* note 79, at 191.

[121] *See* note 86 *supra* and accompanying text. OHIO REV. CODE ANN. § 4901 (Page 1977), sets out the organizational characteristics of the public utilities commission. OHIO REV. CODE ANN. § 4905 (Page 1977), sets out the general powers of the Public Utilities Commission of Ohio. OHIO REV. CODE ANN. § 4906 (Page 1977), gives the Public Utilities Commission of Ohio the power to control the location of generation and transmission facilities within Ohio.

[122] *See* Brief for Defendant, *supra* note 11.

[123] *Id.*

[124] *Id.*

[125] *Id.* *See* note 11 *supra. See also* OHIO REV. CODE ANN § 4906.10(6) (Page 1977).

C. *MUNY Light's Demise Was Self-Inflicted*

Certainly no firm is responsible for the business setbacks of its competitor if that competitor suffered from incompetent management. It is the position of CEI that mismanagement was to blame for MUNY Light's failure to compete effectively.[126]

Since its inception, MUNY Light's growth has depended on CEI. As early as 1907 CEI provided temporary service to MUNY.[127] Since then, CEI has regularly provided standby service. This dependence is neither new nor the result of CEI's conduct; rather, MUNY Light has been forced to rely on CEI because of its own ill-advised managerial decisions.[128] While most utility firms pursued conservative plans designed to in-

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[126] Brief for Defendant, *supra* note 11, at 47. "The decline of MELP [MUNY Light] was caused by a combination of market forces and the managerial failings of successive city administrations, which either did not grasp the nature of electric power service . . . or were politically unwilling or unable to react accordingly." *Id.*

[127] *Id.* at 54.

[128] *Id.* at 55; The Plain Dealer, Feb. 11, 1979, at 1-A, col. 1. Fred Sener, a CEI engineer, testified that a permanent interconnection between MUNY Light and CEI could have been in place by June of 1974 rather than May of 1975. He testified that the delay was due to the City's failure to finance the operation. Further, Mr. Sener testified that any delays in the completion of the temporary tie in 1972 were clearly the fault of the city. The Plain Dealer, Oct. 22, 1980, at 16-A, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Oct. 21, 1980. Testimony of Edward J. Fowlkes, engineer with Federal Power Commission in early 1970's, tended to support the conclusion of Mr. Sener as to the City's fault in the delays in completing a permanent interconnection in 1975. Mr. Fowlkes also testified that CEI did not operate the 11 kv overhead tie in a manner which was below industry standards. The Plain Dealer, Oct. 23, 1980, at 22-A, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Oct. 22, 1980.

Alan D. Donheiser of Arthur D. Little Inc., management consultant for CEI, testified that MUNY Light's problems were the result of twenty years of mismanagement. Using data compiled by CEI, Mr. Donheiser felt that MUNY Light's management failed to properly plan for the future and did not carry out their long range goals. Specifically, he stated that MUNY Light officials had problems "dealing with the Cleveland City Council and described said dealings as cumbersome and ineffective. . . ." The Plain Dealer, Oct. 24, 1980, at 10-B, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Oct. 23, 1980.

William Chaney, CEI engineering consultant, testified that MUNY Light could have interconnected with three other private utilities, Pennsylvania Electric Co., Ohio Power Co., and Ohio Edison Co., all of which do not compete with MUNY Light. All of said companies are CAPCO members. Further, Mr. Chaney testified that in 1961, MUNY Light could have and should have interconnected with the Painesville and Orrville municipal systems. Mr. Chaney stressed the fact that CEI would not have been a viable choice for interconnection due to the fact that it is in direct competition with MUNY Light. The Plain Dealer, Oct. 23, 1980, at 22-A, col. 1; Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975), proceedings of Oct. 22, 1980.

crease distribution while expanding generating capacity, MUNY Light recklessly expanded its distribution territory without replacing or developing its generating capacity. During the 1930's MUNY Light successfully grew by over 10,000 customers (most of whom were changeovers from CEI service), but did not add or replace generating capacity.[129] In 1940, MUNY's strained and aged generating capacity gave way, and CEI actually served MUNY's load for eleven months.[130] For the next ten years, MUNY's peak load exceeded its capacity.[131]

