UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Control and Affiliation for Purposes of the Commission's Market-Based Rate Requirements Under Section 205 of the Federal Power Act and the Requirements of Section 203 of the Federal Power Act	))))	Docket No. RM09-16-000

COMMENT OF THE FEDERAL TRADE COMMISSION

March 29, 2010

On January 21, 2010, the Federal Energy Regulatory Commission (FERC) issued a Notice of Proposed Rulemaking (NOPR) that would amend its regulations in two respects.[1] First, it would expand blanket authorizations under Section 203 of the Federal Power Act (FPA), 16 U.S.C. § 824b, for acquisitions and transfers of certain voting securities. Second, it would modify the definition of "affiliate" under Part 35 of FERC's regulations concerning the standards for grants of market-based rate authority under Section 205 of the FPA, 16 U.S.C. § 824d. Pursuant to FERC's NOPR inviting comments, the Federal Trade Commission (FTC) respectfully recommends that FERC strengthen the proposed rule's certifications to protect against the adverse risks associated with changed competitive incentives caused by partial acquisitions, especially among competitors.

In particular, FERC proposes new blanket authorizations for the acquisition or transfer of voting securities where a holding company or person (hereafter "acquirer") (1) holds 10 percent or more but less than 20 percent of the outstanding voting securities of an issuer and (2) submits an Affirmation, new Form 519-C, certifying that the purpose or effect of the acquisition is not to

[1] When published in the Federal Register, the NOPR set March 29, 2010, as the due date for comments. 75 Fed. Reg. 4498 (Jan. 28, 2010).

change the influence or control over the issuer. The new blanket authorizations would exempt the acquirer or the issuer, or both, from having to make certain filings under Section 203, including showing that the transaction does not adversely affect competition. In addition, the acquirer or issuer, or both, would not be deemed "affiliates" for purposes of market-based rate analyses under Section 205, thus allowing them to treat their generation assets as not under common ownership or control.

The NOPR is a follow-up to an earlier FERC inquiry regarding a clarification request filed by the Electric Power Supply Association (EPSA) that FERC (1) expand the blanket authorizations in a manner similar to that described above and (2) afford parties to such transactions an exemption from certain regulatory requirements, including competition analyses, associated with acquisitions of voting securities and authorizations for market-based rates.[2] EPSA proposed to permit such exemptions where, among other things, the acquirer files Securities and Exchange Commission (SEC) Schedule 13G expressing its intent not to acquire control of an issuer.

The FTC submitted a comment on the EPSA request on April 28, 2009,[3] expressing concern that EPSA's proposal, as well as comments submitted to FERC regarding the proposal, placed too much emphasis on the role of control, or its absence, in the competitive analysis, with

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[2] *Control and Affiliation for Purposes of the Commission's Market-Based Rate Requirements under Section 205 of the Federal Power Act and the Requirements of Section 203 of the Federal Power Act*, Docket No. PL09-3-000.

[3] Federal Trade Commission, Comment before the Federal Energy Regulatory Commission on *Control and Affiliation for Purposes of the Commission's Market-Based Rate Requirements under Section 205 of the Federal Power Act and the Requirements of Section 203 of the Federal Power Act*, Docket No. PL09-3-000 (Apr. 28, 2009), *available at* http://www.ftc.gov/os/2009/05/V090008ferccomment.pdf.

little discussion of the incentive effects associated with partial acquisitions. The FTC also expressed concerns about the possible increased risks of coordinated interaction from such investments. The FTC showed that legal and economic scholarship, judicial decisions, and the work of the federal antitrust agencies consistently teach that partial acquisitions can change the competitive *incentives* of the acquiring and acquired firms, even when the acquiring firm does not gain *control or influence* over the acquired firm. Such transactions can also create opportunities and incentives for information sharing that facilitates collusion. The FTC urged FERC to avoid adopting policies that assess competitive effects based only on the presence or absence of control or influence and that thus foreclose examination of the non-control-related competitive effects associated with partial acquisitions.

The proposed Form 519-C includes behavioral prohibitions, such as certifications that the acquirer will not have representation on the issuer's board or receive non-public information from the issuer. These certifications may provide some behavioral protections against the anticompetitive effects resulting from the acquirer's control or influence over the decisions of the issuer or receipt of competitively sensitive information. FERC, however, has not addressed the central concern expressed in our earlier comment: the potential diminution in the acquirer's and the issuer's *incentives* to compete.

As shown below, the incentive effects associated with partial acquisitions are cognizable and serious, but they can be addressed. FERC should add two certifications to those already proposed: (1) that the acquirer does not compete in the same product and geographic markets as the issuer and (2) that the acquirer does not own or control inputs to the production of electric energy in the same product and geographic markets in which the issuer participates. These certifications would provide structural protections against the adverse incentive effects

associated with partial acquisitions. They would also reinforce the behavioral restrictions proposed by FERC to impede an acquirer's control or influence over the issuer.

