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Proposed Merger Reform's Effects On FERC Analysis

Law360, New York (July 12, 2010) -- The U.S. Department of Justice and the Federal Trade Commission recently issued proposed revisions to their horizontal merger guidelines. Because the Federal Energy Regulatory Commission's analytical framework for assessing the competitive effects of horizontal electric utility mergers is based on the current DOJ/FTC horizontal merger guidelines, proposed revisions to the guidelines could trigger changes to FERC's horizontal electric utility merger analysis and potentially lead to a significant divergence of merger analysis between FERC and the antitrust enforcement agencies.

FERC's Horizontal Merger Analysis

In its 1996 merger policy statement, FERC identified three factors it will take into account in analyzing proposed electric utility mergers: the effect on competition, the effect on rates and the effect on regulation.

FERC has since supplemented its merger policy statement to consider cross-subsidization effects when analyzing proposed electric utility mergers, but it has retained its primary analytical focus on the competitive effects of proposed electric utility mergers.

In its 1996 merger policy statement, FERC adopted the DOJ/FTC horizontal merger guidelines as the analytical framework for analyzing a proposed electric utility merger's effect on competition in horizontal markets and developed an analytical screen for horizontal competition issues that it included as Appendix A to its merger policy statement.

FERC's Appendix A horizontal competition analysis outlines a five-step analysis based closely on the DOJ/FTC horizontal merger guidelines: (1) assess whether the merger would significantly increase concentration; (2) assess whether the merger could result in adverse competitive effects; (3) assess whether market entry could mitigate the adverse effects of the merger; (4) assess whether the merger will result in efficiency gains not achievable by other means; and (5) assess whether, absent the merger, either party would likely fail, causing its assets to exit the market.

FERC's Appendix A horizontal competition screening mechanism focuses primarily on step 1 of the current DOJ/FTC horizontal merger guidelines analysis: an assessment of whether the merger would significantly increase concentration.

In this step of the analysis, the product and geographic markets likely to be affected by a proposed utility merger are defined and concentration in those markets is measured by use of the Herfindahl-Hirschman Index or other relevant statistical measure.

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Under the 1992 DOJ/FTC horizontal merger guidelines and FERC's Appendix A analysis, if the post-merger HHI is below 1,000, regardless of the change in HHI, the merger is considered unlikely to have an adverse effect on competition.

If the post-merger HHI ranges from 1,000 to 1,800 and the change in HHI is greater than 100, the merger is considered to potentially raise significant competitive concerns, and if the post-merger HHI exceeds 1,800 and the change in HHI exceeds 100, the merger is presumed to create or enhance market power.

If HHI concentration levels exceed the concentration thresholds identified in the 1992 DOJ/FTC horizontal merger guidelines and FERC's Appendix A analysis, the merger applicants must provide further analysis supporting the merger's pro-competitive effects consistent with steps 2 through 5 of the guidelines (competitive effects of merger, mitigation through market entry, efficiency gains, and potential for the failure of one of the merger partners).

Electric utility merger applicants confronted with competitive screen failures also may propose remedial options designed to lessen the competitive effects of the proposed merger, such as transmission expansion, generation divestiture, or other conduct measures.

Proposed DOJ/FTC Revisions to Horizontal Merger Guidelines

On April 20, the DOJ and the FTC released for public comment proposed revised horizontal merger guidelines, which were issued most recently in 1992 with some minor updates in 1997.

In a statement announcing the initiation of the joint agency effort to update the guidelines, FTC Chairman Jon Leibowitz remarked that "[t]he aim of this project will be to demystify the process and provide more accurate guidance than practitioners and the courts have been getting from the guidelines to date."

The agencies conducted several public workshops during late 2009 and 2010 and solicited input to the guidelines revision process from attorneys, academics, economists, consumer groups, and businesses.

The DOJ and the FTC did not scrap the 1992 horizontal merger guidelines in their entirety, but they have proposed to revise them in several very significant ways. The agencies identified numerous proposed changes to the guidelines, including:

- The proposed guidelines state that merger analysis would not use a single framework of analysis or methodology, but would be a fact-specific process in which the agencies would use a variety of techniques and types of evidence to analyze whether a merger may substantially lessen competition.

- The proposed guidelines introduce a new section on "Evidence of Adverse Competitive Effects" that discusses several categories and sources of evidence that the agencies have found informative in predicting the likely competitive effects of mergers.

- The proposed guidelines state that market definition is not an end itself or even a necessary starting point of merger analysis, but instead a tool that is useful or necessary only to the extent it illuminates the merger's likely competitive effects.

- The proposed guidelines provide an updated explanation of the "hypothetical monopolist test" used to define relevant antitrust markets and how the agencies implement that test in practice.

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- The concentration levels that are likely to warrant either further scrutiny or challenge from the agencies are updated in the proposed guidelines.

The proposed guidelines note that the agencies generally will classify markets as “unconcentrated” where the HHI level is below 1,500, as “moderately concentrated” when the HHI level is between 1,500 and 2,500, and as “highly concentrated” when the HHI level is above 2m500.

The proposed guidelines state that mergers involving an HHI increase of less than 100 or mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily will not require any further analysis; that mergers resulting in moderately concentrated markets that involve an HHI increase of more than 100 potentially raise significant competitive concerns and often will warrant scrutiny; and that mergers resulting in highly concentrated markets that involve an HHI increase of between 100 and 200 potentially raise significant competitive concerns and often will warrant scrutiny, while mergers resulting in highly concentrated markets that involve an HHI increase of more than 200 points will be presumed likely to enhance market power.

Impact of the Revised Horizontal Merger Guidelines on FERC’s Merger Analysis

FERC has not publicly commented on the revised DOJ/FTC horizontal merger guidelines, so FERC’s reaction to them is not known. It seems likely, however, that FERC may need to consider updating its standard Appendix A horizontal electric utility merger analysis, which closely tracks the 1992 DOJ/FTC horizontal merger guidelines.

By diminishing the role of the HHI and focusing on the types of evidence and various analytical techniques that the antitrust agencies will rely on, the DOJ and the FTC appear to be trying to provide themselves with greater flexibility in merger analysis.

Rather than prescribe the use of a single methodology for assessing horizontal mergers, or setting out a clear hierarchy of standards for decision-making, the proposed guidelines would employ a fact-specific process, using a variety of new analytical tools to analyze a proposed merger’s competitive effects.

These tools would include the upward pricing pressure test, analysis of consumer purchase switching patterns, diversion ratios and critical loss approaches, none of which FERC has used in the past and some of which could be difficult to apply in the context of energy industry mergers and joint ventures.

The proposed guidelines also would update the HHI concentration levels that will flag the existence of potential or presumptive competitive effects in a proposed merger and trigger the need for further scrutiny or remedial measures.

Unless updated, FERC’s Appendix A analysis, based on the more rigid prescriptions of the 1992 guidelines and reflecting those guidelines’ concentration levels, will not reflect the revised approach of the DOJ and the FTC.

While the 2005 enactment of the Energy Policy Act of 2005 and repeal of the Public Utility Holding Company Act of 1935 gave rise to an anticipation in the energy industry and financial community of a wave of utility mergers, countervailing forces, including heightened state regulatory scrutiny of proposed utility mergers and the weakened economy in recent years, have kept that wave from breaking. With the economy in revival, however, energy industry merger activity could accelerate.

The prospect is now present, though, of a potentially significant divergence in merger analysis between FERC and the antitrust agencies in the event the DOJ and the FTC adopt the revised horizontal merger guidelines and FERC does not. Such divergence may complicate and perhaps hinder efficient and successful deal-making in the industry.

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