REPORT ON ELECTRIC MERGER REVIEW BY THE SECTION OF ANTITRUST LAW TO THE ANTITRUST MODERNIZATION COMMISSION

The Section of Antitrust Law of the American Bar Association ("ABA") is pleased to submit these comments to the Antitrust Modernization Commission in response to its request for public comment, dated May 19, 2005, regarding allocation of authority for review of electric power mergers. The views expressed herein are being presented on behalf of the Antitrust Section and have been approved by its Council. They have not been approved by the House of Delegates or the Board of Governors of the ABA and, accordingly, should not be construed as representing the policy of the ABA.

I.

EXECUTIVE SUMMARY

The Section of Antitrust Law recommends that the Antitrust Modernization Commission endorse the Department of Justice ("DOJ") and/or the Federal Trade Commission ("FTC") (together, "Antitrust Agencies") as the primary federal agency to conduct antitrust review of electric power mergers.

Mergers and acquisitions involving electric power assets have been traditionally reviewed by DOJ and the Federal Energy Regulatory Commission ("FERC").[1] Under Section 7 of the Clayton Act, 15 U.S.C. § 18, DOJ analyzes whether the effect of any merger may be "substantially to lessen competition or to tend to create a monopoly." DOJ may also challenge a transaction as an unreasonable "restraint of trade" under Section 1 of the Sherman Act, 15 U.S.C. § 1. Under Section 203(a) of the Federal Power Act ("FPA"), 16 U.S.C. 824b, FERC must approve an electric power merger if it finds that the consolidation "will be consistent with the public

[1] The Report takes no position on which Antitrust Agency should have the primary responsibility for review of electric power transaction. The Report focuses on DOJ's expertise in the area because DOJ has reviewed the majority of transactions involving electric power assets only. Although FTC has concurrent jurisdiction to review such mergers, it has done so primarily in cases involving a combination of natural gas and electric power assets. *See, e.g., DTE Energy Co. & MCN Energy Co.,* FTC Docket No. C-4008 (2001) (direct competition between electricity and natural gas used for cogeneration purposes). *But see United States v. Enova Corp.,* 107 F.Supp.2d 10 (D.D.C.2000) (DOJ review of a merger between a natural gas supplier and an electric power generator).

interest." Among other things, the public interest analysis considers the effect of the transaction on competition.[2]

Although FERC has stated that its antitrust analysis follows that of Antitrust Agencies, in practice FERC's analytical framework departs from the competitive effects analysis employed by DOJ. While DOJ uses concentration statistics as a starting point of its merger analysis, FERC relies on Herfindahl-Hirschman Index ("HHI") thresholds as the main predictor of the merger's likely competitive effects. In cases with significant HHI levels or changes, FERC routinely conditions its merger approval on general HHI-lowering divestitures instead of analyzing whether the merged firm is likely to use specific assets to increase electricity prices.[3] As a result, FERC has conditioned mergers on divestitures that arguably failed to address specific competitive concerns raised by a proposed transaction. FERC has also approved divestitures that were arguably unnecessary because a transaction, despite high concentration statistics, did not raise serious competitive concerns. In contrast, DOJ's competitive effects analysis has led the agency to either order divestitures that were narrowly tailored to fix identifiable competitive concerns, or clear the transaction based on a determination that the merger did not raise serious competitive concerns, despite high concentration levels.

The Section of Antitrust Law recommends that the current dual review be replaced with a single antitrust review to be conducted by DOJ or FTC, as applicable, with FERC providing any necessary assistance based on its industry expertise. On balance, Antitrust Agencies are more experienced with antitrust analysis of mergers across a variety of industries, including the electric power industry. Although FERC has broad industry experience, its narrower HHI–centered analysis does not adequately probe a merger's likely competitive effects and has led to more wooden enforcement in the electric power sector. In addition, dual antitrust review leads to increased transaction and regulatory review costs, without compensating benefit, as well as delays and regulatory uncertainty.