Interest of the FTC

The FTC is an independent agency of the United States Government responsible for maintaining competition and safeguarding the interests of consumers, both through enforcement of the antitrust and consumer protection laws and through competition policy research and advocacy. The FTC often analyzes regulatory or legislative proposals that may affect competition or allocative efficiency in the electric power industry. The FTC also reviews proposed mergers that involve electric and natural gas utility companies, as well as other parts of the energy industry. In the course of this work, as well as in antitrust and consumer protection research, investigation, and litigation, the FTC applies established legal and economic principles and recent developments in economic theory and empirical analysis.

The energy sector, including electric power, has been an important focus of the FTC's antitrust enforcement and competition advocacy.[4] The FTC's competition advocacy program has produced two staff reports on electric power industry restructuring issues at the wholesale

[4] *See*, *e.g.*, Deborah Platt Majoras, Chairman, Federal Trade Commission, Opening Remarks at the FTC Conference on *Energy Markets in the 21st Century: Competition Policy in Perspective* (Apr. 10, 2007), *available at* http://www.ftc.gov/speeches/majoras/070410energyconferenceremarks.pdf. FTC merger cases involving electric power markets have included *DTE Energy/MCN Energy* (2001) (consent order), *available at* http://www.ftc.gov/os/2001/05/dtemcndo.pdf; and *PacifiCorp/Peabody Holding* (1998) (consent agreement), *available at* http://www.ftc.gov/os/1998/02/9710091.agr.htm. (The FTC subsequently withdrew the *PacifiCorp* settlement when the seller accepted an alternative acquisition offer that did not pose a threat to competition.)

and retail levels.[5] The FTC staff also contributed to the work of the Electric Energy Market Competition Task Force, which issued a *Report to Congress* in the spring of 2007 (*available at* http://www.ferc.gov/legal/fed-sta/ene-pol-act/epact-final-rpt.pdf). In addition, the FTC has held public conferences on energy topics, the most recent of which was *Energy Markets in the 21st Century* on April 10-12, 2007.[6]

The FTC has commented on numerous FERC and state initiatives regarding wholesale and retail electricity market structures and rules, including FERC's proceedings regarding competition in wholesale and organized electricity markets.[7] In December 2009, the FTC submitted comments in FERC's proceedings on possible elements of a National Action Plan on Demand Response (Docket No. AD09-10-000)[8] and on transmission planning processes (Docket

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[5] FTC Staff Report, *Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform: Focus on Retail Competition* (Sept. 2001), *available at* http://www.ftc.gov/reports/elec/electricityreport.pdf; FTC Staff Report, *Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform* (July 2000), *available at* http://www.ftc.gov/be/v000009.htm (compiling previous comments that the FTC staff provided to various state and federal agencies).

[6] Conference materials are available at http://www.ftc.gov/bcp/workshops/energymarkets/index.shtml. Other programs have included the FTC's public workshop on *Market Power and Consumer Protection Issues Involved with Encouraging Competition in the U.S. Electric Industry*, held on September 13-14, 1999 (workshop materials *available at* http://www.ftc.gov/bcp/elecworks/index.shtm); and the Department of Justice and FTC Electricity Workshop, held on April 23, 1996.

[7] *See*, *e.g.*, Federal Trade Commission, Comment before the Federal Energy Regulatory Commission on Wholesale Competition in Regions with Organized Electric Markets (Apr. 17, 2008), *available at* http://www.ftc.gov/be/v070014b.pdf. A listing of FTC and FTC staff competition advocacy comments to federal and state regulatory agencies (in reverse chronological order) is available at http://www.ftc.gov/opp/advocacy_date.shtm.

[8] This comment is available at http://www.ftc.gov/os/2009/12/V100002ferc.pdf.

No. AD09-8-000).[9] Earlier this month, the FTC submitted a reply comment on proposed RTO performance metrics.[10]

The FTC and its staff have also commented specifically on market power issues. For example, in March 2007, the Deputy Director for Antitrust in the FTC's Bureau of Economics served as a panelist for a technical conference in Docket No. AD07-2-000 on FERC's merger and acquisition review standards under FPA Section 203. The FTC submitted comments in July 2004 and January 2006 in FERC's proceeding in Docket No. RM04-7-000 on its FPA Section 205 standards for market-based rates. Moreover, as noted above, the FTC submitted a comment at an earlier stage of this proceeding on partial acquisitions.

Background

Currently, if an acquisition or transfer of voting securities results in the acquirer's holding 10 percent or less of the issuer's outstanding voting securities, FERC rules grant blanket authorizations for such transactions. 18 C.F.R. §§ 33.1(c)(2)(ii), (12)(i). This grant relieves the parties from having to demonstrate that the transaction is "consistent with the public interest," 16 U.S.C. § 824b, including assessment of the transaction's effect on competition.[11] In the context of market-based rate authorizations under FPA Section 205, 16 U.S.C. § 824d, an acquirer's

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[9] This comment is available at http://www.ftc.gov/os/2009/12/V100001ferc.pdf.

[10] Federal Trade Commission, Comment before the Federal Energy Regulatory Commission on RTO/ISO Performance Metrics, Docket No. AD10-5-000 (Mar. 19, 2010), *available at* http://www.ftc.gov/os/2010/03/100319performancemetrics.pdf.