During the post-World War II period, larger generators offering increased efficiency were introduced causing greatly increased capital and maintenance costs.[132] Consequently, greater load factors were needed to justify the investment, and greater reserve capacity was required to insure reliability. Instead of responding to these circumstances, MUNY pushed the limits of its capacity. Major outages occurred in 1958, 1961, 1965 and 1966.[133] Eleven outages in 1969 alone culminated in the breakdown of the new 85 megawatt unit.[134] Continuous outages through 1974 have rendered MUNY Light totally dependent upon load transfer service provided by CEI.[135]

MUNY Light's operations have been characterized by bloated administrative and labor costs. The company survived only because of an artificial rate differential supported by municipal funds.[136] MUNY Light paid no taxes by virtue of its status as a municipal corporation. CEI, of course, pays taxes. This savings, having nothing to do with efficiency, allowed MUNY Light to charge consumers less per kilowatt hour, but in fact it was the consumer who subsidized his rate bill with his tax payments.[137] More important than MUNY's tax-free status was the subsidy it received from inflated charges to the City of Cleveland for street lighting services. These higher-than-market rates permitted MUNY Light to cross-subsidize its retail operations with city revenues.[138] But in the capital-dependent electric industry, sustained use of aging produc-

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[129] Brief for Defendant, *supra* note 11, at 56.

[130] *Id.* at 57-58.

[131] *Id.*

[132] *Id. See* M. FARRIS & R. SAMPSON, *supra* note 81, at 5-6.

[133] Brief for Defendant, *supra* note 11, at 61.

[134] *Id.* at 62.

[135] The Plain Dealer, Feb. 12, 1979, at 1-A, col. 1.

[136] Brief for Defendant, *supra* note 11, at 48. CEI alleged that MUNY Light could not exist in the natural monopoly market but for its artificial cross subsidization of its retail rates with profits from electricity sold to the City. While the rates MUNY Light charged for retail service rose, CEI alleged said rates rose only a small amount compared to the rates charged to the City for public loads.

[137] Brief for Defendant, *supra* note 11, at 46-52.

[138] CEI *et al.*, 5 NRC at 167. *See* note 29 *supra* and accompanying text.

tion facilities without maintenance led to power outages which grew progressively worse as outdated equipment failed to meet increased demand.[139] In 1962, rather than interconnect with nearby electrical systems, MUNY Light planned to install generating capacity substantially in excess of MUNY's expected load growth.[140] By 1971, MUNY was bankrupt. Only CEI's continued and stable presence kept the citizens of Cleveland out of the dark. In effect, MUNY's suit complains that CEI has not done enough to revive its incompetent competitor who, nevertheless, remains determined to render useless CEI's investment in Cleveland.[141]

III. Analysis

To sue successfully under section two, MUNY Light must show by a preponderance of the evidence that CEI monopolized or attempted to monopolize the electric distribution market in Cleveland. MUNY Light has no obligation to prove that competition will increase efficiency in the generation or distribution of electricity. The antitrust laws themselves reflect a Congressional policy that free and open markets will supply more goods for lower prices as well as provide consumers a greater choice. Since firms with monopoly power can clog the free flow of goods, the purpose of antitrust law is to diffuse sectors of concentrated economic power. Therefore, proof of the use of such monopoly power to exclude competition, existing or potential, establishes a prima facie case of illegality.

In this case, the legal issue is whether CEI can successfully demonstrate an affirmative defense to MUNY Light's evidence of a monopolistic refusal to deal. CEI's complex attempt to do so weaves together three well known responses to the charge of monopolization: (1) as a regulated utility, CEI is outside of the scope of antitrust jurisdiction; (2) possession of monopoly power is lawful if achieved by lawful means; and (3) as a natural monopolist, CEI's refusal to deal with MUNY Light was legitimate competitive conduct. In order to resolve this controversy, it is therefore necessary to untangle a considerable quantity of case law.

