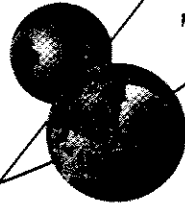


*Antitrust Issues In Electricity
Mergers and Joint Activities*

A Utility Perspective

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C O U N S E L O R S A T L A W

"By the end of 2000, the 10 largest IOUs (investor-owned electric utilities) will own approximately 51 percent of all IOU-owned power production capacity (up from 36 percent in 1992) and the 20 largest IOUs will own approximately 73 percent (up from about 56 percent in 1992). ... Since 1997, 20 mergers between IOUs and natural gas companies have been completed or are pending completion, suggesting a convergence of the electric power and natural gas industries.

U.S. Energy Information Agency, *The Changing Structure of the Electric Power Industry, 1999: Mergers and other Corporate Combinations* (December 16, 1999).

Substantive Issues

- ◆ Merger Statute
 - ❖ Section 7 of the Clayton Act.
 - Prohibits mergers, acquisitions, or joint ventures if their effect "may be substantially to lessen competition."
 - ❖ Section 7 analysis is forward-looking.
 - Actual competition.
 - Potential competition.

DOJ / FTC Horizontal Merger Guidelines

- ◆ Analytical framework used by the agencies.
 - ❖ Guidelines do not specifically address vertical market power concerns that can arise in electric/gas "convergence" mergers.
- ◆ Relevant product and geographic markets.
 - ❖ Wholesale energy markets.
 - ❖ Separate retail power markets.

DOJ / FTC Horizontal Merger Guidelines (cont'd)

- ◆ Market shares
 - ❖ Usually based on various measures of generation capacity
 - ❖ Computer simulation models.
- ◆ Monopsony (buyer power) concerns, e.g., in fuel procurement markets.

Convergence Mergers

- ◆ Consolidations between electric generation companies and their fuel suppliers.
- ◆ Principal antitrust concern is "vertical" market power.
 - ❖ Raising rivals' costs.
 - ❖ Anticompetitive effects in bid situations.

Convergence Mergers (cont'd)

- ◆ Convergence mergers can also raise interfuel competition issues.
 - ❖ Direct competition between electric power and natural gas.
 - ❖ Indirect competition fostered by the emergence of distributed generation.

Pre-Merger Filing Preparation: Reducing The Risk Of A Second Request

- ◆ Begin preparing for the HSR Act premerger notification early.
- ◆ Antitrust counsel should review drafts of competition analyses prepared for the FERC, SEC, and state commissions.
- ◆ Develop a pro-competitive story for the transaction.
 - ❖ Business reasons for the merger
 - ❖ Merger-specific efficiencies or cost savings
 - ❖ Consumer benefits
- ◆ Consider selection of a consulting economist.

Timing Of The HSR PreMerger Filing

Procedural Issues

- ◆ HSR filing may be made anytime after there is a reasonably firm intent between the parties to go forward with the deal.
- ◆ After clearance, the merger or acquisition may be closed at any time within one year.

Timing

- ◆ Because an HSR clearance is only effective for one year, a strategic question is presented in electric power mergers as to when to file.
- ◆ HSR clearance only means that the transaction may go forward.
 - ❖ Not an approval.

Practical Actions At The Time Of HSR Filing

- ◆ Provide DOJ/FTC staff attorney with a courtesy copy of the filing.
- ◆ Provide DOJ/FTC staff attorney with the parties' FERC filing, including affidavits of consulting economists and of any other company or outside experts.
- ◆ Request a meeting with the DOJ/FTC staff attorney and economist early within the initial 30-day waiting period.

Practical Considerations During The HSR Review

The Second Request

- ◆ In most recent energy mergers, the antitrust agencies have issued a Second Request or have suggested re-filing of the HSR.
 - ❖ Second Request extends the 30-day review period.
 - ❖ Alternatively, a voluntary withdrawal and re-filing of the HSR will re-start the 30-day period.

Practical Considerations During The HSR Review (cont'd)

The Second Request

- ◆ An essentially identical Second Request is issued to both parties.
 - ❖ Burdensome set of interrogatories and document requests.
 - ❖ Negotiate with the staff to focus document and data production more narrowly.
- ◆ Second 20 day (in certain circumstances, 10 day) waiting period is triggered following "substantial compliance" by both parties.

