STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE

THREE EMPIRE STATE PLAZA, ALBANY, NY 12223-1350
www.dps.state.ny.us

December 30, 2011

VIA E-MAIL
William H. Stallings, Chief
Transportation Energy & Agriculture Section
Antitrust Division, United States Department of Justice,
Washington, D.C. 20530
E-Mail: **william.stallings@usdoj.gov**

Re: *United States of America* v. *Morgan Stanley,* Civil Case No. 11-civ-6875
Comments of the Public Service Commission of the State of New York

Dear Chief Stallings:

Pursuant to the Tunney Act, 15 U.S.C. § 16(e)(1), enclosed please find comments of the Public Service Commission of the State of New York in response to the notice published in the Federal Register on October 11, 2011. *See* U.S. Dep't of Justice, Antitrust Div., *United States v. Morgan Stanley*, Proposed Final Judgment and Competitive Impact Statement, 76 *Federal Register* 62843 (October 11, 2011).

Please contact me at (518) 474-7663, if you have any questions. Thank you.

Very truly yours,

Sean Mullany
Assistant Counsel

Enclosure

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Civil Case No. 11-civ-6875

United States of America,
Plaintiff
v.

Morgan Stanley,
Defendant.

COMMENTS OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PURSUANT TO THE ANTITRUST PROCEDURES AND PENALTIES ACT, ON THE PROPOSED FINAL JUDGMENT

SUMMARY

The Public Service Commission of the State of New York ("PSC") submits these comments pursuant to the Antitrust Procedures and Penalties Act, 15 U.S.C. §§ 16(b)–(h), in response to the notice published in the *Federal Register* on October 11, 2011, in this matter. U.S. Dep't of Justice, Antitrust Div., *United States v. Morgan Stanley*, Proposed Final Judgment and Competitive Impact Statement, 76 *Federal Register* 62843 (October 11, 2011).

The Department of Justice ("DOJ") is to be commended for its faithful enforcement of the antitrust law to protect the integrity of electricity markets in New York City. The electric capacity market for New York City is highly concentrated. The antitrust law is properly applied in this case to address wrongful anti-competitive practices of Morgan Stanley. DOJ's enforcement of the antitrust law is critical to protect consumers against the harmful effects of Morgan Stanley's anti-competitive conduct in this case and, more generally, to protect the public interest in the integrity of the newly-created competitive electricity markets.

DOJ proposes to settle this litigation by having Morgan Stanley pay the United States government $4.8 million. DOJ asserts such a settlement will be in the public interest because Morgan Stanley's payment of this amount into the U.S. Treasury will deprive Morgan Stanley of "a substantial portion" of its unjust enrichment. Competitive Impact Statement, at 8. DOJ admits it seeks only partial disgorgement of Morgan Stanley's ill-gotten gains, saying that, if it proceeded to trial, it would have

sought disgorgement of all of Morgan Stanley's net transaction revenues, which DOJ asserts were $21.6 million. Competitive Impact Statement, at 9 & n. 4. DOJ nonetheless claims the lesser amount of $4.8 million "will effectively fulfill the remedial goals of the Sherman Act" to "prevent and restrain" antitrust violations because the settlement will "send a message of deterrence" to the financial services community. Competitive Impact Statement, at 9. According to DOJ, the lesser amount of $4.8 million will still prevent market participants from using such financial agreements to manipulate the capacity markets in the future. Competitive Impact Statement, at 8-9.

These claims are central to DOJ's assertion that the settlement is in the public interest, a finding that the Court must make in order to approve DOJ's proposal. DOJ, however, has offered nothing to support its claims that this settlement, which would allow Morgan Stanley to retain almost 80 percent of its ill-gotten gains, will deter such anticompetitive conduct. Because of this, DOJ has not demonstrated that this settlement will achieve a central purpose of the Sherman Antitrust Act, namely preventing anticompetitive arrangements such as those facilitated by Morgan Stanley in this case. POINT I, below.