As a threshold matter, CEI's contention that a regulated utility is exempt from the jurisdiction of the antitrust laws is legally unsupportable. CEI's business was stipulated to involve interstate commerce; the jurisdictional requirements of the law have thereby been met. The scope of Sherman Act jurisdiction is limited only by express exemptions. Electric utilities are not so expressly exempt. The judiciary in re-

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[139] Brief for Defendant, *supra* note 11, at 61-62.

[140] *Id.* at 62-65.

[141] *Id.* at 1-2.

cent years has consistently and repeatedly refused to grant an exemption to regulated utilities accused of anticompetitive behavior.[142]

The second component of CEI's argument, while legally supportable, can be disposed of as factually inapplicable. Since the early decision in *United States v. United States Steel Corp.*,[143] the judiciary has recognized that section two does not condemn successful acquisition of a large market share by innovative or skillful business tactics. There must be some aspect of anticompetitive conduct to support a finding of illegal monopolization. In *United States v. Aluminum Co. of America*,[144] Judge Hand formulated the defense for acquisition of monopoly power as a result of "superior skill, foresight and industry .... The successful competitor, having been urged to compete, must not be turned upon when he wins."[145] More recently, the Second Circuit in *Berkey Photo v. Eastman Kodak*[146] held that neither Kodak's introduction of a new and innovative photographic system without prior notification to competitors, nor its marketing a new film which could only be used in conjunction with the new camera, constituted an illegal act of monopolization despite Kodak's monopoly share of the relevant market. Even though Kodak's competitors were no doubt injured by the introduction of the "126" system, and no one seriously questioned Kodak's monopoly power, the innovation was an example of legitimate conduct under the Sherman Act.

The defense of "superior skill, foresight and industry" is, if factually applicable, an absolute defense. It strikes to the very heart of the policy considerations underlying section two. The purpose of the law is to promote competition, and high on the list of legitimate competitive tactics is innovation. The firm having a monopoly share of the market does not violate the law through innovation. The courts will not punish proper competitive conduct regardless of its effect on smaller competitors. Yet, as stated above, this defense is not applicable here. While reasonable disagreement may exist as to whether a refusal to deal is inherently anticompetitive there can be no question that such refusal is *not* an example of superior skill, foresight and industry. In this controversy, CEI is not accused of having taken advantage of innovative development.

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[142] Cantor v. Detroit Edison Co., 428 U.S. 579 (1979); FPC v. Conway Corp., 426 U.S. 271 (1976); City of Mishawaka v. Indiana & Michigan Electric Co., 560 F.2d 1314 (7th Cir. 1977), *cert. denied*, 436 U.S. 922 (1978); *see* Central Power and Light Co. v. PUC of Texas, 592 F.2d 234 (5th Cir. 1979); City of Butania v. FPC, 548 F.2d 1056 (D.C. Cir. 1977); *see also* Town of Norwood v. FERC, 587 F.2d 1306 (D.C. Cir. 1978). *See generally* City of Lafayette v. Louisiana P. & L. Co., 435 U.S. 389 (1978).

[143] 251 U.S. 417 (1920).

[144] 148 F.2d 416 (2d Cir. 1945).

[145] *Id.* at 429.

[146] 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 445 U.S. 1093 (1980).

The complaint against CEI alleges a monopolistic refusal to sell and to wheel power with intent to exclude a competitior. If true, the allegation is not defensible as superior competitive performance.

With the unravelling of these peripheral defenses, it is possible to more clearly examine the natural monopoly defense. Ironically, while the natural monopoly defense shares little in theory or application with the defense of superior skill, foresight and industry, both are derived from the same paragraph in Judge Hand's *Alcoa* opinion. The following two sentences are the genesis of CEI's argument:

> Persons may unwittingly find themselves in possession of a monopoly automatically so to say: that is, without having intended either to put an end to existing competition, or to prevent competition from arising when none had existed; they become monopolists by force of accident. A market may, for example, be so limited that it is impossible to produce at all and meet the cost of production except by a plant large enough to supply the whole demand.[147]

