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Merger Focus: Equitable/Dominion a Merger Litigation “Win” for the FTC

By J. Bruce McDonald

The FTC’s challenge to Equitable Resources’ proposed acquisition of a Pennsylvania natural gas utility competitor has just been completed, and the agency will put this one in the “win” column. Although a district court rejected the FTC challenge, while awaiting appellate decision the parties abandoned their transaction, and the appeals court has vacated the district court decision. Although the merits of the challenge now will not be litigated, the district court’s ruling that the FTC action was precluded by “state action”—in the form of the Pennsylvania PUC’s authorizing the merger—might have created an obstacle to federal merger enforcement in regulated industries.

Equitable Resources produces natural gas and distributes gas to residential and commercial customers in Pennsylvania and West Virginia. In 2006, Equitable agreed to purchase a subsidiary of Dominion Resources, The Peoples Natural Gas Company, which owns local gas distribution systems that serve customers in southwestern Pennsylvania (“Dominion”). These distribution systems have since the early 1900s overlapped in Pittsburgh and nearby counties in western Pennsylvania, although such overlapping retail service now is rare and generally disapproved by the Pennsylvania PUC. About 500 industrial and commercial customers enjoyed the benefits of this “gas on gas” distribution competition.

The PUC, under its statutory authority to review and approve mergers, examined the proposed merger and approved it in April 2007. The PUC determined that the gas-on-gas distribution competition between Equitable and Dominion was inefficient and that elimination of the overlap would produce overall efficiencies, benefiting about 650,000 retail customers.

The FTC, disagreeing on the merits with the PUC decision, filed a challenge seeking a preliminary injunction.¹ The FTC alleged that Equitable and Dominion had competed vigorously in providing gas distribution services to the overlap business customers, by offering rates below their PUC-approved maximum rates and by offering better service and other incentives.² The FTC alleged that the merger would lessen competition and increase prices for those 500 overlap customers.³

Of most interest to practitioners is the ruling by the district court on the defendants’ motion to dismiss the FTC complaint on state action grounds. The PUC has the authority to review and approve a merger of gas distribution companies, to determine if it is likely to result in “anticompetitive or discriminatory” conduct or harm a variety of other “consumer protection” interests.⁴ The PUC also has the authority to determine whether a distribution company’s proposed maximum rates are just and reasonable.⁵ The defendants asserted that the grant of this authority to the PUC satisfied the “state action” defense, which recognizes that federal antitrust legislation should give way to decisions by state governments to allow anticompetitive activities, subject to state oversight.

For the state action defense to apply, an antitrust defendant must satisfy two requirements. First, the defendant’s conduct must have been the “foreseeable result” of a “clearly articulated and affirmatively expressed... state policy” to replace competition with regulation.⁶ Second, the defendant must show that the state “actively supervised” its program and that state officials had the power to review the defendant’s activities and disapprove any that were inconsistent with state policy.⁷

The district court agreed with the defendants, holding that the PUC’s merger approval authority and ongoing regulatory authority constituted a “clearly articulated policy to displace competition” along with active supervision going forward.⁸ The court dismissed the FTC’s action; however, the Court of Appeals for the Third

Circuit enjoined the parties from closing the merger pending the FTC's (now moot) appeal.⁹

Obviously the FTC reached different conclusions than did the Pennsylvania PUC on the likely anticompetitive effects of the combination, possible efficiencies, and significance of the fact (found by the PUC) that a large category of customers would benefit even if a small group might suffer. The district court too implied its disagreement with the FTC on the merits:

The FTC continually and inaccurately labels the merger as "anti-competitive," which it is not. Further, the FTC stated that this Court "suggest[ed]" that "the PUC may permit an anti-competitive merger," which it did not. The merger benefits 600,000 plus customers and may disadvantage approximately 500 customers—that is not an anti-competitive merger.¹⁰

There appeared to be legitimate merits arguments on both sides. The FTC has not made public the full reasoning behind its challenge to this merger, although it has asserted it has evidence that Equitable projected a significant price increase and that the merging parties had begun to refrain from competing with each other premerger.¹¹ Furthermore, the FTC may have considered whether the competitive benefits obtained by the business customers might redound to the benefit of many ultimate consumers. On the other hand, the PUC had determined that, given the Pennsylvania rate regulation scheme, the residential customers were essentially subsidizing the below-cost-of-service rates that the overlap business customers had obtained from these competing suppliers.¹²

The district court's view on the merits of the FTC's merger challenge may have influenced its decision on the state action question. The court cited the supposed benefits of the merger in its decision granting the defendants' motion to dismiss:

While this statement [that the PUC's public interest review does not conflict with federal antitrust policy] may be true on some theoretical level, the real world implications are that the FTC is attempting to stop a transaction which the PUC has found to be in the overall public interest of the citizens of the Commonwealth of Pennsylvania.¹³

In the Third Circuit, the FTC argued that the existence of pervasive industry regulation is not enough to conclude that the legislature has authorized particular activities that are inconsistent with competition or empowered the PUC to regulate the postmerger

conduct that allegedly would cause antitrust injury.¹⁴ However, before the court of appeals ruled, the parties abandoned the transaction.