[11] 1996 Merger Policy Statement, Order No. 592, 61 Fed. Reg. 68606, FERC Stats. & Regs. ¶ 31,044 (1996) (*codified at* 18 C.F.R. § 2.26); *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, 65 Fed. Reg. 70984 (Nov. 28, 2000), FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 66 Fed. Reg. 16121 (Mar. 23, 2001), 94 F.E.R.C. ¶ 61,289 (2001) (*codified at* 18 C.F.R. Part 33).

ownership of less than 10 percent of an issuer's voting securities also means that the parties are not treated as "affiliates" under FERC's market-based rate program. 18 C.F.R. § 35.36(a)(9)(i). Absent affiliation under FERC's rules, an entity is presumed not to have control over its affiliate's generation or inputs for the production of electric energy, which increases the chances that the parties will pass the market power screens required for receipt of market-based rate authority. 18 C.F.R. Part 35, Subpart H, Appendices A, B (2008).

The NOPR would expand the blanket exemptions, making them available to an acquirer or person that owns 10 percent or more, but less than 20 percent, of an issuer's outstanding voting securities where the acquirer also files proposed Form 519-C. NOPR P 33. (The Form refers to the acquirer as the "reporting person.") Via this Affirmation, which must be signed under oath by a senior executive officer, the acquirer would certify that the securities are not acquired or held for the purpose or effect of changing or influencing the control of the issuer, and further that:

(1) Neither the reporting person nor any of its employees, officers, or investors shall request or receive disclosure of non-public information, either directly or indirectly, concerning the business or affairs of the issuer.

(2) Neither the reporting person nor any of its employees, officers or investors shall seek or accept representation on the board of directors (or equivalent governing body) of the issuer or propose a director or slate of directors in opposition to the nominee or slate of nominees proposed by the management of the issuer.

(3) Neither the reporting person nor any of its employees, officers or investors shall solicit or participate in soliciting proxies with respect to any matter presented to the investors of the issuer or any of its subsidiaries.

(4) Neither the reporting person nor any of its employees, officers or investors shall have or seek to have any representative serve as an officer, agent or employee of the issuer.

(5) Neither the reporting person nor any of its employees, officers or investors shall seek to influence, in any way, by voting shares of the voting securities of the issuer or otherwise, the management or conduct of the day-to-day operations of the issuer [in the marketplace].

(6) The reporting person will make quarterly reports on the outstanding shares of the voting securities of the issuer then held and the percent of the total number of outstanding voting securities of that class that such shares represent.

NOPR PP 36-37 and n.24. The NOPR further provides that qualifying for the new blanket authorization exempts the acquirer and the issuer from the requirements otherwise imposed on affiliates under FERC's market-based rate program, including certain competitive analyses. Proposed 18 C.F.R. § 33.1(c)(2)(ii)(B)(II).

The Affirmation Improves on the EPSA Proposal but Must Contain Additional Protections, Including Enforcement Mechanisms and Structural Safeguards Against Control or Influence, To Be Effective

FERC states that it believes the Affirmation addresses concerns raised by the FTC and others, "because the Affirmation will require the investor to abide by commitments to not take specific actions that would unduly influence the management of the utility, interfere with the operation of the utility's facilities, or request or receive non-public information." NOPR P 34. It also seeks comments on this proposal. *Id.*

We agree that a commitment by the acquirer not to seek to control or influence the decisions of the issuer, and not to receive non-public information, provides some behavioral safeguards against the competitive risks of partial ownership. FERC, however, does not identify how it will enforce these commitments. For example, the NOPR (P 41) contemplates that a reporting person could decide to cease complying and could request Section 203 authorization to retain the securities. The NOPR, however, does not describe whether a reporting person that ceases compliance – but does not request Section 203 authority to retain the securities, or delays

doing so – would be subject to penalties for violation of a FERC rule pursuant to 16 U.S.C. § 825o-1(b). The FTC's experiences with the various rules that it has promulgated and enforces under the FTC Act, especially in the consumer protection area, indicate that the threat of penalties can play an important role in encouraging compliance.

Monitoring compliance is another potential concern. A reporting person's failure to abide by some of the commitments, such as not having board representation or soliciting proxies, presumably would be detected readily, because outsiders would observe such an action or omission. The failure to abide by some of the other commitments could be harder to detect and may be deliberately clandestine (*e.g.,* receipt of non-public information or voting one's shares in a manner that seeks to influence the competitive decisions of the issuer). FERC may want to consider and identify how it will monitor compliance with Affirmation's certifications.

We also recommend that FERC consider structural safeguards against the acquirer's incentive to seek to control or influence the issuer. As developed below, an acquirer's position as a competitor of the issuer, or as the owner of production inputs serving markets in which the issuer participates, creates incentives for the acquirer to engage in anticompetitive conduct, whether by controlling or influencing the issuer's conduct or by changing the acquirer's own actions in the marketplace. A requirement that the acquirer certify that it is not a competitor of the issuer, and that it does not own or control production inputs (as defined by FERC rules)[12] serving the markets in which the issuer participates, would provide structural safeguards – and not simply behavioral commitments – by denying the benefits of the blanket authorization to

[12] The rules define "inputs to electric power production" as "intrastate natural gas transportation, intrastate natural gas storage or distribution facilities; sites for generation capacity development; physical coal supply sources and ownership of or control over who may access transportation of coal supplies." 18 C.F.R. § 35.36(a)(4).

those with incentives to control or influence the issuer. Competitors would not be precluded from acquiring the voting securities of a competitor, but such acquisitions would be subject to FERC's pre-existing rules, which would allow FERC to undertake the competitive and other analyses that a blanket authorization would otherwise eliminate.