The key to understanding this controversy in terms of antitrust doctrine is to distinguish the natural monopoly defense from *Kodak's* application of superior skill, foresight and industry. The latter defense, if proven, is absolute; it goes to the essence of what the law means by anticompetitive conduct. By contrast, the natural monopoly defense merely asserts that one firm's possession of a large market share is not presumptively anticompetitive where the technological process involves such enormous capital investments that realizable economies of scale are nearly perpetual. The theory of natural monopoly does justify utility regulation for electricity and gas distribution and for telephone communications; it has long been recognized that a regulated electric utility serving 100% of the market does not necessarily violate the law simply by virtue of its size. Thus, the natural monopoly defense means that where the relevant market can support only one firm, the inability of other competitors to compete does not by itself establish a prima facie case of monopolization. However, the defense, even if proven, does not resolve the antitrust controversy; it does not fundamentally address the question of whether the defendant's conduct was anticompetitive. The defendant who can prove that two or more firms cannot efficiently serve the relevant market may still be subject to the charge that, in competing for the position of sole market participant, it has engaged in anticompetitive conduct which unfairly excluded its competitor from attaining the sought after position. As will be discussed at length below, the successful interposition of this "natural monopoly" defense can significantly increase MUNY Light's burden of proving a cause of action under section two, but the important point is that even if the distribu-

[147] 148 F.2d at 430.

tion of electrical power in Cleveland is a natural monopoly, CEI is still required under the antitrust laws to abstain from engaging in anticompetitive conduct.

Two critical issues derive from the foregoing analysis: Can CEI prove that another firm's presence in the market is necessarily inefficient? If so, can MUNY Light prove that CEI's conduct was, in light of the natural monopoly characteristics of the market, anticompetitive?

A. *The Role of Competition in the Distribution of Electricity*

CEI has argued that because the distribution of electric power in Cleveland is a natural monopoly, its willful refusal to sell or to wheel power to MUNY Light was not an act of illegal monopolization. The critical flaw in CEI's argument is that competition has an important role to play in the electrical industry. The existence of utility regulation establishes only a presumption, not a conclusion, that the presence of two or more firms is inefficient.

The electric power industry performs three vertically integrated functions: generation of power, transmission of that power in bulk and distribution of electricity to the ultimate consumer. Commonly, a large, integrated enterprise serves an extensive geographic area, with smaller cooperative or municipal systems purchasing wholesale power from it and distributing the power to "islands" within the larger firm's sphere of operation.[148]

1. Generation

Sizeable quantities of electrical power can be generated by hydroelectric or steam turbine plants. The latter may be fueled by oil, natural gas, coal or nuclear energy. The economies of scale available through the use of large capacity generating units are enormous. Therefore, most plant construction today involves large facilities. To construct a large generating facility, an electric company must obtain necessary state and federal permits and licenses.[149] As a threshold matter, the applicant must establish that a specified sector of consumers needs the power. If there is no need for the power within the area to be served then the application should not be approved.[150] Correspondingly, if there

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[148] *See generally* Meeks, *Concentration In The Electric Power Industry: The Impact of Antitrust Policy*, 72 COLUM. L. REV. 64 (1972) [hereinafter cited as Meeks].

[149] *See generally* Quarles, *Federal Regulations of New Industrial Plants*, 11 ENVIR. REP. (BNA) MONOGRAPHS 28 (May 4, 1979).

[150] The determination of need is typically made by the state utility commission and this finding is rarely challenged by a federal agency. The Atomic Energy Act, for example, specifically provides that state public utility commissions are empowered to make the initial decision regarding the need for power. 42 U.S.C. § 2021 (1977).