To remedy this, the Court should, under the authority of the Tunney Act, direct DOJ to supplement the record to show how and why the settlement will prevent such violations from recurring. POINT II, below.

DOJ has not shown that a settlement for $4.8 million would be reasonable. DOJ alleges Morgan Stanley's net revenues were $21.6 million. It asserts that $4.8 million is reasonable given the risks and costs of fully litigating the case. However, DOJ has offered only a summary statement of Morgan Stanley's anticipated position at trial. Competitive Impact Statement, at 9 & n. 4. This statement does not shed light on the actual risks and costs of litigation. Moreover, in considering whether a $4.8 million settlement would be reasonable, the Court should weigh the nature of Morgan Stanley's wrongdoing, the impact of such a settlement on DOJ's enforcement role, and the overall efficacy of antitrust law as a mechanism for preventing such harmful market manipulation.

DOJ has already settled with KeySpan for $12 million, an amount equal to 24.5 percent of KeySpan's alleged wrongful gain. That settlement was approved by the court on February 2, 2011. United States v. KeySpan Corporation, 10 Civ. 1415 (WHP) *Memorandum and Order,* (S.D.N.Y. Feb. 2, 2011). Now DOJ proposes to settle with Morgan Stanley, the financial institution that allegedly actively facilitated KeySpan's wrongful manipulation of the capacity market. DOJ alleges that KeySpan, knowing it could not directly buy an interest in Astoria (its largest competitor), enlisted Morgan Stanley to act as an intermediary. Thus, Morgan Stanley's involvement was designed to allow KeySpan to do indirectly what it could not do directly. In effect, DOJ alleges that Morgan Stanley actively facilitated KeySpan's attempt to evade the law. Despite allegations of such egregious conduct, DOJ

proposes to settle with Morgan Stanley for only 22.2 percent of Morgan Stanley's wrongful gain. Such an arrangement, however, is more akin to a tax than a penalty.

The settlement amount is particularly unreasonable given the fact that Morgan Stanley's illegal conduct had a much larger harmful impact. As the PSC noted in its comments on DOJ's earlier settlement with KeySpan, the illegal market manipulation that KeySpan and Morgan Stanley orchestrated imposed unnecessary costs on consumers which may have totaled tens of millions of dollars. Even if DOJ could not recover all those damages under the Sherman Antitrust Act, the reasonableness of seeking only 22.2 percent of what DOJ can recover should be measured, in part at least, by the larger consumer harm KeySpan and Morgan Stanley caused. United States v. KeySpan Corporation, 10 Civ. 1415 (S.D.N.Y.) (WHP), *Comments of the Public Service Commission of the State of New York, Pursuant To the Antitrust Procedures and Penalties Act, On the Proposed Final Judgment,* (Apr. 30, 2010). POINT III, below.

BACKGROUND

In this civil antitrust action, brought DOJ under Section 1 of the Sherman Act, 15 U.S.C. §1, the government seeks equitable and other relief against Morgan Stanley for violating the antitrust law. According to DOJ, in late 2005 and early 2006, Morgan Stanley entered into a "swap" agreement with KeySpan Corporation ("KeySpan"), then the largest electricity producer in the New York City metropolitan area. DOJ asserts this agreement (the "Morgan/KeySpan Swap") ensured that KeySpan would withhold substantial output from the New York City electric

generating capacity market, thereby discouraging competitive bidding and increasing capacity prices. On or about the same time, Morgan Stanley entered into an offsetting "swap" agreement with Astoria - KeySpan's largest competitor (the "Morgan/Astoria Swap"). Morgan Stanley, acting as the intermediary between KeySpan and Astoria, extracted revenues for its role. Thus, Morgan Stanley facilitated an arrangement "[t]he likely effect ... was to increase capacity prices for the retail electricity suppliers who must purchase capacity, and, in turn, to increase the prices consumers pay for electricity." 76 *Federal Register,* at 62844.