The Affirmation Should Include Structural Safeguards Against Competitive Harm from Changes in the Acquirer's and the Issuer's *Incentives*

Structural safeguards would also address the NOPR's more fundamental lacuna – its failure to address the changes in the acquirer's and the issuer's competitive incentives due to its partial ownership interest. These changes can arise even where the acquirer cannot influence or control the issuer. The NOPR does not address, or even acknowledge, these incentive effects, which leaves a significant risk of adverse competitive effects resulting from partial acquisitions.

Legal and Economic Scholarship

Antitrust scholarship recognizes that partial acquisitions, including by private equity firms, can lead to anticompetitive effects. "Even a non-controlling partial acquisition by a private-equity firm of a competitor to a portfolio company that the private equity firm already owns in whole or in part can lead to anticompetitive effects if it: (1) alters the *incentives* of one or both of the relevant firms to compete; (2) creates the ability to control or even *influence* any competitive decisions of the acquired firm; or (3) facilitates the exchange of competitively sensitive *information*." Laura A. Wilkinson & Jeff L. White, *Private Equity: Antitrust Concerns with Partial Acquisitions*, 21 Antitrust 28, 29 (Spring 2007) (emphasis in original); *see also* President's Council of Economic Advisers*, Economic Organization and Competition Policy*, 19 Yale J. Reg. 541, 555 (2002) ("A partial acquisition can affect the firms' subsequent decisions

through three distinct channels: by altering incentives, altering information, or altering control.").

An assessment of the competitive effects of partial ownership requires that two aspects of partial ownership be distinguished and analyzed – financial interest and corporate control. Daniel P. O'Brien & Steven C. Salop, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control*, 67 Antitrust L.J. 559, 568 (2000).

> Financial interest refers to the acquiring firm's entitlement to a share of the profits of the acquired firm. Corporate control refers to the acquiring firm's ability to control or influence the acquired firm's competitive decision making, including pricing and product selection as well as sale of the company's assets.

Id. Whether a specific partial acquisition may harm competition depends on several factors, including the size of the partial investment, whether it is accompanied by control, and the ability and incentives to exchange competitively sensitive information. For these reasons, "an across-the-board lenient attitude toward passive investments in rivals may be misguided." *See* David Gilo, Yossi Moshe, and Yossi Spiegel*, Partial Cross Ownership and Tacit Collusion*, 37 RAND J. Econ. 81, 93 (2006). FERC's assessment of partial acquisitions and its standards for granting blanket authorizations should consider both the control/influence and incentive aspects of partial ownership.

Effects on Competitive Incentives

The financial interest that accompanies partial ownership can affect both the acquirer's and the acquired firm's competitive interests. If an acquiring firm were to raise prices, leading to a loss of sales due to customers' migration to other sellers, the acquirer could recoup some of its losses to the extent those customers migrate to an acquired firm. O'Brien & Salop*, supra*, 67 Antitrust L.J. at 574. *This recoupment occurs even if control is not acquired and increases the*

incentive for the acquirer to raise price. Id. "This incentive analysis applies directly to the case in which the acquiring firm purchases less than a 100 percent financial interest in the acquired firm." *Id.* at 575. Although "the incentive of the acquired firm to increase prices is smaller than it would be in a full merger," it is still present. *Id.* For example, suppose that firm A acquires a passive, 5 percent stake in a direct competitor, firm B. "If firm A raises its price, for example, the five percent stake in firm B could reduce the effect of any loss of customers on firm A's profits because some of the lost customers would be purchasing from firm B." Council of Economic Advisers, *supra*, 19 Yale J. Reg. at 556. In this case, A gets the full benefit of its price increase as well as its share of the increased sales that B achieves through A's loss of customers.[13]

One can illustrate this incentive effect in the electricity context. Assume a market having 1,050 MW of load served by three suppliers. Baseload Energy has 1,000 MW of capacity, with a marginal cost of $20 per MWh and an offer cap of $30 per MWh; Acquisitive Energy has 100 MW of capacity, with a marginal cost of $100 per MWh and an offer cap of $120 per MWh; and Combustion Turbine Energy has 50 MW of capacity, with a marginal cost of $200 per MWh and an offer cap of $250 per MWh. Acquisitive takes a 5 percent stake in Baseload. Baseload, which is always inframarginal in this market, bids its marginal cost to ensure that it is dispatched. Acquisitive bids at its offer cap, $120 per MWh. Combustion Turbine will bid no

[13] This recoupment potential is one reason for the Horizontal Merger Guidelines' concern for mergers between close competitors. *See* Federal Trade Commission and Department of Justice, Horizontal Merger Guidelines, § 2.22 (1992), *available at* http://www.ftc.gov/bc/docs/horizmer.shtm. FERC's assessment of mergers and acquisitions (*see supra* n. 11) is based upon the Horizontal Merger Guidelines, so a policy that ignores altered competitive incentives associated with partial acquisitions would be inconsistent with FERC's stated policy for assessing mergers and acquisitions.

lower than $200 per MWh. In the 1,050 MW market example, Acquisitive's $120 per MWh offer will set the clearing price, and the firm will sell 50 MW at a profit of $1,000 (50 x $20). Baseload's profit will be $100,000 (1,000 x $100). With partial ownership, Acquisitive will get 5 percent of Baseload's profit, so Acquisitive ends up with a total profit of $6,000 ($1,000 + (.05 x $100,000)).