is an unsatisfied need for power, the economies of scale available in the construction and operation of generating facilities usually require that a minimal number of large units be built to meet that need. In this very real sense, the generation of large quantities of power to satisfy exclusively local demand should be undertaken by only one firm. These technological characteristics justify a regulatory commission's adverse determination regarding a competitive facility on the grounds that the area is adequately served by an existing supplier. Yet this outcome does not determine that the generation of electrical power is a natural monopoly function. On the contrary, generating large quantities of electric power is in many respects similar to most basic production industries for which competition serves as the primary regulatory control. Given a broader view of the relevant geographic market, it is apparent that many firms generate power and that this power can be sold competitively across service territories. Furthermore, recent developments in small-scale and cogeneration technologies indicate that competition can have a greater role in electricity generation. Large industrial and agricultural users are increasingly generating some or all of their own power. Indeed, the Public Utility Regulatory Policy Act of 1978 (PURPA)[151] specifically recognizes the role that competitive forces can have by providing that excess power produced by non-utilities may be sold without objection to the local utility at the prevailing rates.[152] In this manner, PURPA demonstrates a Congressional acceptance of competition principles which have been developed by the courts in regard to previous antitrust challenges to utility activity.[153]

2. Transmission

The transmission of bulk power is truly a natural monopoly function. Competitive transmission facilities are undesirable for economic and environmental reasons. Their high fixed costs render it far cheaper to build one transmission grid rather than two or more parallel grids. In addition, aesthetic and land use considerations require the fewest lines possible. In this sense, bulk transmission facilities are analogous to railroad tracks or long-distance telephone lines. Under the common law, these other natural monopoly distribution systems have been treated as common carriers. Analogous principles have, in the last decade, been implemented under the antitrust laws regarding electrical distribution.[154]

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[151] 16 U.S.C.A. §§ 2601-2645 (West Supp. 1981).

[152] *Id.* § 824a-3.

[153] These principles were shaped into their present form primarily by the Federal Communications Commission in regard to competition for telecommunications services. *See* Kellman, *supra* note 86, at 32-44.

[154] Note, *The Duty of a Public Utility to Render Adequate Service: Its Scope and Enforcement*, 62 COLUM. L. REV 312 (1962).

Large systems which control sectors of the transmission grid can exclude competition, at either the generation level or the distribution level, by refusing to allow access to potentially alternative sources of power. The monopoly over transmission by vertically-integrated systems "presents the most serious obstacle to potential competition."[155] Antitrust law has long recognized that the use of legitimately obtained monopoly power at one level of production to extend into another level of production is illegal under section two. Indeed, in *Otter Tail Power Co. v. United States*,[156] the Supreme Court confronted this exact question and held that the monopolistic refusal to wheel power so that Otter Tail, a large integrated utility, could extend itself into the distribution market was illegal. That decision, a clear manifestation of traditional antitrust doctrine, remains the dominant legal statement on attempts by regulated utilities to extend their state-granted monopoly power into adjoining markets. Given its straightforward application, there should be no question that CEI's refusal to wheel power from PASNY was, if excess capacity is factually proven, per se illegal.

3. Distribution

CEI would distinguish *Otter Tail* on the grounds that that decision involved the extension of monopoly power from one level of production (transmission) to a distinctly different level of production (distribution) whereas CEI and MUNY Light were direct competitors in the same distribution market. Even if this distinction is meaningful, it does not address the central fact that competition offers significant advantages for the local distribution of power. Five benefits offered by an existing municipal power company in competition with an integrated utility can be identified:

a. *Yardstick competition* refers to the effect that a competing municipal power system can have on an integrated firm's rate-making determinations. According to the theoretical basis for regulating electric companies, the state commission sets rates at a level sufficient only to compensate the firm for its costs plus a reasonable return on its invested capital. Were this process absolutely precise, yardstick competition would be of no value. However, belief that such precision actually typifies the rate process is a naivete which the law has not blindly accepted. Rates are made within a "zone of reasonableness"[157] between a ceiling and a floor which may at times be quite vast. Another firm's presence in the market requires that the regulatory body

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[155] Meeks, *supra* note 148, at 87.

[156] 410 U.S. 366 (1973).

[157] FPC v. Conway, 426 U.S. 271, 278 (1976).

confront adversary evidence regarding costs, thereby resulting both in a better informed commission as well as a downward pressure on rates. A yardstick competitor can, therefore, offer a moderating pressure on the rates of large electric firms.

b. *Competition for new customers.* Electrical markets are constantly expanding as population and technology expand. Residential developments and shopping centers on the exterior fringes of a service territory invite competition for the right to serve. Similarly, electric firms regularly vie to serve new industrial facilities. This direct competition among firms at the same level of production is precisely the activity to be encouraged and promoted under the antitrust laws.