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[2] *Inquiry Concerning the Commission's Merger Policy under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) ("Merger Policy Statement"). In addition, FERC considers the effect of the transaction on rates, the ability of state and federal regulators to retain jurisdiction over the merged firm, and the potential for cross-subsidization of unregulated affiliates. These factors are considered separately from the competition factor. *Id.*

[3] FERC's power to require asset divestitures derives from its conditioning authority under Section 203(b) of the FPA, which provides that FERC may approve a proposed merger "in whole or in part and upon such terms and conditions as it finds necessary or appropriate."

Single antitrust review by an applicable Antitrust Agency will facilitate development of a consistent competition policy in the energy sector, giving energy firms and other market participants a greater degree of certainty and transparency. Moreover, single review will be consistent with the general trend toward a single merger review by an Antitrust Agency, such as in the airline industry where merger review authority was turned over to DOJ in 1989.

II.

DISCUSSION

A. There Are Significant Differences Between FERC's And Antitrust Agencies' Analysis.

1. DOJ Focuses On Competitive Effects Analysis.

Under the Horizontal Merger Guidelines,[4] DOJ focuses its merger analysis on whether the transaction under review is likely to create or enhance market power. DOJ's analytical framework typically encompasses the analysis of: (a) market definition and concentration; (b) potential adverse competitive effects; (c) likelihood of entry; and (d) efficiencies.

"At the center of the [DOJ's] application of the Guidelines . . . is competitive effects analysis," that is, whether the merger may increase market power by facilitating coordinated interaction among rival firms and whether the merger may enable the merged firm unilaterally to raise price or otherwise exercise market power.[5] "[M]arket share and concentration data provide only the starting point for analyzing the competitive impact of a merger."[6] "[M]any mergers falling outside the [concentration thresholds established under the Guidelines] . . . nevertheless, upon full consideration of the factual and economic evidence, are found unlikely substantially to lessen competition."[7]

In assessing potential risks of competitive harm arising from a merger, DOJ considers the views of customers on market structure, the competitive process, and

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[4] U.S. Department of Justice and Federal Trade Commission, The Horizontal Merger Guidelines (1992).

[5] U.S. Department of Justice and Federal Trade Commission, Commentary on the Horizontal Merger Guidelines at 2 (March 2006).

[6] *Id.*

[7] *Id.* at 15-16.

anticipated effects from the merger, as well as information provided by the parties, including voluntarily-supplied economic analyses. DOJ also considers market characteristics using data, documents, and other information obtained from the parties' competitors, as well as relevant databases, academic literature or private industry studies. DOJ often employs formal economic modeling to predict the outcome of the competitive process after the merger.[8]

In the context of the electric power industry, DOJ primarily inquires whether the merged firm could strategically use its electric generation assets to increase electricity prices. DOJ analyzes, for example, whether there are any plausible strategies for withholding supply or creating artificial congestion on the electric power grid within each identified market. In the event that problems are found in the post-merger market structure that cannot be solved by the marketplace itself, DOJ will typically seek divestiture to solve those specific problems. Thus, DOJ requires divestiture of specific units that can either be strategically used by the parties to increase electricity prices or would benefit from such price increases. *See, e.g.*, *United States v. Enova Corp.*, Competitive Impact Statement at 5-9 ("The Final Judgment requires Defendant to sell all generation assets that would likely give PE/Enova the incentive to raise electricity prices," *i.e.*, "lower-cost plants that run most of the time, and as a consequence, would benefit from an increase of the price of electricity. . . . Enova is not required to divest certain generation assets that are not likely to provide an incentive to raise . . . prices.").

2. FERC's Merger Analysis Relies Heavily On HHI Statistics.

FERC's Merger Policy Statement states that the agency's antitrust analysis follows the Horizontal Merger Guidelines.[9] Yet, in practice, FERC's analysis frequently departs from that traditionally employed by DOJ.

To begin with, FERC relies almost exclusively on the parties' so-called Appendix A analysis and public comments filed by intervenors. Unlike DOJ, FERC often does not undertake an independent economic review of the transaction, does not engage in economic modeling, does not seek additional market data from the parties' competitors, and does not consult the parties' customers.[10]

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[8] *Id.* at 9.

[9] Merger Policy Statement, 61 Fed. Reg. at 68,596 n. 3 ("First, our analysis of the effect on competition will . . . adopt the Department of Justice/Federal Trade Commission Merger Guidelines as the analytical framework for analyzing the effect on competition.").

