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Implications of the DOJ/FTC Revised Merger Guidelines On FERC's Merger Analysis



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Summary of Presentation

- Overview of the DOJ/FTC Merger Guidelines
- FERC's Current Horizontal Merger Analysis
- Revised DOJ/FTC Merger Guidelines
- Implications of Revised DOJ/FTC Merger Guidelines on FERC's Merger Analysis
- Q&A

Overview of the DOJ/FTC Merger Guidelines

- **What is a “horizontal” merger?**
 - A “vertical” merger?
 - A “convergence” merger?
- **Statutory framework for DOJ/FTC merger jurisdiction**
 - Clayton Act § 7
 - Sherman Act § 1
 - FTC Act § 5
- **Core elements of 1992 DOJ/FTC Merger Guidelines**
 - Market definition and concentration
 - Potential adverse competitive effects
 - Entry analysis
 - Efficiencies
 - Failing and exiting assets

The Hart-Scott-Rodino Antitrust Improvements Act



- Established the federal premerger notification program, which provides the FTC and the Department of Justice with information about large mergers and acquisitions before they occur.
- The parties transactions above specified thresholds must submit “HSR forms” to the FTC and DOJ.
- The parties may not close their deal until the waiting period outlined in the HSR Act has passed, or the government has granted early termination of the waiting period.

HSR Thresholds

- As a general rule, the HSR Act requires both acquiring and acquired persons in mergers, acquisitions, or certain other transactions to file pre-closing notifications if the following *post-adjustment* jurisdictional thresholds are met:
 1. One person has net sales or total assets of at least \$126.9 million
 2. The other person has net sales or total assets of at least \$12.7 million, and
 3. As a result of the transaction, the acquiring person will hold an aggregate amount of stock and assets of the acquired person valued at more than \$63.4 million.

OR

- As a result of the transaction, the acquiring person will hold an aggregate amount of voting securities and assets of the acquired person valued at more than \$253.7 million, regardless of the sales or assets of the acquiring and acquired persons.

The HSR Forms

- The HSR Form, formally known as the “Notification and Report Forms for Certain Mergers and Acquisitions” requires parties to provide certain information about the transactions, their business activities, and potential overlap in their business activities.
- Item 4(c) of the HSR Form also requires the parties to produce to the agencies any "studies, surveys, analyses and reports that were prepared by or for any officer(s) or director(s) (or in the case of unincorporated entities, individuals exercising similar functions) for the purpose of evaluating or analyzing the acquisition with respect to market shares, competition, competitors, markets, and potential for sales growth or expansion into product or geographic markets."
 - Essentially all high-level documents discussing the proposed transaction and any potential impact on competition.

The HSR Process: Initial Review

- After filing, the parties may not close the transaction until the statutorily defined waiting period expires.
 - For most transaction, the waiting period is 30 days.
 - Certain acquisitions by means of a cash tender offer, as well as acquisitions subject to certain federal bankruptcy provisions are subject to a 15 day waiting period.
- Any filing party may request early termination. transactions. Requests for early termination typically are granted within two weeks from the beginning of the waiting period.
- The waiting period is automatically extended if the agency reviewing the transaction issues a request for additional information or documentary material.
- HSR forms and submitted documents are confidential and will not be released by DOJ/FTC, absent litigation concerning the transaction.

The HSR Process: Second Requests

- Either the FTC or the DOJ may issue a request for additional information or documents. These requests are commonly referred to as “second requests.”
- A typical second request will include interrogatory-type questions as well as requests for the production of documents. The interrogatories and document requests are intended to provide the agency reviewing the transaction with additional information regarding areas of potential overlap or diminished competition.
- There is no deadline for the parties to comply with the second request, but the transaction cannot close until 30 days after the parties have complied with the second request.
- Within 30 days of the parties complying with the second request, the reviewing agency must either file a complaint in federal court seeking to enjoin the merger or do nothing and permit the transaction to close.