Suppose, however, that Acquisitive experiences problems with its plant, requiring it to go off line, and has to decide how quickly to try to get it back on line. Acquisitive's absence from the market will increase the market clearing price – possibly as high as $250 per MWh, if Combustion Turbine bids its offer cap – which will increase Baseload's profit to $230,000 (1,000 x $230). Prior to its acquisition of a 5 percent interest in Baseload, Acquisitive would have had an incentive to return quickly to service, because it makes no money without any sales. By contrast, post-acquisition, Acquisitive's 5 percent share of Baseload Energy's profits will be $11,500 (.05 x $230,000), making it very profitable for Acquisitive Energy to stay off line (since $11,500 exceeds $6,000). Thus, Acquisitive Energy's passive investment could adversely affect competition in this market.

Similarly, a passive investment could prompt the acquiring firm to compete less vigorously, if aggressive competition would lower the value of an investment in which it had partial ownership. David Gilo, *The Anticompetitive Effect of Passive Investment*, 99 Mich. L. Rev. 1, 4 (2000); *see also* Phillip E. Areeda & Herbert Hovenkamp, V Antitrust Law ¶ 1203c at 280-83 (2d ed. 2003). Returning to the foregoing example, suppose that rather than Combustion Turbine Energy, the third seller in the 1,050 MW market is Renewable Energy, with 30 MW of capacity having a marginal cost of $110 per MWh. Prior to acquiring its 5 percent interest in Baseload Energy, Acquisitive Energy bids $109.99 per MWh (which is below its $120 per MWh

offer cap) so that Acquisitive (rather than Renewable) is dispatched, for a resulting profit of $499.50. Note, however, that even if Acquisitive bid $120 per MWh, giving Renewable the opportunity to underbid it, Acquisitive could still be dispatched at 20 MW (because Renewable has only 30 MW of capacity) and earn a profit of $400 (20 MW x $20 per MWh). Absent partial ownership in Baseload, Acquisitive has the incentive to compete aggressively with Renewable, because its aggressive bidding generates larger profits ($499.50) than its less aggressive bidding ($400).

Post-acquisition, Acquisitive no longer has the incentive to undercut Renewable Energy's offer of $110 per MWh and instead bids at its offer cap of $120 per MWh. Under this strategy, Acquisitive would sell 20 MW at $120 per MWh for a profit of $400, but also would get 5 percent of Baseload's $100,000 profit, for a total of $5,400. As a partial owner of Baseload, Acquisitive could still choose to compete aggressively with Renewable by bidding $109.99, but this would now decrease total profits because Acquisitive would earn $499.50 from its own sales plus 5 percent of Baseload's profits, which (at a market clearing price of $109.99 per MWh) would be $89,990, for a total profit to Acquisitive of $4,999. The benefit to Acquisitive from increasing its sales by underbidding Renewable is now more than offset by the adverse effect such aggressive bidding would have on Acquisitive's share of Baseload's diminished profits.

Increased Collusion Risks

Passive investment also increases the likelihood of sustaining collusive pricing, such as through avoidance of price wars. Gilo, *supra*, 99 Mich. L. Rev. at 8, 13. Consider an oligopolistic market with prices that reflect tacit collusion. When firms tacitly collude, they recognize that they could deviate from the collusive outcome, increasing their own short-run profits at the expense of the other firms, but choose not to do so because they expect a stream of

future profits that are sufficiently higher if the collusion persists. When a firm has partial ownership of another firm in the collusive group, the short-term gains from deviation are diminished, because the deviation decreases the profits of the partially owned firm. Thus, there is less incentive to cheat on the collusive strategy, which prolongs the collusion.

The change in incentives can affect the acquiring firm as well as the acquired firm. *Id*. at 9. Suppose that Acquisitive Energy acquired a partial interest in Renewable Energy. Pre-acquisition, if it anticipates that Acquisitive might deviate from a collusive outcome in the future, Renewable might take the first step in deviating from collusion so as to get the short-term gains. If Acquisitive is less likely to deviate, however, then Renewable's need to anticipate and preempt Acquisitive's deviation diminishes. Acquisitive's ownership share in Renewable can make such deviation less attractive to Acquisitive, which may then have the secondary effect of making Renewable less likely to engage in a preemptive deviation.