[10] Some of the shortcomings of FERC's merger analysis were noted in FTC staff's comments to FERC a couple of years after FERC's Merger Policy Statement was issued. *Before the Federal Energy Regulatory Commission, 18 CFR Part 33, Revised Filing*

The most serious departure, however, is FERC's heavy reliance on market concentration statistics. The parties' Appendix A analysis, which is the crux of a FERC merger process: (a) identifies the relevant products; (b) identifies geographic markets through the identification of affected customers and potential competing suppliers; and (c) calculates concentration statistics in the identified product/geographic markets. The objective is comparison of the resulting concentration levels with the market concentration thresholds set forth in the Horizontal Merger Guidelines. "[A]n increase of more than 50 HHI in a highly concentrated market or an increase of 100 HHI in a moderately concentrated market fails [the Merger Guidelines'] screen and warrants further review."[11]

Requirements, Docket No. RM98-4-000, Comment of the Staff of the Bureau of Economics of the Federal Trade Commission (Sept. 11, 1998). Thus**:**

> *The primary theme of the FTC staff's comment is that FERC may wish to expand its merger analysis beyond its current strong emphasis on market share information. In a wide variety of instances, the information available to FERC and its staff appears to be substantially more limited in quantity, quality, and scope than the information that can be obtained using the procedures available to the federal antitrust agencies. Accordingly, FERC may wish to pursue authority, as part of its merger review process, to subpoena and hold under strong confidentiality provisions, the following materials: decision, planning, and marketing documents of the merging parties, and related documents of competitors, suppliers, customers and trade associations.*
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> *In addition to improving access to information, the comment indicates seven areas in which FERC may wish to bring its merger filing requirements and analysis of mergers in the electric industry into closer alignment with the information requirements of the DOJ/FTC Horizontal Merger Guidelines.*
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> *With respect to merger analysis technique, the comment suggests that FERC may wish to use computer simulation modeling to evaluate alternative scenarios about future technical, economic and regulatory conditions in its electric industry merger reviews.*

Press Release, Federal Trade Commission, *FTC Staff Files Comment with FERC About Electric Power Industry Merger Filing Requirements* (Sept. 15, 1998), *available at* http://www.ftc.gov/opa/1998/09/fercadv.htm.

11 *Louisville Gas and Electric Co. & LG&E Energy LLC*, 114 FERC ¶ 61,282, at **45 n.47 (relying on Merger Policy Statement). FERC's vertical market power analysis similarly focuses on concentration statistics. According to FERC, "for a merger to create or enhance vertical market power, both the upstream and downstream markets must be highly concentrated." *Revised Filing Requirements Under Part 33 of the Commission's Regulations, Order No. 642,* 65 Fed. Reg. 70,983, at 31,911 (2000), *order on reh'g*, *Order No. 642-A*, 66 Fed. Reg. 16,121 (2001).

To our knowledge, FERC has rarely undertaken an in-depth competitive effects analysis. Instead, the agency has approved divestitures designed to lower the offending HHI thresholds -- namely divestiture of an appropriate amount of generating capacity as measured in megawatts ("MW") -- without inquiring whether any divestiture is actually necessary or, if so, which specific generating units, if any, would be most suitable for divestiture based on identifiable competitive concerns.[12]

In a recent order approving a proposed merger between Exelon and Public Service Enterprise Group ("PSEG"), FERC confirmed that "[t]he Commission's analysis focuses on a merger's effect on competitive conditions in the market. *That is, we look at the merger's effect on the concentration of the relevant markets, as measured by the HHI.*" *Public Service Enterprise Corp., Inc.,* 112 FERC ¶ 61,011, at 61,076 (July 1, 2005) (rejecting "arguments that applicants should have [among other things] analyzed the merger's effect on their ability and incentive to harm competition by engaging in strategic bidding") (emphasis added), *aff'd*, 268 F.3d 1105. FERC stated:

> Protestors argue that Applicants have erroneously interpreted the Commission's HHI screen as an absolute standard for merger authorization and, thus have offered mitigation that is focused solely on passing the screen, rather than on mitigating the merger-related harm to competition. We agree with protestors that the mitigation needs to preserve competition, not necessarily to restore the HHIs to avoid screen violations. . . . [Nonetheless,] Applicants' proposal to divest sufficient capacity to reduce market concentration to within the screening tolerance for increases from the pre-merger concentration level is one reasonable way to mitigate the merger-related harm to competition. . . . [T]he HHI conveys information about the likelihood of both the coordinated and unilateral exercise of market power. By restoring the HHI to near pre-merger levels, Applicants will restore competition to the pre-merger level, and meet their burden to show that the merger, as mitigated, will not harm competition in wholesale energy markets.