According to DOJ, the Morgan/KeySpan Swap unlawfully restrained competition in New York City's electric capacity market. KeySpan entered into that agreement to protect itself against increased losses from its preferred bidding strategy, due to the entry of new competitors into the capacity market. 76 *Federal Register,* at 62844. Under the Morgan/KeySpan Swap, KeySpan, which already possessed substantial market power in the highly concentrated and constrained New York City capacity market, "enter[ed] into an agreement that gave it a financial interest in the capacity of Astoria – KeySpan's largest competitor." 76 *Federal Register,* at 62844. By giving KeySpan revenues not only from its own sales, but also from the capacity sales of its largest competitor, the Morgan/KeySpan Swap "effectively eliminated KeySpan's incentive to compete for sales" of capacity. 76 *Federal Register,* at 62846. Thus, "[t]he clear tendency of the Morgan/KeySpan Swap was to alter KeySpan's bidding in the NYC Capacity Market auctions." 76 *Federal Register,* at 62846.

As a result, electric capacity prices remained unlawfully inflated, and Morgan Stanley earned approximately $21.6 million in net revenues from the Morgan/KeySpan Swap and the Morgan/Astoria Swap. 76 *Federal Register,* at 62846. In addition, the elimination of competitive pressures, due to the anti-competitive Morgan/KeySpan Swap imposed unnecessary costs on consumers which may have totaled tens of millions of dollars.

POINT I
DOJ HAS NOT PROVIDED ENOUGH INFORMATION TO DETERMINE WHETHER THE PROPOSED SETTLEMENT IS IN THE PUBLIC INTEREST

Before entering any consent judgment proposed by the United States, the court must first determine that entry of such a judgment "is in the public interest." 15 U.S.C. § 16(e)(1). In doing so, "the court shall consider--

> (A) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration of relief sought, anticipated effects of alternative remedies actually considered, whether its terms are ambiguous, and any other competitive considerations bearing upon the adequacy of such judgment that the court deems necessary to a determination of whether the consent judgment is in the public interest; and
>
> (B) the impact of entry of such judgment upon competition in the relevant market or markets, upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

15 U.S.C. § 16(e)(1)(A) &(B).

In seeking this Court's approval, DOJ has the burden to "provide a factual basis for concluding that the settlements are reasonably adequate remedies for the

alleged harms." *United States v. SBC Communs., Inc.*, 489 F. Supp. 2d 1, 17 (D.D.C. 2007). In this case, DOJ has not met this burden. Neither the competitive impact statement, nor the proposed consent decree provides the information needed to evaluate whether this settlement would be a reasonably adequate remedy for the harm caused by KeySpan.

Under the proposed settlement, Morgan Stanley would be required to pay the United States government a total of $4.8 million dollars. United States v. Morgan Stanley, Proposed Final Judgment and Competitive Impact Statement, 76 *Federal Register* 62843, 9949 (October 11, 2011). According to DOJ, this amount "remedies [Morgan Stanley's] violation by requiring Morgan to disgorge profits obtained through the anticompetitive agreement." 76 *Federal Register,* at 62846. According to DOJ, "[d]isgorgement will deter Morgan and others from future violations of the antitrust laws." 76 *Federal Register,* at 62846. Thus, according to DOJ, the public interest is served because the proposed settlement will both prevent Morgan Stanley's unjust enrichment, and will deter such wrongful conduct in the future.

Preventing Morgan Stanley's unjust enrichment is a legitimate purpose of any proposed settlement. In fashioning relief in response to a violation of the antitrust law, "[o]ne of [the] objectives ... is to 'deny to the defendant the fruits of its statutory violation.'" *Massachusetts v. Microsoft Corp.*, 373 F.3d 1199, 1232 (D.C. Cir. 2004) (quoting *United States v. Microsoft Corp.*, 253 F.3d 34, 103 (D.C. Cir. 2001)). However, the unstated premise underlying DOJ's claims (that disgorgement is necessary to

prevent unjust enrichment, and a $4.8 million penalty is adequate) is that Morgan Stanley's unjust enrichment totaled only $4.8 million. Yet DOJ itself asserts that Morgan Stanley's net revenues totaled $21.6 million. 76 *Federal Register,* at 62847. Thus, DOJ itself acknowledges it is seeking only partial disgorgement.