Practical Considerations During The HSR Review (cont'd)

- ◆ Agencies can extend this second waiting period by agreement of the parties.
- ◆ At any time, the parties may seek to resolve the agency's competitive concerns through certain remedial actions.
 - ❖ Embodied in a consent order.
 - ❖ Possibility of a "hold separate" order.
- ◆ Remedies may be different from those required by and agreed to with other federal agencies or the states.

Pre-Merger Transition Planning

- ◆ The HSR Act is procedural.
- ◆ Until the companies close the merger, they continue to be independent competitors and are subject to the antitrust laws.
- ◆ HSR pre-merger agreement ("gun jumping") violations potentially risk:
 - (1) monetary sanctions;
 - (2) delay of the merger review.

PreMerger Transition Planning (cont'd)

- ◆ Impermissible premerger coordination and integration may also risk a challenge under Section 1 or 2 of the Sherman Act or Section 5 of the Federal Trade Commission Act.

Questions to Ask

- ◆ What is the competitive significance of the coordinated activity?
- ◆ How strong is the justification for the activity?
- ◆ Would the activity survive a termination of the merger?
- ◆ Does the activity require exchange of sensitive information?

Practical Safeguards

- ◆ Limit exchange of confidential, competitively significant information to selected "transition team" employees.
- ◆ Exchange competitively sensitive information only for the limited purposes of:
 - (1) performing due diligence, and
 - (2) transition planning on an appropriate time-line.
- ◆ Transition *planning* should not extend to actual *implementation*.

Practical Safeguards (cont'd)

- ◆ Exchange of confidential, competitively significant information closer to the time of closing.
- ◆ Consider a confidentiality agreement.
- ◆ Consider use of a "Fire wall."
- ◆ Recognize that documents may be disclosed to regulators/enforcement agencies.

Joint Activities

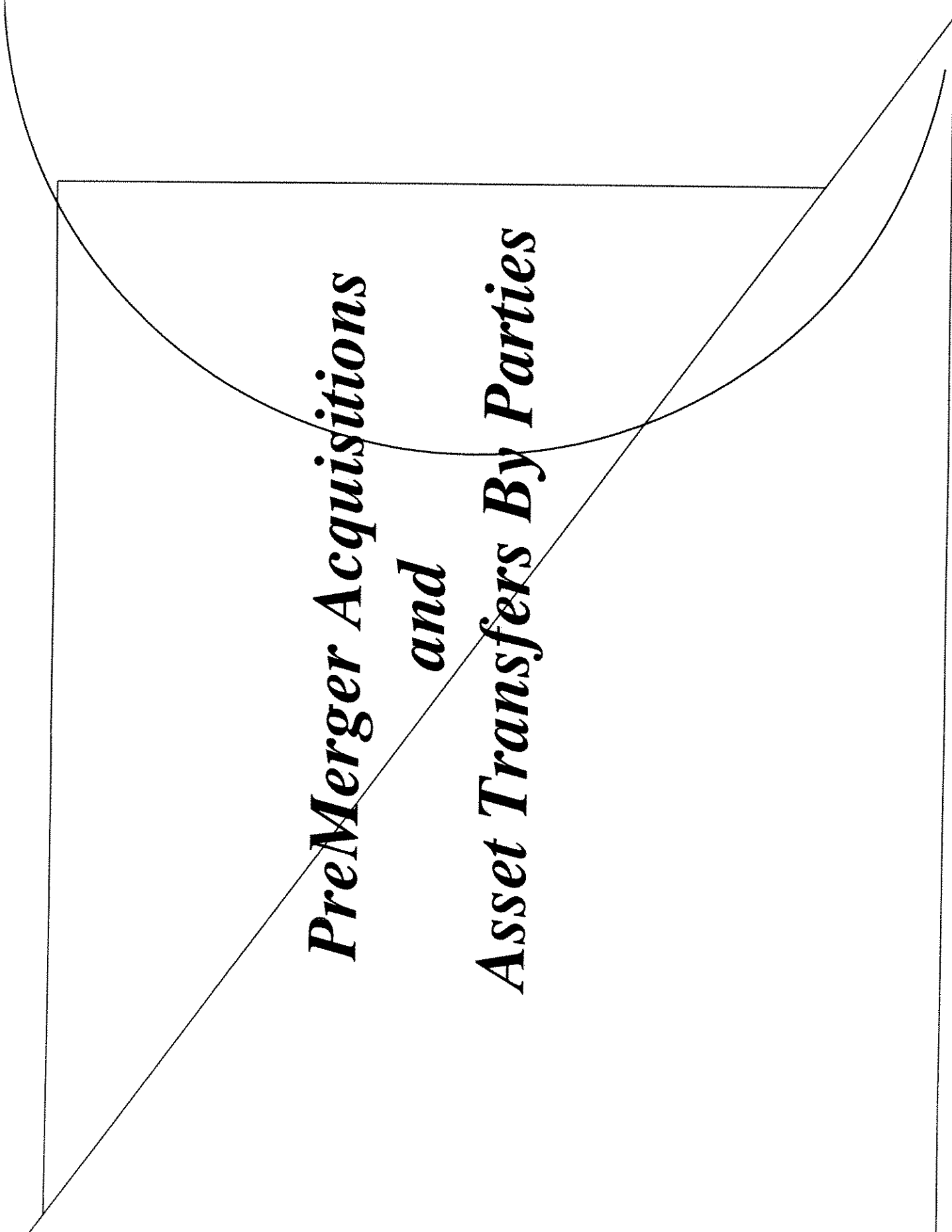
- ◆ Merging parties may undertake joint activities prior to closing.
- ◆ DOJ/FTC Draft Antitrust Guidelines for Collaboration Among Competitors (October 1999).
 - ❖ "Safety zone" for joint activities if parties account for less than 20 percent of relevant market.
- ◆ Subject to "rule of reason" analysis

