



Mergers and Acquisitions: Regulatory Economics (Market Power) Developments



INTERNATIONAL

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Reemerging Activity

- **Some observers had thought that PUHCA repeal would lead to a surge in merger activity**
- **Instead, 2006 saw the collapse of two major mergers, primarily as a result of state opposition (not entirely merger related)**
- **A lot of recent activity has involved private equity; at least the first round for an entrant does not create market power issues, though there has been significant state opposition to private equity purchasers**
- **Merchant portfolio and nuclear consolidation continues**
- **We also are seeing new utility/utility mergers (on-going and under study)**

Sources of Potential Change in M&A Policy

- **There are three new commissioners at FERC**
 - Have not participated in merger review, either at FERC or elsewhere
 - None of the three ex-PSC commissioners are from RTO states
- **Changes in FERC's larger agenda may result in emphasis on aspects of merger review that are not obvious**
 - The old and no longer relevant example is, “join an RTO, stupid”
- **In recent times, FERC has shown greater tolerance for non-systematic screen failures**
- **States are “feeling their oats” after the collapse of Exelon/PSEG and Constellation/FPL and defeat of private equity acquisitions**

No Changes in Basic FERC Policy Regarding Horizontal Aspects are Apparent

- **“Appendix A” is still the rule, and there are no signs of a fundamental change**
 - Appendix A allows only small HHI changes in market concentration
 - Both Economic Capacity (no allowance for load) and Available Economic Capacity (load taken into account) must be assessed
 - Control area is the default geographic market definition
- **Emphasis seems to be shifting away from EC to AEC for areas where restructuring has not occurred and is unlikely**

Current Issues in FERC Horizontal Analysis

- **Change of control arising from contracts**
 - Has evolved from beneficial ownership to dispatch control standard
 - One year standard still exists
- **Transmission measurement: precedents from market rate authority proceedings may be unhelpful**
- **Will standard be changed for unstructured areas to take into account the size of wholesale load?**
- **Will “buyers market power” become an issue?**

FERC Horizontal Screen Failure Mitigation

- **Will a standard of acceptable failure rates evolve?**
 - Small non-systematic failures and failures in intermediate markets
 - Failures in very low price periods
- **Will “virtual divestiture” be acceptable?**
 - Accepted by FERC in Exelon-PSEG but seems to have been discounted by DOJ and New Jersey
- **Will transmission mitigation continue to be accepted?**
 - Restore competitive alternatives versus cure HHI failures
 - Interim mitigation where there is no RTO is difficult
 - Non-physical mitigation (e.g. rights assignment)
- **Will standard evolve to be deferent to state concerns in unstructured areas?**

State Review of Mergers

- **Historically, most states deferred market power issues to FERC/DOJ and focused on rates, jobs, etc.**
- **States killed two major mergers in 2006 due to a combination of excessive greed, anger and wholesale market concerns**
- **States also recently have killed two major hedge fund acquisitions but have not shown the same hostility to long term financial players**
- **At the state level, mergers are not just regulatory but also political**
 - Maryland legislature
 - Current activity in Texas re TXU acquisition

Vertical Issues at FERC

- **Transmission Market Power**

- Join an RTO as a requirement seems off the table but works as a solution
- Anything beyond reformed OATT?

- **Gas Transmission and Distribution**

- Existing standard makes little sense but is commendably weak
 - Standard is that both electricity and gas pipeline rights markets are not highly concentrated
 - Gas generation assumed to be controlled by pipeline
 - Gas market measured in terms of firm pipeline rights
 - In fact, at least absent direct pipeline control, shouldn't be an issue at all



Key Conclusions

- **Little substantive change in approval criteria are on the horizon, but little things matter, in some cases, a lot**
- **Financial player acquisitions and long-distance mergers are easier to do from an antitrust perspective**
- **Conversely, nearby mergers, with the most synergy possibilities are hardest, particularly where generation remains attached to affiliated load**
- **There remain plenty of acquisition-oriented players**