The incentive effects associated with a partial owner's financial interest can be even more pronounced if the investment is made, not by the acquiring firm itself, but by its controller (such as a private equity firm). *Id.* at 22-23. For example, suppose that Acquisitive's controller holds only 20 percent of Acquisitive and nothing else. That controller would have the incentive to run Acquisitive in order to maximize Acquisitive's profits, just as if it owned 100 percent of Acquisitive. Now suppose that this controller also has a passive ownership of 20 percent of Renewable. If a pricing strategy were to cause Acquisitive to gain a dollar but Renewable to lose two dollars, the controller would not have the incentive to pursue this strategy. Rather, the controller would have the incentive to take actions that maximize the sum of Acquisitive's and Renewable's profits, so the passive partial ownership would make Acquisitive less likely to act as an aggressive competitor.

Collusion may also arise via information sharing. Council of Economic Advisers, *supra*, 19 Yale J. Reg. at 556.

> Competitive effects, in the form of traditional coordination concerns, can arise from a partial investment in a competitor through the facilitation of information sharing, exchange, or access among competing companies. In the private-equity context, in particular, the acquisition of a partial ownership interest in a competitor of a private-equity firm's other wholly or partially owned portfolio companies could provide the private-equity firm with access to competitively sensitive information that could be shared between the two companies. This concern can arise even in situations where the private-equity firm does not own a controlling interest in either competitor. Rather, the concern simply could be that the partial acquisition places the private-equity firm in a position to act as a conduit for the flow of competitively sensitive information between the two companies.

Wilkinson & White, *supra*, 21 Antitrust at 30; *see also* Areeda & Hovenkamp, *supra*, V *Antitrust Law* ¶ 1203c at 282. Although in cases of explicit collusion the participants in an information-sharing scheme could be pursued through government or private antitrust enforcement for violations of Section 1 of the Sherman Act, FERC can play a role in discouraging tacit collusion and other types of anticompetitive conduct that may not violate Section 1. *See Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 760 (1973) ("Consideration of antitrust and anticompetitive issues by [FERC], moreover, serves the important function of establishing a first line of defense against those competitive practices that might later be the subject of antitrust proceedings.").

A requirement that the acquirer not request or receive non-public information provides some protection against anticompetitive information sharing. *See* NOPR P 37. A structural measure that makes the blanket authorization unavailable to competitors can be more effective, however, because it addresses the incentive to share information at its root. The additional Affirmations that we recommend below would make the blanket authorizations unavailable to

certain competitors and thus would treat the cause of the incentives problem, not just the symptoms.

Judicial and Enforcement Agency Policies and Actions

The FTC's and the Department of Justice's antitrust enforcement policies illustrate the concerns expressed in legal and economic scholarship. The agencies' Antitrust Guidelines for Collaborations Among Competitors (Collaboration Guidelines) prescribe examination of more than control in an assessment of whether participants in a collaboration will have the ability and incentive to compete against the collaboration as well as each other.[14] The Collaboration Guidelines note that the "potential impact [of financial interests] may vary depending on the size and nature of the financial interest (*e.g.*, whether the financial interest is debt or equity)," and that "the analysis is sensitive to the level of financial interest in the collaboration or in another participant relative to the level of the participant's investment in its independent business operations in the markets affected by the collaboration." *Id.* § 3.34(c).[15]

Both agencies' enforcement actions in connection with partial acquisitions have focused on incentive effects. In *TC Group, LLC, et al.*,[16] the Carlyle Group and Riverstone Holdings, LLC, both private equity firms, jointly owned a private equity fund, CR-II, that held a 50 percent interest in MCG Midstream Holdings GP, LLC. MCG Midstream, in turn, served as the general

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[14] Federal Trade Commission and U.S. Department of Justice, *Antitrust Guidelines for Collaborations Among Competitors* § 3.34 (Apr. 2000), *available at* http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf.

[15] The Guidelines also underscore the fact-specific nature of the inquiry.

[16] *In the Matter of TC Group, L.L.C., Riverstone Holdings LLC, Carlyle/Riverstone Global Energy and Power Fund II, L.P., and Carlyle/Riverstone Global Energy and Power Fund III, L.P.,* File No. 061-0197, Analysis of Proposed Agreement Containing Consent Orders to Aid Public Comment, *available at* http://www.ftc.gov/os/caselist/0610197/analysis.pdf.

and controlling partner of Magellan Midstream Partners, LLP, a publicly traded limited partnership primarily engaged in the storage, transportation, and distribution of refined petroleum products and ammonia. CR-II had the right to designate two of MCG Midstream's four-member Board of Managers. Magellan also competed directly against Kinder Morgan Inc. (KMI).

Carlyle/Riverstone proposed to acquire an 11.3 percent interest in KMI, accompanied by the right to name a KMI board representative. Carlyle also proposed to acquire its own 11.3 percent interest in KMI, again with a board representative. The FTC identified a number of competitive harms from the transaction, including reduced competition between Magellan and KMI and the risk of an exchange and use of competitively sensitive information between them. The parties agreed to settle the FTC's competition concerns by eliminating Carlyle/Riverstone's control over Magellan and prohibiting exchanges of competitively sensitive information. The FTC's remedy thus focused, *inter alia*, on how the acquisition changed Carlyle/Riverstone's incentives to have Magellan compete less vigorously against the newly acquired KMI.