Id. See also American Electric Power Co. & Central and Southwest Corp., 90 FERC ¶ 61,242, at 61,201 (2000) (conditioning merger approval on divestiture of 550 MW based on FERC's concurrence with the parties' assessment that the divestiture

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[12] In addition to divestiture, FERC has imposed behavioral remedies such as affiliate transaction rules, open access requirements, and participation in a regional transmission operator. FERC has also heavily relied on market monitors designed to detect anticompetitive behavior by market participants, including the parties, after the merger.

"reduces, for the most part, pre- to post-merger increases in concentration in the affected relevant markets to acceptable levels").[13]

B. The Inconsistencies Between Antitrust Agencies' And FERC's Antitrust Analysis Increase The Risk Of Inconsistent Outcomes.

On several occasions, the differing DOJ and FERC approaches have resulted in an inconsistent antitrust assessment of the same transaction. The most common inconsistency occurs when FERC concludes that, because the transaction exceeds FERC's market power screen, an acquisition is anticompetitive and therefore requires a remedy such as divestiture, while DOJ, following a competitive effects analysis, determines that the transaction does not raise any serious competitive concerns and therefore does not require any remedies.

The examples of such cases are difficult to provide because of the confidentiality aspects of DOJ's merger review process. DOJ publicly announces the fact of an early termination or a consent agreement imposing remedies. DOJ does not publicly announce the fact that, following a merger investigation, it decided to clear the transaction without any remedies. In contrast, the fact of a FERC merger review is publicly known and so is its outcome.

Information is nonetheless available that, for example, after a lengthy investigation, DOJ cleared the 2000 merger between American Electric Power Company ("AEP") and Central and Southwest Corporation ("CSW") without any remedies. In contrast, after its own three-year investigation, FERC conditioned its approval on the parties' divestiture of 550 MW of generating capacity, in addition to other remedies. *See American Electric Power Co. & Central & Southwest Corp.*, 90 FERC ¶ 61,242 (2000).

The pending merger between PSEG and Exelon also involves an inconsistent outcome, although in that case both the regulator and the antitrust enforcer have concluded that the transaction raised significant competitive concerns. The main reason for the inconsistent outcome was that FERC-imposed remedies were designed to lower HHI levels, while DOJ-imposed remedies were tailored to fix identifiable competitive problems raised by the transaction. FERC approved the merger subject to physical divestiture of a total of 4,000 MW of fossil generation,

[13] On occasion, FERC conditioned its merger approval on divestitures ordered by another agency, without undertaking a separate inquiry concerning the suitability of such a remedy. *See, e.g., Sierra Pacific Power Co., Nevada Power Co. & Portland General Electric Co.*, 93 FERC ¶ 61,217 (2000) (divestiture ordered by the Nevada State Commission to be completed as a condition of FERC approval); *Consolidated Edison Co. of New York, Inc. & Orange and Rockland Utilities, Inc.*, 86 FERC ¶ 61,064 (1999) (divestiture plans approved by the New York Public Service Commission)

without specifying the units to be divested. FERC also required the parties to sell output from 2,600 MW of nuclear capacity, characterized as "virtual" divestiture. *Public Service Enterprise Corp., Inc.*, 112 FERC ¶ 61,011 (2005). Under a proposed consent decree, DOJ required the parties to divest twenty six fossil-fueled units at six electricity generating plants, for a total of 5,600 MW. The targeted DOJ-imposed divestitures exceed by 1,600 MW the total divestiture package approved by FERC. DOJ did not, however, require divestiture of nuclear generation, including the virtual divestiture of nuclear capacity required by FERC. *United States v. Exelon Corp*., D.D.C., No. 1:06cv01138 (6/22/06); DOJ 06/22/06 Release, *Justice Department Requires Divestitures in $16 Billion Merger of Exelon and Public Service Enterprise Group, Divestiture of Six Electricity Generating Plants Will Preserve Competition for Customers throughout Mid-Atlantic Region. See also* Exelon News Release, *June 22, 2006 - Exelon and PSEG Announce Agreement with U.S. Department Of Justice.*