DOJ nonetheless claims such partial disgorgement will "send a message of deterrence[,]" thereby "deterring Morgan and other parties from entering into similar financial agreements ... or from otherwise engaging in similar anticompetitive conduct in the future." 76 *Federal Register,* at 62848. While these claims are central to DOJ's contention that the settlement would be in the public interest, DOJ has not offered any evidence to support the proposition that this settlement will act as a deterrent. This lack of evidence showing the settlement would prevent and deter such conduct is a critical omission. As DOJ acknowledges, preventing and restraining antitrust violations are "the remedial goals" of the Sherman Antitrust Act. 76 *Federal Register,* at 62848. Yet the absence of any evidence supporting these claims makes it virtually impossible for the Court to meaningfully evaluate whether a $4.8 million settlement "represents a reasonable method of eliminating the consequences of the illegal conduct." *National Soc. of Professional Engineers v. United States*, 435 U.S. 679, 698 (1978). This holds true both with respect to depriving Morgan Stanley of its unjust enrichment, and with respect to evaluating whether the settlement will deter such wrongful conduct in the future. Thus, on the current record, the Court has no basis for finding the proposed settlement would be "in the public interest."

Given what DOJ has presented, the settlement would not be in the public interest. DOJ seeks only partial disgorgement, so the settlement would not prevent Morgan Stanley's unjust enrichment, since anything less than full disgorgement would not fully strip Morgan Stanley of its wrongful gains. The proposed settlement amount, however, is only a minor fraction (22.2%) of Morgan Stanley's unjust enrichment.[1] Why would such a penalty deter similar violations of the antitrust law in the future? Common sense suggests that such an amount will instead be viewed as merely a cost of doing business. S.E.C. v. Citigroup Global Markets, Inc., Slip Op. at 10 (S.D.N.Y. Nov. 28, 2011) ("[A] consent judgment that does not involve any admissions and that results in only very modest penalties is just as frequently viewed, particularly in the business community, as a cost of doing business imposed by having to maintain a working relationship with a regulatory agency ...."). Allowing Morgan Stanley to retain almost 80 percent of its ill-gotten gains can hardly be characterized as

[1] In approving DOJ's earlier $12 million settlement with KeySpan, the court noted that, according to DOJ, KeySpan "did not necessarily earn additional revenues" by not competing. Instead, the swap offered greater revenue certainty even though "competing could have earned the company greater revenues...." United States v. KeySpan Corporation, 10 Civ. 1415 (WHP) *Memorandum and Order,* at 14-15 (S.D.N.Y. Feb. 2, 2011). Because of this, in part, the Court found the $12 million settlement with KeySpan to be reasonable. Here, Morgan Stanley's swap revenues (aside from transactional costs) were profits since it would have had no revenues if KeySpan competed instead of entering into the swap. Accordingly, the court's rationale for finding the KeySpan settlement amount reasonable does not support this proposed settlement with Morgan Stanley.

an effective deterrent without something more to support such a claim.[2] Thus, the proposed $4.8 million settlement would not satisfy either of DOJ's rationales (*i.e.*, preventing Morgan Stanley's unjust enrichment, and deterring such wrongful conduct in the future) for a judicial finding that the settlement is in the public interest.

POINT II
THE COURT SHOULD DIRECT DOJ TO SUPPLEMENT THE RECORD ON THE DETERRENT EFFECT(S) OF THE PROPOSED SETTLEMENT

The Morgan/KeySpan Swap, in both purpose and effect, violated the antitrust law. Its purpose was to "effectively eliminate[ ] KeySpan's incentive to compete for sales in the same way a purchase of Astoria or a direct agreement between KeySpan and Astoria would have done." 76 *Federal Register,* at 62848. Thus, regardless of its effect on the market, the Morgan/KeySpan Swap violated the Sherman Act. *Cf. Summit Health v. Pinhas*, 500 U.S. 322, 330 (1991) ("[B]ecause the essence of any violation of § 1 [of the Sherman Act] is the illegal agreement itself[,] rather than the overt acts performed in furtherance of it, ... proper analysis focuses, not upon actual consequences, but rather upon the potential harm that would ensue if the conspiracy were successful").