In Time Warner Inc.'s acquisition of Turner Broadcasting System, Inc., the FTC investigated and obtained relief in the form of divestiture and limits on voting rights of, *inter alia*, minority shareholders (Tele-Communications, Inc. (TCI) and Liberty Media Corp.) that were anticipated to own less than 10 percent of the stock of Time Warner.[17] The relief addressed competitive concerns that the minority shareholder, TCI/Liberty, would compete less aggressively against Time Warner once it acquired Time Warner stock. Among other things, the

[17] *Time Warner, Inc., Turner Broadcasting System, Inc., Tele-Communications, Inc., and Liberty Media Corp.*, FTC File No. 961-0004, Analysis of Proposed Consent Order to Aid Public Comment, *available at* http://www.ftc.gov/os/1996/09/twanalys.pdf.

FTC was concerned that once TCI had an interest in Time Warner, TCI would refrain from placing non-Time Warner programming on its cable systems or from investing in programming that would compete against Time Warner's own. The FTC required the cancellation of long-term agreements that would have obligated TCI to carry certain Time Warner programs, thus restoring incentives for TCI to place non-Time Warner programming on its cable system.[18]

The Department of Justice similarly obtained relief in a proposed transaction in which U S West, a telecommunications provider, indirectly would have acquired a partial interest in a competing provider.[19] U S West proposed to acquire all the stock and assets of Continental Cablevision, Inc., which held a 20 percent interest in Teleport Communications Group (TCG), a direct competitor of U S West in several geographic markets. After the acquisition was announced, Continental reduced its interest in TCG from 20 percent to 11 percent and relinquished its seats on the TCG board. To address the Department's continuing concerns that U S West's 11 percent ownership interest in TCG could influence U S West's competitive decisions and lessen its competitive vigor – and also could provide U S West with competitively sensitive information about TCG's business decisions – U S West agreed to divest all of Continental's interest in TCG.

The Sixth Circuit has likewise held that the absence of control or influence did not preclude a finding that an acquisition could lessen competition. *United States v. Dairy Farmers of America, Inc.*, 426 F.3d 850, 860-62 (6th Cir. 2005). *Dairy Farmers* involved a Department

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[18] *Id.*

[19] *United States v. U S West, Inc. and Continental Cablevision, Inc.*, No. 96 2529, Competitive Impact Statement (CIS) (D.D.C. Nov. 5, 1996), *available at* http://www.usdoj.gov/atr/cases/f0900/0973.pdf.

of Justice challenge to an acquisition where the acquirer would not have obtained control over the acquired party. The district court had rejected the Justice Department's claim that the acquisition lessened competition in the absence of control. The Sixth Circuit reversed, stating that "even without control or influence, an acquisition may lessen competition." *Id.* at 860. It continued: "The key inquiry is the effect on competition, regardless of cause." *Id.*

Two other cases, while not partial acquisitions along the lines contemplated by the NOPR, nonetheless vividly illustrate the incentive for an entity to engage in anticompetitive activity if it can share in the increased revenues earned by another entity as a result of that anticompetitive activity. The first case, *United States v. KeySpan Corp.*,[20] did not involve the acquisition of an equity interest, control, or influence. Rather, KeySpan acquired the right, through a swap involving an intermediary, to receive revenues from its competitor when electric generating capacity prices rose above a certain level. In suing KeySpan for violating Section 1 of the Sherman Act, 15 U.S.C. § 1, the Department of Justice concluded that the revenue stream from the swap provided an incentive for KeySpan to economically withhold capacity from the market, thus raising prices. The revenues KeySpan lost when its withholding strategy priced its own capacity out of the market were offset by KeySpan's receipt of its competitor's share of the higher revenues caused by the withholding strategy:

> Without the swap, KeySpan likely would have chosen from a range of potentially profitable competitive strategies in response to the entry of new capacity and, had it done so, the price of capacity would have declined. The swap, however, effectively eliminated KeySpan's incentive to compete for sales. By adding revenues from Astoria's capacity to KeySpan's own, the KeySpan Swap made bidding the cap [economic withholding] KeySpan's most profitable

[20] *United States v. Keyspan Corp.*, Civ. Action No. 10-cv-1415 (WHP), Competitive Impact Statement (CIS) (S.D.N.Y. Feb. 23, 2010), *available at* http://www.justice.gov/atr/cases/f255500/255578.pdf.

> strategy regardless of its rivals' bids. ... By transferring a financial interest in Astoria's capacity to KeySpan, the Swap effectively eliminated KeySpan's incentive to compete for sales in the same way a purchase of Astoria or a direct agreement between KeySpan and Astoria would have done.

CIS at 7.

The KeySpan case shows how an entity's capturing a share of its competitor's revenue stream can render profitable an anticompetitive bidding strategy, even where that entity has no control or influence over its competitor's actions. The adverse competitive effects are seen in the acquirer's incentives. FERC's NOPR does not address these effects when they arise in the partial acquisition context.