Yardstick competition and competition for new customers are forces which can exist any time two or more electrical distribution firms trade in the same market. That one of those firms is a municipally-owned company is irrelevant; any competing firm can foster such competition. Whether or not these two forces are strong enough to warrant a total abandonment of the natural monopoly concept as applied to electricity distribution is debatable, but not directly relevant to this controversy. Here, the competing firm is a municipally-owned company and as such can supply three additional competitive forces:

c. *Access to cheaper fuel supplies.* Municipal utilities in the Northeast have access to inexpensive hydroelectric power generated by the Power Authority of the State of New York. By purchasing this power, a cost savings can be passed along to the consumer, an advantage which an investor-owned utility cannot provide. In addition, with the increasing development of alternative energy sources, the prospect for inexpensive municipal generation of power have never been brighter. Conversion of municipal biomass to methane gas which can then fuel electrical generation is a proven technique in the early stages of commercial application.[158] As the price of conventional fuel soars, alternative technologies available to public bodies will become increasingly important.

d. *Ability to realize consumption efficiencies.* As the need to conserve energy while levelling peak/off-peak loads grows more critical, so does the ability of local firms to encourage thrifty use of power. Municipal firms can effect temperature and lighting controls in public buildings, parks and streets. Patterns of energy use can be manipulated by municipal development agen-

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[158] *See* ENVIRONMENTAL PROGRAMS LANDFILL METHANE UTILIZATION TECHNOLOGY WORKBOOK, The Johns Hopkins University Applied Physics Laboratory, April 1980; Fourth Report to Congress, Resource Recovery and Waste Reduction, U.S. Environmental Protection Agency, 1977.

cies, regulatory bodies and the municipal power company. Such coordination is a highly complex task, but significant savings can be realized if local governments will recognize their opportunities.

e. *No need to pay dividends.* An investor-owned utility acquires capital from the national financial market and compensates for the use of that capital by payment of dividends to its stockholders. Thus, that portion of a company's rates represented as the reasonable return on capital investment is essentially a transfer of wealth from the local consumers of power to a group of nationally diverse investors. By contrast, a municipal utility is owned by the community; no dividends are paid. Every dollar of revenue over the cost of providing service remains in the locality. Capital is raised through the issuance of tax exempt revenue bonds.

These advantages of municipal electric companies may account for the existence of over 2,000 such firms in forty-eight states supplying power to 13% of the consumers in the United States.[159] It may further explain why the State of Ohio specifically provides for the existence of municipally-owned electric companies and gives to municipalities the right to control the distribution of electric power within their borders.[160] Finally, these advantages may explain why the voters of Cleveland have consistently supported the continued existence of MUNY Light.[161]

All of these considerations come to this: In a free market democracy, the public as voters and consumers must determine the appropriate market structure for the production and distrubution of goods and services. For a variety of historical reasons, the people of Cleveland, Ohio, have chosen to maintain MUNY Light as a distributor of electrical power. This choice may reflect a popular evaluation of how trustworthy the managers of electric power companies are. Perhaps it reflects a concern over a perceived inability of state regulators to control utilities' rates and service. The motives behind the public's approval of and support for MUNY Light are no doubt numerous and complex; but no economic model, regardless of its elegance, can prove that such a choice is irrational. Where competition exists and where the affected consumers have expressed their collective willingness to support that competition, then a utility's protestations that the electric industry cannot tolerate competition are meaningless. The efficiency or inefficiency of competitive electric distrubution companies should be determined by consumers, not CEI.

A strong argument can be made that the natural monopoly concept should have no application to the distribution of electrical power. The

[159] Meeks, *supra* note 148, at 67-68.

[160] *Id. See* OHIO REV. CODE ANN. §§ 743.26 *et seq.* (Page 1976 & Supp. 1980).