Horizontal Merger Guidelines

- Joint DOJ/FTC guidelines stating the agencies' current enforcement policies
- These guidelines articulate the analytical framework the agencies apply in determining whether a merger is likely to substantially lessen competition
- On August 19, 2010, the FTC and DOJ released revised Horizontal Merger Guidelines to bring them in line with agencies' current policies and approaches. The guidelines were last extensively updated in 1992.

FERC's Current Horizontal Merger Analysis

- **FERC's authority over electric utility mergers**
 - FPA § 203(a)
 - As amended by Energy Policy Act of 2005, imposes obligations on public utilities and holding companies to obtain FERC authorizations for certain mergers and transactions
 - Focus here will be on utility and holding company mergers

FERC's Current Horizontal Merger Analysis (cont.)

- **Pre-EPA Act 2005 FPA 203**
 - FERC authorization required for public utility mergers and sales, leases, and other dispositions of public utility facilities
 - FERC obligated to approve jurisdictional transaction if it finds transaction “consistent with the public interest”
- **1996 Merger Policy Statement**
 - Stated purpose of 1996 Merger Policy Statement:
 - Ensure that future mergers are consistent with competitive goals of Energy Policy Act of 1992 (which promoted competition in wholesale power markets and expanded FERC authority to order transmission open access) and Order No. 888
 - Establish procedural innovations to allow FERC to act more quickly on merger approval applications

FERC's Current Horizontal Merger Analysis (cont.)

- **Pre-Merger Policy Statement Non-Exclusive Merger Criteria**
 - Effect of proposed merger on competition
 - Effect of proposed merger on applicants' operating costs and rate levels
 - Reasonableness of purchase price
 - Whether acquiring utility coerced the to-be-acquired utility into acceptance of the merger
 - Impact of merger on the effectiveness of state and federal regulation
 - Contemplated accounting treatment
- **Mergers' effects on competition, costs, and rates typically are the most controversial issues**

FERC's Current Horizontal Merger Analysis (cont.)

- **1996 Merger Policy Statement Adopted Three Primary Factors for Consideration in FPA § 203 Proceedings**
 - Effect on competition
 - Effect on rates
 - Effect on regulation
- **2007 Supplemental Merger Policy Statement per EPAct 2005 Changes to FPA § 203**
 - Consideration of transaction-related cross-subsidization
 - Available mitigation measures to address cross-subsidization
 - Blanket authorizations under FPA § 203
 - Continued application of Appendix A analysis for transactions that raise competition issues

FERC's Current Horizontal Merger Analysis (cont.)

- **In Merger Policy Statement, FERC adopted DOJ/FTC Horizontal Merger Guidelines as “analytical framework” for analyzing a transaction’s effect on competition**
- **FERC’s 5-step analysis based on DOJ/FTC Horizontal Merger Guidelines**
 - Will merger significantly increase concentration in defined markets?
 - Will merger result in adverse competitive effects?
 - Could market entry mitigate adverse effects of merger?
 - Could merger result in efficiency gains?
 - Absent merger, would either party fail?
- **FERC’s Merger Analysis is detailed in Merger Policy Statement’s “Appendix A Analysis”**

FERC's Current Horizontal Merger Analysis (cont.)

• Appendix A Analysis – Analytical Steps

1. Define affected product markets: products sold by merger entities
2. Define affected geographic markets: customers likely to be affected by merger
3. Define affected geographic markets: suppliers that can compete to supply products to affected customers
4. Measure concentration in affected product and geographic markets and changes in concentration caused by merger using defined Herfindahl-Hirschman Index (“HHI”) standards or other relevant statistical measures
 - a. If post-merger HHI is <1000 regardless of HHI change, merger unlikely to have adverse competitive effect
 - b. If post-merger HHI between 1000 to 1800 and change >100 , merger potentially raises significant competitive concerns
 - c. If post-merger HHI >1800 and change >100 , merger is presumed to create or enhance market power

FERC's Current Horizontal Merger Analysis (cont.)