The second case involved a vertical merger by which Pacific Enterprises, the dominant provider of natural gas transportation and storage services in southern California, proposed to merge with Enova Corporation, the corporate parent of San Diego Gas & Electric, one of California's three, large investor-owned utilities. The U.S. Department of Justice concluded that the merger would provide the merged firm with both the ability and the incentive to use Pacific Enterprises' monopoly over natural gas transportation and storage to raise the price of natural gas supplied to gas-fired generation facilities, which, in turn, could raise the price of electricity during peak periods when such gas-fired generation units set the market clearing price in California electricity markets. Such a price increase would prove profitable to San Diego Gas & Electric because of its ownership of two low-cost gas-fired generation facilities that would likely operate during peak periods and thus would be paid the higher market price. Pacific Enterprises would then share in those increased revenues, providing it with the incentive to raise gas prices without the need to control the competitive conduct of San Diego Gas & Electric. The decree settling the case removed the source of the incentive – Pacific Enterprises' equity interest in the

natural gas plants generating the revenues – by requiring San Diego Gas & Electric to sell those facilities. *United States v. Enova Corp.*, 107 F. Supp. 2d 10, 18 (D.D.C. 2000).

FERC's NOPR also does not address such situations in which the transaction changes the competitive incentives of the owner of production inputs. If the owner of upstream assets can share in the increased revenues in the downstream market associated with an anticompetitive price increase in the upstream market, the revenue stream provides the incentive for that anticompetitive conduct. This incentive exists even if the upstream asset owner does not control or influence the conduct of the downstream seller. The NOPR, however, ignores these incentives and would allow the acquirer with production inputs to benefit from the blanket authorization so long as it does not control or influence the conduct of the issuer owning downstream assets.

Modification of Affirmation To Address Incentive Effects

The foregoing discussion of legal and economic scholarship, judicial decisions, and antitrust agency policies and enforcement actions illustrates that the competitive effects of partial acquisitions depend on more than whether the acquiring firm can control or influence the decisions of the acquired firm. Incentive concerns also can arise where the acquirer is a horizontal competitor of the issuer, or where the acquirer owns inputs into production. The FTC recommends that FERC address these concerns by adding two certifications to the ones already set forth in the Affirmation:

> Neither the reporting person nor any of its employees, officers, or investors competes in the same product and geographic markets as the issuer.
>
> Neither the reporting person nor any of its employees, officers, or investors owns, controls, or is affiliated with an entity that owns or controls "inputs to electric power production" (as defined in 18 C.F.R. § 35.36(a)(4)) serving the same product and geographic markets as the issuer.

These additional certifications would make the blanket authorization unavailable when there is a risk that the investment would change the acquirer's or the issuer's competitive incentives, even if the acquirer could not control or influence the decisions of the issuer. The added certifications thus would address the incentive effects identified above at their core. They also would create structural, and not merely behavioral, impediments to the sharing of competitively sensitive information or the use of control or influence to adversely affect competition, because an acquirer that cannot benefit from such conduct is less likely to be tempted to engage in it.

The certifications that we recommend are similar to the Hart-Scott-Rodino Antitrust Improvements Act's (HSR Act's) exemption from that statute's notification requirements for acquisitions "solely for the purpose of investment" where the acquiring person would hold 10 percent or less of the outstanding voting securities of the issuer. 15 U.S.C. § 18a. The FTC's regulations implementing the HSR Act state: "Voting securities are held or acquired 'solely for the purpose of investment' if the person holding or acquiring such voting securities has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer." 16 C.F.R. § 801.1(i)(1). Among other things, an acquiring person's "being a competitor of the issuer" could be viewed as evidence of intent inconsistent with investment purposes. 43 Fed. Reg. 33450, 33465 (1978). The FTC has consistently interpreted the exemption to be unavailable to competitors.

The additional certifications are practicable, because the reporting person should have access to the information necessary to make the certification. The proposed Affirmation requires the reporting person to identify (1) the issuer; (2) the reporting person's affiliates, including their locations; and (3) the "input to electric power production" owned by the reporting person or its

affiliates. NOPR P 36. Based upon this information, the reporting person should be able to determine whether it is a horizontal competitor of the issuer and whether it owns, controls, or is affiliated with an entity that owns or controls, inputs to electric power production serving the market in which the issuer competes.

The additional certifications should not chill investments in the electricity sector. The NOPR projects that there will be 10 initial filers of Form 519-C. NOPR P 65. Given the universe of potential investors, it seems unlikely that limiting the blanket exemption to investors that are not competitors of, or holders of inputs for, the issuer will reduce the investor pool appreciably. Moreover, even if an investor does not qualify for the blanket exemption, it may still seek to acquire the voting securities, if it complies with FERC's existing regulatory requirements, *see* 18 C.F.R. Parts 33 and 35, which presumably will screen out investors whose acquisitions would adversely affect competition.

Conclusion

The competitive effects of partial acquisitions depend on more than whether the acquiring firm can control or influence the acquired firm. Equally important are the changes in the incentives of the acquirer and issuer to engage in competitive conduct. The NOPR does not address these latter competitive concerns. Accordingly, the FTC respectfully urges FERC to consider the two additional certifications proposed herein that would provide structural safeguards against the range of adverse competitive effects associated with partial acquisitions.