Certainly it is not unusual for a federal antitrust agency to disagree with the conclusions of a regulatory agency on whether a particular transaction should be allowed, especially where the regulatory agency applies a "public interest" or similar standard of which the competition analysis is only one part.¹⁵ Nevertheless, this was a novel defense as applied here, and in the past there have been numerous federal challenges to mergers in regulated industries to which this argument might have applied.¹⁶ Therefore, the Third Circuit's opinion would have been of exceptional significance to the federal antitrust enforcers. Although Equitable and Dominion have abandoned their transaction, it seemed unlikely that the state action defense would have been successful. On February 5, 2008, The Third Circuit granted the FTC's motion to vacate the district court's decision, despite the opposition of Equitable and Dominion and the Pennsylvania PUC.¹⁷ ■

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- 1 *FTC v. Equitable Res. Inc.*, No. 07CV0490, (W.D. Pa. filed Apr. 13, 2007).
- 2 Compl. ¶¶ 19-20, available at <http://www.ftc.gov/os/adjpro/d9322/070413cmpltforpi-tro.pdf>.
- 3 *FTC v. Equitable Res. Inc.*, 512 F.Supp.2d 361 (W.D. Pa. 2007).
- 4 *Id.* at 369.
- 5 *Id.* at 365.
- 6 *City of Columbia v. Omni Outdoor Adver., Inc.*, 499 U.S. 365, 373 (1991); *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980).
- 7 *Midcal*, 445 U.S. at 105.
- 8 2007 WL 1437447, at *6, *8.
- 9 *FTC v. Equitable Res. Inc.*, No. 07-2499, Order at 1 (3d Cir., May 21, 2007). The FTC asked the court of appeals to vacate the district court opinion. FTC's Suggestion of Mootness and Motion To Vacate the District Court's Decision, No. 07-2499 (3d Cir., filed Aug 17, 2007).
- 10 *FTC v. Equitable Res. Inc.*, No. 07CV0490, 2007 WL 1500046, at *8 (W.D. Pa. May 21, 2007).
- 11 *Id.* at 4.
- 12 Opinion and Order, Joint Application of Equitable Resources, Inc., No. A-122250F5000, Before the Pennsylvania Public Utility Com'n, at 63-65 (Apr. 13, 2007).
- 13 2007 WL 1437447, at *7.
- 14 *FTC v. Equitable Res. Inc.*, No. 07-2499, Emergency Motion of the FTC at 11, 15-16 (3d Cir., filed May 18, 2007).
- 15 Compare Press Release, DOJ, Statement by Assistant Attorney General Thomas O. Barnett Regarding the Closing of the Investigation of AT&T's Acquisition of BellSouth (Oct. 11, 2006) (announcing closing of Antitrust Division investigation without challenge), available at http://www.usdoj.gov/atr/public/press_releases/2006/218904.pdf, with *In re AT&T Inc. & BellSouth Corp. Application for Transfer of Control, Memorandum Op. & Order*, at 150, 10-11 (imposing special access requirements as condition for merger and contrasting FCC "public interest" review and DOJ review "limited solely to an examination of the potential competitive effects of the acquisition, without reference to national security, law enforcement, or other public interest considerations"), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-06-189A1.pdf.
- 16 Both federal agencies have challenged mergers that also required approval of a state or local authority that postmerger would have some ongoing regulatory authority over the merged entity. For example, the FTC and DOJ have challenged cable mergers, which may be subject to review by county and municipal authorities with responsibility for granting and overseeing cable franchise agreements. *E.g.*, *In re Am. Online, Inc. & Time Warner, Inc.*, No. C-3989 (FTC, filed Dec. 14, 2000), available at <http://www.ftc.gov/os/2000/12/aolcomplaint.pdf>. The Antitrust Division has challenged mergers of electricity generators and telecommunications companies that were subject to approval of state utility commissions with ongoing regulatory authority. *E.g.*, *United States v. Exelon Corp.*, No. 1:06CV01138 (D.D.C., filed June 22, 2006), available at <http://www.usdoj.gov/atr/cases/f216700/216785.pdf>; *United States v. Verizon Commc'ns Inc.*, No. 1:05CV02103, (D.D.C., filed Oct. 27, 2005), available at <http://www.usdoj.gov/atr/cases/f212400/212428.pdf>.
- 17 *FTC v. Equitable Res. Inc.*, Order at 1, No. 07-2499 (3d Cir., Feb. 5, 2008).

The original article is available on the American Bar Association website at <http://www.abanet.org/abanet/common/login/securedarea.cfm?areaType=premium&role=at&url=/antitrust/mo/premium-at/at-tei/Spring2008.pdf>

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