- **Effect of Appendix A Analysis**
 - If HHI levels exceed concentration thresholds, merger applicants required to provide further analysis (e.g., delivered price test) showing merger's pro-competitive effects (e.g., enhanced market entry for competitors, efficiency gains, etc.) or propose mitigation measures (e.g., transmission expansion, generation divestiture, etc.)
- **Appendix A Analysis in a Word: Inflexible**

Horizontal Merger Guidelines: 2010 Revisions

- **New Statement of Flexible Analysis:**
 1. The 1992 Guidelines set out a sequential process the agencies were to follow in analyzing mergers. The agencies have moved away from this sequential analysis and its focus on market definition and concentration.
 2. Instead, the revised Guidelines state that merger analysis involves a “fact-specific process through which the Agencies...apply a range of analytical tools.”

Horizontal Merger Guidelines: 2010 Revisions (cont.)

- **Evidence to be Used in Merger Analysis:** The revised Guidelines identify
 1. Types of evidence the agencies often find informative, including: post-closing price increases; historical analogues in similar or adjacent markets; market shares and concentration levels; and
 2. Sources of helpful information, including: documents; testimony; data from the merging parties, customers, and competitors.
 3. The revised Guidelines emphasize that the agencies will use a range of analytical tools and evidence in merger reviews.

- **Importance of Market Definition Minimized**
 1. The 1992 Guidelines and court precedent generally begin merger analysis with defining the relevant product and geographic market.
 2. The revised Guidelines minimize the importance of market definition, stating that it is simply a “useful” exercise but “is not an end of itself” and the agencies’ analysis need not start with market definition.

Horizontal Merger Guidelines: 2010 Revisions (cont.)

- **Greater Focus on Price Discrimination:** The revised Guidelines describe how the agencies analyze price discrimination, which occurs when suppliers charge higher prices to certain customers, and explain that such discrimination is feasible where:
 1. Suppliers can identify different classes of customers to charge different prices; and
 2. Customers cannot protect themselves from price discrimination by, for example, buying the product from other customers rather than from the supplier.
 3. Capability or exercise of price discrimination would be used in analyzing whether product or service markets are separate, in terms of demand or geography.

- **Location of Customers in Geographic Market Definition:**

1. The 1992 Guidelines primarily base geographic market definition on the location of suppliers.
2. The revised Guidelines state that geographic markets may also be defined by reference to customer location, such as where price discrimination based on customer location is feasible.

Horizontal Merger Guidelines: 2010 Revisions (cont.)

- Upward Adjustment of Market Concentration Thresholds:**
 The agencies evaluate market shares and concentration by using the Herfindahl-Hirschman index of concentration (“HHI”) and consider the post-merger HHI and the HHI increase resulting from a proposed merger. The revised Guidelines raised the HHI levels at which the agencies will presume the transaction poses a potential threat to competition.

Market Characterization	1992 Guidelines		2010 Guidelines	
	Post-merger HHI	HHI Increase	Post-merger HHI	HHI Increase
Unconcentrated	<,1000	Irrelevant: Anticompetitive Effects Unlikely	<,1500	Irrelevant: Anticompetitive Effects Unlikely
Moderately Concentrated	1,000-1,800	<100: Anticompetitive Effects Unlikely >100" Potentially Raise Significant Concerns	1,500-2,500	<100: Anticompetitive Effects Unlikely >100: Potentially Raise Significant Concerns
Highly Concentrated	>1,800	<50: Anticompetitive Effects Unlikely 50-100: Potentially Raise Significant Concerns >100: Market Power Presumed Likely	>2,500	<100: Anticompetitive Effects Unlikely 100-200: Potentially Raise Significant Concerns >200: Market Power Presumed Likely

Horizontal Merger Guidelines: 2010 Revisions (cont.)

