Multi-Jurisdictional Merger Investigations: A Case Study of The Equitable-Dominion Resources Transaction

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A. Factual Background

1. In 1999, PUC denied Equitable's application to expand its service territory and compete with other utilities because "gas-on-gas distribution competition in overlapping service territories is wasteful and a duplication of fixed distribution facilities"

2. However, unique situation in Pittsburgh where there have been overlapping pipelines. As a result, 500 commercial and industrial customers have negotiated below cost-of-service discounts

3. Since utilities are supposed to recover their costs and earn a reasonable rate-of-return, 99.9% of 600,000 customers pay higher rates to make up the revenues lost due to discounts provided to .1% of customers

4. PA Legislature gave PUC comprehensive authority to regulate LDCs

   a. PA PUC ensures "just and reasonable" rates and determines extent of competition, if any, permitted

5. PA Legislature also gave PUC full authority to review and either approve or reject utility mergers. Equitable was required by PA law to obtain certificate of public convenience from PA PUC to make acquisition

   a. PUC can grant certificate of public convenience for a utility merger only if it is substantially in public interest

6. Under PA law, PUC is required to consider utility merger's impact on all affected parties, not just on one particular group or geographic subdivision

7. Parties applied to PUC

8. PUC's ALJ received comments and testimony from numerous interested parties, reviewed briefs and conducted hearings

   a. Commercial and industrial customers that currently have discounts submitted objections

   b. After weighing all of evidence, ALJ concluded that transaction will substantially benefit the public

   c. Ruled that gas-on-gas distribution competition is contrary to PA public policy because leads to discriminatory discounts that benefit a few customers and are subsidized by higher rates paid by all other customers

   d. PUC affirmed finding that transaction would be substantially in public interest

   e. PUC specifically found that ending gas-on-gas distribution competition will be a benefit of transaction:

   "To continue to allow contract customers the ability to maintain their current rates would be to allow discriminatory treatment to continue. . . . Currently, due to gas-on-gas distribution competition, contract customers' rates are below the cost to serve, and the deficit is paid for by the non-contract customers. This is precisely what needs to be reversed."

   f. PUC also relied on the substantial cost savings and efficiencies produced by transaction

9. At same time, FTC was investigating through Second Request process

   a. By a 4-1 vote, FTC disagreed with parties about merits and state action immunity, and authorized complaint

b. After PUC approved transaction, FTC filed for preliminary injunction in Pittsburgh federal court because the discounts to the 500 commercial and industrial customers would be eliminated

10. In May, 2007, District Court granted motion to dismiss holding that state action immunity doctrine bars the FTC's claims

a. FTC appealed to 3rd Circuit

11. Appeal focused on interpretation of Supreme Court's two-part test in *Midcal* for application of state action immunity to actions taken by private parties

a. "First, the challenged restraint must be one clearly articulated and affirmatively expressed as state policy."

b. "Second, the policy must be actively supervised by the state itself."

12. Equitable eventually terminated deal while appeal was pending because of length of litigation process

a. HSR filing made in March 2006

b. PA PUC approval granted in April 2007

c. Appeal still pending in January 2008

d. Prospect of further appeals even if parties prevailed

B. Strategy for Simultaneous Regulatory and FTC Investigations

1. Equitable's initial strategy was to expedite PA PUC approval process

a. Required for state action immunity defense

2. Antitrust investigation commenced when FTC issued Second Request in April 2006

3. FTC's focus – potential anticompetitive effects vs. efficiencies and cost savings

4. Burden is on parties to demonstrate efficiencies and cost savings outweigh potential anticompetitive effects

   a. Buyer primarily responsible for demonstrating efficiencies

5. Equitable's strategy for handling simultaneous PUC application process and FTC investigation

   a. Equitable's concern about making commitments to PUC

   b. Delay in developing and presenting support for efficiency and cost savings justification

   c. Delay in having economist prepare report

   d. Was this strategy a good idea?

C. Reasons for Application of State Action Immunity Doctrine

1. Primary purpose of antitrust laws is to protect consumer welfare

2. On the other hand, LDCs provide necessary utility services to the public. PA PUC heavily regulates gas distribution companies to ensure that the public interest is protected when they provide these utility services. This is a traditional area of state regulation and utilities typically have monopolies in their exclusive territories. As part of this regulatory scheme, gas utility mergers can be approved by PUC only if PUC finds that they will be substantially in the public interest.

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a. There was a battle here between the state's public interest determination and the federal government's judgment about consumer welfare under the antitrust laws

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b. Under our federal system, when a state regulatory agency decides that an activity is substantially in the public interest of its citizens, should the antitrust laws still apply? Which judgment should prevail?

c. The purpose of antitrust laws is to protect competition, but Supreme Court created the state action immunity doctrine because antitrust laws are not supposed to limit or infringe on the sovereign power of the states to regulate their economies.

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d. In fact, under our fundamental principles of federalism, the state action immunity doctrine sets forth the circumstances in which the federal antitrust laws are superceded by state regulatory programs. This wholly intrastate transaction in a market that is subject to comprehensive state regulation falls squarely within the state action immunity doctrine because the state is exercising its power to regulate its economy. The state legislature has delegated full regulatory authority to the

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PUC in an area of traditional state regulation, and this transaction is a product of that state policy and regulatory process. As a result, the judgment of the state should be respected and antitrust laws should not apply.