Joint Purchasing Arrangements

- ◆ "Antitrust safety zone":
 - ❖ If purchases are less than 35% of the total sales of the purchased product or service; and
 - ❖ Cost of the products and services purchased jointly is less than 20% of the total revenues from all products or services sold by each competing participant.

Joint Selling Arrangements

- ◆ Relatively little judicial precedent.
- ◆ Particular issues in the merger context for joint selling:
 - ❖ Exchange of competitively significant information?
 - ❖ Transfer of operational control?



*PreMerger Acquisitions
and
Asset Transfers By Parties*

PreMerger Acquisitions

- ◆ While the antitrust agency is reviewing the transaction under HSR, the parties may enter into other agreements to acquire or sell assets.
- ◆ Each such transaction ordinarily will require a separate HSR filing and antitrust review.

Pre-Merger Acquisitions (cont'd)

- ◆ Additional transactions may or may not affect the ongoing HSR review of the merger or acquisition.
 - ❖ Is the asset located within the relevant geographic market(s)?
 - ❖ Would the asset affect a party's ability to generate and deliver power within the relevant geographic market(s)?
 - ❖ Would the asset transfer affect another power supplier's ability to generate and deliver power within the relevant geographic market(s)?

Pre-Merger Acquisitions (cont'd)

- ◆ Parties should also consider the implications of asset transfers on the competitive analyses submitted to the FERC and the state commissions in connection with the merger.
 - ❖ Would the asset transfer affect the conclusions of the competitive analyses?
 - ❖ Would the Appendix A computer modeling have to be re-done?
 - ❖ Would the regulatory filings required by the transaction provide a forum for intervenors to raise new issues concerning the merger?

Wholesale Power Contracts

- ◆ Outside of the HSR context, long-term wholesale power contracts, even purchase and sales agreements between competitors, ordinarily do not present antitrust risk, so long as the contracts are negotiated on an arm's-length basis and make business sense for both sides.

Wholesale Power Contracts (cont'd)

- ◆ Long-term purchase and sales agreements between the merging parties could have a substantive impact on the HSR review of the merger, and could also affect the FERC's review of the merger.
 - ❖ Appendix A analysis assigns control of capacity to the owners of long-term purchase contracts.
 - ❖ The DOJ or FTC may also make the same assignment.

Conclusions

- ◆ Antitrust analysis in the energy context is still evolving at this initial stage of electricity industry restructuring.
- ◆ Proper preparation is essential to reducing the risk of a Second Request, or limiting the scope and burdens of a Second Request.
- ◆ Even during the HSR review period, merging parties can lawfully engage in a significant amount of transition planning and other collaborative activity, provided appropriate safeguards are instituted and followed.