[161] *See* note 3 *supra* and accompanying text.

courts have not, however, gone so far. More accurately, the burden of proof should be on the party claiming the natural monopoly defense to prove that those competitive forces either cannot exist in the relevant market or are definitely outweighed by the actual economies which can be realized from the exclusion of competition. While this formulation leaves it to a jury to decide whether a local distribution market is a natural monopoly, the burden of proof on the defendant to so prove is enormous.

B. *The Legal Evaluation of CEI's Conduct*

If the jury finds that competition can be advantageous to the consumers of electricity in Cleveland, then CEI's refusal to sell and wheel power—coupled with its announced intent to eliminate MUNY Light as a competitor—conclusively establishes illegal monopolization. In such event, no further analysis is necessary. If, however, the jury finds that as a matter of fact competition confers no advantages because of the natural monopoly characteristics of the market, then the burden of proof switches back to the plaintiff to establish that defendant's conduct constituted unfair trade practices which are inherently anticompetitive.

That the natural monopoly defense may be defeated by a showing of unfair trade practices is a principle derived from Judge Wyzanski's opinion in *Union Leader Corp. v. Newspapers of New England.*[162] The relevant market in that case—newspaper publishing in Haverhill, New Hampshire—was only large enough to support one newspaper. The Haverhill Gazette exclusively served this market until 1957 when Union Leader Corp. (ULC), publisher of the nearby Manchester Union, entered the Haverhill market seeking to displace the Gazette. In the ensuing battle, ULC organized a group boycott of the Gazette, bribed advertisers by use of secret rebates and engaged in systematic price discrimination. Judge Wyzanski held that while legitimate competition—including underpricing one's competitor—is legal regardless of the effects on existing or potential competitors, it is illegal in a natural monopoly market to engage in anticompetitive conduct so as to exclude an existing market participant: "In a situation where it is inevitable that only one competitor survive, the evidence which shows the use, or contemplated use, of unfair means is the very same evidence of exclusionary intent."[163]

Considerable authority has recognized the contribution of *Union Leader* to antitrust theory.[164] In a natural monopoly market there is no

[162] 180 F. Supp. 125 (D. Mass.), *modified,* 284 F.2d 582 (1st Cir. 1960), *cert. denied,* 365 U.S. 833 (1961).

[163] *Id.* at 140.

[164] International Travel Arrangers v. Western Airlines, Inc., 623 F.2d 1255, 1268 (8th Cir. 1980); Mid-Texas Communications v. AT&T, 615 F.2d 1372, 1388 (5th Cir. 1980); Hecht v. Pro Football, Inc., 570 F.2d 982, 990 (D.C. Cir. 1977); Lamb Enterprises, Inc. v. Toledo Blade Company, 461 F.2d 506, 514 (6th Cir.

long-term price or service competition among firms for a marginal sale, and entry by new firms is severely limited. Therefore, the most viable form of competition is among two firms engaged in a struggle for survival. Since the winner will determine the nature of the market for years to come, the choice should be made on the basis of projected long-run efficiency, not because one firm can temporarily dominate the other by leveling an unfair blow. Though a firm which enters another firm's exclusive market does not thereby violate the law by legitimately and efficiently doing business, acquisition of a monopoly position must reflect real managerial superiority. To use predatory or exclusionary tactics to acquire sole possession of a natural monopoly market by forcing one's competitors out of business is an egregious offense of monopolization. In such circumstances, the natural monopoly defense is nothing more than a self-fulfilling and self-serving prophecy.