---

[2] Arguably, even total disgorgement would have only a limited deterrent effect. "[T]o 'limit the penalty ... to disgorgement is to tell a violator that he may [break the law] with virtual impunity; if he gets away undetected, he can keep the proceeds, but if caught, he simply has to be give back the profits of his wrong.'" *SEC v. Bear, Stearns & Co.*, 626 F. Supp. 2d 402, 406 (S.D.N.Y. 2009) (quoting *S.E.C. v. Rabinovich & Assoc.*, 2008 U.S. Dist. LEXIS 93595, 2008 WL 4937360, at *6 (S.D.N.Y. Nov. 18, 2008)).

The Morgan/KeySpan Swap also violated the Sherman Act because of its effect on the market. Its "clear tendency" was to alter KeySpan's bidding, in order to prevent competition and keep prices high. 76 *Federal Register,* at 62848. *Cf. United States v. Staszcuk*, 517 F.2d 53, 60 & n.17 (7th Cir. Ill. 1975)("The federal power to protect the free market may be exercised to punish conduct which threatens to impair competition even when no actual harm results").

However, because, as discussed in POINT I, DOJ has not proffered evidence sufficient to enable the Court to evaluate whether the proposed settlement is in the public interest, DOJ should be directed to do so. Under the Tunney Act, "[t]he court may 'take testimony of Government officials or experts' as it deems appropriate, 15 U.S.C. § 16(f)(1); authorize participation by interested persons, including appearances by amici curiae, *id.* § 16(f)(3); review comments and objections filed with the Government concerning the proposed judgment, as well as the Government's response thereto, *id.* § 16(f)(4); and 'take such other action in the public interest as the court may deem appropriate,' *id.* § 16(f)(5)." *Massachusetts v. Microsoft Corp.*, 373 F.3d 1199, 1206 (D.C. Cir. 2004).

Requiring DOJ to adduce facts relating to whether such a minimal penalty will prevent and deter such anti-competitive conduct will provide a record basis for any public interest determination made by the Court. *Cf. S.E.C. v. Bank Of America Corp.*, ___ F. Supp.2d ____, 2010 U.S. Dist. LEXIS 15460 (S.D.N.Y. Feb. 22, 2010) (approving a proposed consent judgment because, *inter alia*, after the court rejected an

earlier proposed settlement, the parties conducted extensive discovery which established facts supporting the new proposal).

POINT III
THE REASONABLENESS OF THE PROPOSED SETTLEMENT SHOULD BE EVALUATED IN LIGHT OF THE RATEPAYER HARM CAUSED BY MORGAN STANELY

In determining whether the settlement is in "the public interest," the Court should consider the impact of the proposed settlement on the ratepayers that were harmed by Morgan Stanley's anti-competitive conduct. *See* 15 U.S.C. § 16(e)(1)(B) ("the court shall consider ... the impact of entry of such judgment upon ... the public generally ....").[3] DOJ acknowledges ratepayers were harmed, in the form of inflated capacity prices, because of Morgan Stanley's conduct. According to DOJ, "[w]ithout the Morgan/KeySpan Swap, KeySpan likely would have chosen from a range of potentially profitable competitive strategies in response to the entry of new capacity. Had it done so, the price of capacity would have declined." 76 *Federal Register,* at 62846. Because KeySpan decided to withhold capacity rather than compete, ratepayers were harmed in amounts far exceeding Morgan Stanley's $21.6 million in wrongful profit.

---

[3] *Cf. United States v. SBC Communs., Inc.*, 489 F. Supp. 2d 1, 17 (D.D.C. 2007) ("the court should be concerned with any allegations that the proposed settlement will injure a third party").

