UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Control and Affiliation for Purposes of the	)	
Commission's Market-Based Rate Requirements	)	Docket No. PL09-3-000
Under Section 205 of the Federal Power Act and the	)	
Requirements of Section 203 of the Federal Power Act	)	

COMMENT OF THE FEDERAL TRADE COMMISSION

April 28, 2009

The Federal Energy Regulatory Commission (FERC) has under consideration in this proceeding a clarification request by the Electric Power Supply Association (EPSA) to the effect that if an investor in a publicly held company (1) owns less than 20 percent of such company's voting securities and (2) certifies (through the filing of Securities and Exchange Commission (SEC) Schedule 13G) that the investment is not for the purpose of controlling the company, then such investment will not be deemed to convey "control" or to result in "affiliation" for market-based rate purposes under Section 205 of the Federal Power Act (FPA) or acquisition purposes under FPA Section 203. Among other things, the presumed absence of control or affiliation apparently would relieve the parties to the transaction from having to submit market power analyses otherwise required under FERC rules, or would allow them to treat generation assets of the respective companies as not under common ownership or control for purposes of any required competitive analysis. Related premises of the proposed clarification appear to be (1) that the ability of the acquiring firm to control the acquired firm is largely determined by ownership share, and (2) that the presence or absence of such control is dispositive of the transaction's competitive effects.

The Federal Trade Commission (FTC) only recently had occasion to familiarize itself with the pendency of the issues raised by the EPSA petition. After reviewing the issues, the FTC has concluded that its experience may prove helpful to FERC's deliberations. The FTC is aware, however, that FERC provided an opportunity for public comment earlier this year, and so we respectfully request that FERC accept this comment at this time. The FTC appreciates FERC's consideration of our views.

Based upon its review of the other comments filed in this proceeding, the FTC is concerned that commentators have placed too much emphasis on the role of control in the competitive analysis, with little discussion of the incentive effects associated with partial acquisitions or of the possible increased risks of coordinated interaction from such investments. In these comments, the FTC describes the antitrust analysis of the competitive effects of partial acquisitions, including those in the energy industry.[1] As developed below, 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 where the acquiring firm does not gain control of the acquired firm. In addition, passive investments can create opportunities and incentives for firms with partial common ownership to share information that facilitates collusion. The FTC encourages FERC to avoid adopting policies that assess competitive effects based solely on control and that foreclose examination of these non-control-related competitive effects associated with partial acquisitions.

[1] Although FERC is not responsible for enforcement of the antitrust laws, over the years its competitive analyses in both the Section 203 and Section 205 contexts increasingly have reflected the approaches of the antitrust agencies, including perspectives set forth in the U.S Department of Justice/Federal Trade Commission Horizontal Merger Guidelines.

[2] *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/070410e

Competition Task Force, which issued a *Report to Congress* in the spring of 2007 (*available at*

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provided to various state and federal agencies).

[4] 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**.**

[5] *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**.**

[6] 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. & Reg

EPSA's clarification presumably would mean that when a disposition or an acquisition of jurisdictional assets results in the acquirer's having less than 20 percent of the voting securities of a public utility, the acquirer would not have to obtain prior FERC approval for the transaction under Section 203. EPSA further requests that the no-control presumption be applied in the Section 205 context, such that the generation or generation inputs owned or controlled by other entities would not be attributed to the public utility seeking market-based rate authority.

EPSA's proposal and comments thereon largely have focused on the control issue and on whether a firm's having less than a 20 percent interest in the acquired firm, combined with the acquirer's submission of SEC Schedule 13G, provides sufficient assurances that the acquirer does not control the acquired public utility. Absent such control, it is claimed, the acquirer cannot dictate the operation of the acquired firm's generation, for example, to cause it to be withheld from the market, thus alleviating concerns that a transaction would adversely affect competition. Economic and legal scholarship and cases considered by courts and the antitrust agencies, however, uniformly teach that control over the acquired firm does not alone determine whether a transaction will adversely affect competition. Even partial acquisitions of passive interests can affect the competitive incentives of both the acquirer and the acquired firm. Such acquisitions also increase risks for anticompetitive information sharing.

<u>Legal and Economic Scholarship</u>

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, a

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[7] It is not clear from the EPSA proposal whether a partial owner having the ability to name a board representative could still file SEC Schedule 13G.

[8] In contrast to the opportunities of major holders to exert disproportionate influence in corporate governance, the views of investors with very small individual holdings may be underrepresented because of the difficulties associated with organizing such investors, even if they hold a large proportion of shares in the aggregate.

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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, requiri has only 30 MW of capacity) and earn a profit of $400 (20 MW x $20 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 fr $120 0.00000 1.00000 0a2

$120 $120 0.0377j72.8400 inwould ea0.00 0.00 total profits because diminished, because the deviation decreases the profits of the partially owned firm. Thus, there is less incentive to cheat on the collusive strategy.

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.

Information Sharing

Beyond effects on the acquiring and acquired firms' incentives, partial acquisitions can facilitate coordinated interaction through information sharing. Council of Economic Advisers, Whether a specific partial acquisition may harm competition depends on the facts, 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). Because the EPSA proposal focuses only on the control factor, however, it appears to preclude consideration of other factors relevant to the competitive analysis

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

investment in its independent business operations in the markets affected by the collaboration." *Id*. § 3.34(c).[12]

Both agencies have exercised their enforcement authority in connection with partial acquisitions. The most recent case was the FTC's action in *TC Group, LLC, et al*.[13] There, 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 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 on Carlyle/Riverstone's ability to cause Magellan to compete less

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

[13] *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 Comments, *available at* http://www.ftc.gov/os/caselist/0610197/analysis.pdf.

[14] *Time Warner, Inc., Turner Broadcasting System, Inc., Tele-Communications, Inc., and Liberty Media Corp.*, File No. 961-0004, Analysis of Proposed Consent Order to Aid Public

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.

Conclusion

The competitive effects of partial acquisitions depend on more than whether the acquiring firm can control the acquired firm. Legal and economic scholarship, judicial decisions, and antitrust agency policies and enforcement actions demonstrate that the financial interests acquired and the resulting effects on the competitive interests of both the acquiring firm and the acquired firm must be examined to determine whether the transaction can increase the risk of an exercise of unilateral or coordinated (collusive) market power, as well as create opportunities for exchanges of competitively sensitive information. Whether and how these factors will affect competition depends upon the facts of the specific transaction. The FTC thus encourages FERC to avoid adopting policies that assess competitive effects based solely on control, and to engage in a careful, case-by-case analysis of the potentially significant competitive effects that may stem from partial – but not control-conferring – acquisitions.