The natural monopoly defense, properly understood, is innocent enough: a firm does not violate the law simply by being the only entity of its type within the relevant market. If the market is so thin as to support only one firm, the law will not punish that firm. In the context of regulated industries, the defense is applicable to utilities who serve their operating territories subject to state regulation. But the natural monopoly defense does not exempt capital intense industries from antitrust enforcement, nor is it an excuse for anticompetitive conduct. The electrical industry is not simply and entirely a natural monopoly industry. Certain sectors of that industry have, for a variety of reasons, been organized according to the economic principles of natural monopoly regulation. Of course, no antitrust issue is raised thereby. Nevertheless, when one electric firm has faced direct competition for seventy years, that firm cannot force its competitor out of business by denying access to needed supplies of power and then attempt to shroud itself by arguing from economic theory that, after all, only one firm should distribute electricity. It is critical to understand that the more limited the opportunities to compete, the more important the preservation of existing competitors becomes. Thus, to define a market as "natural monopoly" should evoke the most stringent antitrust scrutiny of any attempt to eliminate competition. To claim a defense for anticompetitive behavior because of the inherent level of concentrated resources is to stand antitrust policy on its head. If indeed electrical distribution is a natural monopoly, than rather than justify an antitrust

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1972); Auburn News Co. Inc. v. Providence Journal Co., 504 F.Supp. 292, 304 (D. R.I. 1980); Homefinders of America, Inc. v. Providence Journal Co., 471 F. Supp. 416 (D. R.I. 1979). *See also* Cooper, *Attempts & Monopolization: A Mildly Expansionary Answer to the Prophylactic Riddle of Section Two*, 72 MICH. L. REV. 375 (1980).

[165] Justice Douglas, in United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964), held that in a regulated industry where entry is limited both by the requirement of commission approval and the capital expense of facilities, "competi-

exemption, a singularly rigorous enforcement of the law's policy to promote competition should ensue.[165]

The critical questions remaining for this analysis are:

(1) Was the refusal to sell inspired by an intent to monopolize?
(2) Could the sought-for sale of power be accomplished without materially affecting any of CEI's obligations?
(3) Did CEI understand the consequences to MUNY Light of its refusal to sell power?

If the answers to these questions are in the affirmative, then a jury may properly find that CEI's refusal to sell its power to MUNY Light was unreasonable. On the contrary, only if CEI can establish that its refusal was based on sound business concerns about either technological interference with its operations or a potential inability to meet other commitments if it sold to MUNY Light, can CEI then claim that its refusal to sell was reasonable. These are issues of fact for jury determination.

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tion then is for the new increments of demand that may emerge with an expanding population and with an expanding industrial or household use of gas." *Id.* at 660. In this context, the elimination of competition was more to be feared than in a "field where merchants are in a continuous daily struggle to hold old customers and to win new ones over from their rivals." *Id. Accord*, Northern Natural Gas Co. v. Fed. Power Comm'n, 339 F.2d 953 (D.C. Cir. 1968).

EPILOGUE

At the close of trial, Judge Krupansky charged the jury to answer five Special Interrogatories:

1. What do you find to be the relevant geographic market for retail firm power?
2. Did CEI monopolize or attempt to monopolize the relevant market?
3. If the answer to Interrogatory No. 2 is "Yes," did CEI's conduct proximately cause damage to the business or property of the City of Cleveland?

4A. If the answer to Interrogatory No. 3 is "Yes," is the relevant market in this case a "natural monopoly" market?

4B. If the answer to Interrogatory No. 4(A) is "Yes," did CEI monopolize or attempt to monopolize the relevant market by unfair or predatory means?

5. If the answer to Interrogatory No. 2 is "Yes," and if the answer to Interrogatory No. 3 is "Yes," and if the answer to Interrogatory No. 4(A) is "No," or if the answer to Interrogatory No. 4(B) is "Yes," then a verdict in favor of the plaintiff should be returned, and the jury should decide the amount of damages sustained by the City as a result of CEI's refusal to interconnect, CEI's refusal to wheel PANSY power, and CEI's free wiring program.[166]

In July, 1981, the jury, after lengthy deliberations, reported to the Judge that they were unable to reach a unanimous decision. Five jurors found that CEI had violated the antitrust laws, but one juror adamantly refused to so find. The case was re-tried, and in October, 1981, a second jury unanimously answered Special Interragatory No. 2 in the negative; as a consequence of this finding in CEI's favor, the remaining issues, including the natural monopoly defense, were not reached.[167]

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[166] Special Verdict Form, Cleveland v. CEI, No. C75-560 (N.D. Ohio, filed July 1, 1975).

[167] *Id.*