Yet, in its earlier settlement with KeySpan, DOJ indicated ratepayers may have no recourse under the antitrust law because of the "filed rate" doctrine. *See* 75 *Federal Register,* at 9951. Moreover, ratepayers may not be able to obtain any relief from FERC because, in early 2008, well before DOJ brought its civil antitrust action against KeySpan, FERC's Staff concluded there was no evidence that KeySpan's bidding behavior violated FERC's Anti-Manipulation Rule, 18 C.F.R. §1c2(a). FERC Docket Nos. IN08-2-000 & EL07-39-000, Enforcement Staff Report, Findings of a Non-Public Investigation of Potential Market Manipulation by Suppliers in the New York City Capacity Market, p. 17 (February 28, 2008). Thus, in this case ratepayers harmed by KeySpan's anti-competitive conduct may have no meaningful recourse under either the antitrust law or the Federal Power Act.

Even if DOJ could not recover damages under the Sherman Antitrust Act for harm suffered by ratepayers, and is limited to Morgan Stanley's $21.6 million total net revenues, the Court should, when weighing the reasonableness of settling for roughly 20 cents on the dollar, consider the larger consumer harm Morgan Stanley caused, and the apparent lack of any other effective remedy for consumers that were harmed. This lack of a remedy for customers is highly significant given the potential size of the consumer harm Morgan Stanley caused by violating the antitrust law. Yet DOJ has not offered any evidence of how much Morgan Stanley's alleged illegal conduct increased electricity capacity market prices.

If Morgan Stanley's illegal conduct harmed consumers by preventing price declines that could have totaled tens of millions of dollars, then the proposed $4.8 million settlement is so low it would not be fair, reasonable, adequate or in the public interest. *Cf. S.E.C. v. Bank Of America Corp.*, 653 F. Supp.2d 507 (S.D.N.Y. 2009) (disapproving a proposed settlement in part because the proposed $33 million fine was "a trivial penalty for a false statement that materially infected a multi-billion-dollar merger"). *But cf. S.E.C. v. Bank Of America Corp.*, ___ F. Supp.2d ____, 2010 U.S. Dist. LEXIS 15460 (S.D.N.Y. Feb. 22, 2010) (approving a $150 million fine even though it would have only "a very modest impact on corporate practices or victim compensation").

Accordingly, the Court should direct DOJ to address this defect in the settlement proposal. Although exactitude is not required, some evidence should be proffered on this point. *See New York v. Julius Nasso Concrete Corp.*, 202 F.3d 82, 88-89 (2d Cir. 2000) ("Where ... there is a dearth of market information unaffected by the collusive action of the defendants, the plaintiff's burden of proving damages, is, to an extent, lightened[,] [and] the State need only provide the court with some relevant data from which the district court can make a reasonable estimated calculation of the harm suffered...") (citations and internal quotations omitted); *id.*, 202 F.3d at 89 ("[T]o do otherwise would be a perversion of fundamental principles of justice [and would] deny all relief to the injured person, and thereby relieve the wrongdoer from making any amends for his acts"); *New York v. Hendrickson Bros., Inc.*, 840 F.2d 1065, 1078 (2d

Cir. 1988) (""The most elementary conceptions of justice and public policy require that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created"") (quoting *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264 (1946)); *Fishman v. Estate of Wirtz*, 807 F.2d 520, 551 (7th Cir. Ill. 1986) ("The concept of a 'yardstick' measure of damages, that is, linking the plaintiff's experience in a hypothetical free market to the experience of a comparable firm in an actual free market, is also well accepted").

CONCLUSION

For the reasons stated above, the Court should direct DOJ to supplement the record to demonstrate why this settlement will prevent such violations in the future.

Respectfully submitted,

Peter McGowan
General Counsel

By: Sean Mullany, Assistant Counsel
Of Counsel
Public Service Commission
of the State of New York
Three Empire State Plaza
Albany, New York 12223-1350
(518) 474-7663

Dated: December 30, 2011
Albany, New York