- **Unilateral Effects Analysis:** The revised Guidelines present the agencies' view of unilateral effects—that post-merger, a single firm may have the ability to raise prices, lower output, or reduce innovation. The revised Guidelines eliminate the presumption that a post-merger market share of 35% indicates unilateral effects are likely.
- **Coordinated Effects Analysis:** Similarly, the revised Guidelines state the agencies' view of coordinated effects—that a post-merger market with few remaining firms is ripe for collusion that could raise prices or reduce output. Factors suggesting that coordinated effects are more likely include: evidence of past collusion attempts; transparency of market pricing; and market structures that enable firms to punish competitors for lowering prices or raising output.
- **Upward Pricing Pressure Test:** Proposed use of new test, suggesting concern regarding a proposed merger if it can be considered likely to result in price increases.

Horizontal Merger Guidelines: 2010 Revisions (cont.)

- **Monopsony Power:**
 1. The revised Guidelines include a discussion of mergers that may create or enhance monopsony power—market power by competing *buyers* of products—and treat them the same as mergers among competing suppliers.
 2. The Guidelines also acknowledge that mergers among buyers may lead to efficiencies in operations.
- **Ease of Entry:** Former bright-line test of potential new entry within two years as mitigating any potential anticompetitive effects replaced with indefinite “rapid entrance” standard.
- **Non-Price factors:** Statements that non-price potential effects of a transaction, such as quality, service, variety, and innovation, could be part of a competitive effects analysis also increase unpredictability of merger analyses, especially since no framework for analysis of these factors is set out.

Horizontal Merger Guidelines: 2010 Revisions (cont.)

- **Partial Acquisitions:** For the first time, the revised Guidelines address the agencies' analysis of partial (i.e., minority) acquisitions of competitors, explaining that the agencies are concerned about three things:
 1. Acquirers having the ability to influence the target's competitive conduct through voting interests, governance rights, or board seats;
 2. Acquirers having diminished incentive to compete with the target because, for example, the acquirer shares in any sales gains and losses by the target; and
 3. Acquirers gaining access to nonpublic competitively sensitive information about the target and vice versa.

DOJ/FTC Practical Merger Enforcement Issues

- **Current DOJ/FTC practical issues affecting merger enforcement include:**
 1. Continuing focus on energy industry mergers and joint ventures because of Administration and Congressional concerns regarding potential impact on prices to consumers.
 2. Reported shift at DOJ Antitrust Division of power to political appointees for operations, to more directly control staff investigations. (Daily Deal at 4, October 8, 2010)
 3. Greater likelihood of review and Second Requests in part because of steep decline in merger filings.
 - FTC HSR 2009 Annual Report, released October 1, 2010, notes a decline of 59% in HSR filings from 2008 to 2009, but an increase to 4.5% from 2.5% in Second Requests and an increase to 4.3% from 2.1% in court challenges.
 4. Greater uncertainty in DOJ/FTC merger reviews in view of use of more, and unprioritized, factors than the 1992 Guidelines.

Implications for FERC Merger Policy Analysis

- **How do revised DOJ/FTC Merger Guidelines vary from FERC's Merger Policy Analysis?**
 - Enhanced flexibility applying a range of analytical tools in place of rigid sequential analysis
 - Greater focus on price discrimination
 - Reduced importance on market definition, which is “useful” but “not an end of itself” nor the analytical starting point
 - Reduced reliance on absolute HHI levels and upward adjustment of HHI levels that prompt further scrutiny
 - Adoption of Unilateral Effects Analysis and Coordinated Effects Analysis
 - Attention to monopsony power
 - Enhanced focus on evidence and analytical techniques

Implications for FERC Merger Policy Analysis (cont.)

- **Challenges in adapting FERC Merger Guidelines to revised DOJ/FTC Merger Guidelines**
 - FERC does not have experience applying new analytical tools
 - Analytical tools may be difficult to apply in energy industry
 - Updated HHI levels are higher than HHI levels under Appendix A analysis

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