C. Continuation Of Dual Antitrust Review Is Inappropriate.

Dual enforcement is always a concern but especially so where the industry regulator, here FERC, does not always tailor its divestitures to specific competitive concerns, as an antitrust agency does. This is especially troubling when even very substantial HHI-lowering divestitures fail to protect competition by failing to fix the competitive issues raised by a particular merger. Because DOJ analyzes competitive effects of a transaction, the possibility of such inadequate DOJ-ordered remedies is less likely.

FERC's merger policy may also lead to unnecessary divestitures in cases where a transaction poses no identifiable competitive concerns. As indicated, this frequently happens if a transaction significantly exceeds applicable HHI thresholds, prompting FERC to approve HHI-lowering divestitures in lieu of analyzing the merger's likely competitive effects. Such unnecessary remedies also fail to enhance competition in the electric power industry as they potentially lower efficiencies stemming from a given transaction and prevent consumers from enjoying such efficiencies.

The dual review also causes delays, especially in larger merger cases where each agency can take as long as a year to conduct its investigation. Because of discovery concerns, merging parties typically wait for the conclusion of the FERC case before making an HSR filing. This can lead to a combined two-year long investigation, or longer if the DOJ review is more protracted. For example, the combined DOJ/FERC review of the AEP/CSW merger took several years. The DOJ investigation took approximately a year, while the FERC investigation took nearly three years.[14]

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14 Under its recently promulgated regulations, the maximum amount of time FERC can take to act on a merger application is 12 months. 18 C.F.R. § 33.11 (2006) (providing

Because the parties made their HSR filing before the conclusion of the FERC case, they also faced the threat of the expiration of the DOJ consent agreement before the completion of FERC's merger investigation. In the case of the Exelon/PSEG merger, the DOJ investigation took over 15 months, while the FERC review took approximately 4 months. Such protracted merger review inevitably increases costs associated with preparation and conduct of two separate antitrust investigations, both by the merging parties and the federal agencies involved.

Finally, inconsistent regulatory outcomes create uncertainty regarding the final shape and the timing of a given transaction, and hamper the parties' ability to plan their business operations.

III.

CONCLUSION

Given the redundancies and weaknesses of the current scheme, continuation of dual antitrust review is not justified. DOJ or FTC, as applicable, should take the primary responsibility for the antitrust review of electric power mergers, with FERC providing guidance based on its industry-specific expertise. On balance, Antitrust Agencies ares more experienced than FERC in the economic analysis of mergers and acquisitions, including mergers involving industries in transition to competitive markets such as the electric power industry. Experience suggests that Antitrust Agencies have a refined understanding of the workings of today's electric power markets, including the effects of regulation on those markets. Most importantly, in cases raising serious competitive concerns, Antitrust Agencies are more likely than FERC to address those concerns by ordering targeted divestitures of assets that are most likely to be used by the parties to raise electricity prices or to benefit from such increases. Because of their detailed analysis of likely competitive effects of a transaction, Antitrust Agencies are also less prone to restricting a pro-competitive transaction based on HHI statistics alone.

At this point, with its focus on market concentration statistics, FERC's antitrust analysis does not reflect modern antitrust analysis and economic thinking. In addition, FERC's review is often based on limited market and company data and is arguably subject to influence by special interest groups, and changing regulatory policies to respond to political pressure. As a result, FERC is more inclined to order inadequate or unnecessary divestitures that fail to enhance competition in the electric power sector. Review by an applicable Antitrust Agency will bring greater

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for expedited procedures for processing of merger applications within 180 days, with 180-day extensions for good cause shown).

transparency to the merger process and provide greater consistency to merger policy throughout the American economy.

Respectfully submitted,

Section of Antitrust Law
American Bar Association