# FEDERAL TRADE COMMISSION LOSES TWO BIDS TO BLOCK TWO ENERGY MERGERS IN ONE MONTH

The Federal Trade Commission (the "FTC"), which often finds itself criticized for a perceived unwillingness or inability to "control" energy prices, recently filed challenges to two energy-related acquisitions. In both cases, the FTC sought a preliminary injunction to prevent the merger and the district court refused to grant the injunction. The FTC has appealed one decision and withdrawn the other matter from adjudication, but the FTC's consecutive losses in the politically sensitive energy sector are noteworthy. The FTC lost both challenges—(1) Equitable Resources, Inc.'s proposed takeover of Peoples Natural Gas Co. in Pennsylvania,[1] because of the state action doctrine, and (2) Western Refining, Inc.'s proposed merger with Giant Industries, Inc. in New Mexico,[2] because of a factual disagreement with the court.

## 1. ***FTC v. Equitable Resources, Inc.***

### Background

On March 14, 2007, the FTC issued an administrative complaint challenging the proposed intrastate acquisition of Peoples Natural Gas Co. by Equitable Resources, Inc. as a violation of Section 5 of the Federal Trade Commission Act and Section 7 of the Clayton Act. Shortly thereafter, on April 13, 2007, the Pennsylvania Public Utility Commission (the "PUC") found that the acquisition was in the public interest and approved the transaction.[3] The FTC then filed a complaint in federal district court requesting a preliminary injunction to prevent the acquisition from going forward pending the outcome of the already filed administrative complaint.

The FTC contends that the proposed merger will have a harmful competitive effect on approximately 500 industrial and commercial customers who currently have access to two gas distribution systems (known as "gas-on-gas" competition) and can negotiate discounted rates that are lower than the maximum tariff rates. The PUC, however, found that the discount competitive rates available to those customers caused increased prices to over 600,000 other primarily retail customers in the state. After considering the competitive effects and other factors, the PUC approved the transaction, finding that it would create efficiencies and benefit the public as a whole. The district court dismissed the FTC's complaint, holding that state action immunity insulated the merger from federal antitrust scrutiny. That decision is notable because it represents the first time a court has pre-empted federal antitrust review of a merger involving two private entities on the basis

[1] *FTC v. Equitable Res., Inc.*, No. 07-490, 2007 U.S. Dist. LEXIS 35061 (W.D. Pa. May 14, 2007).

[2] *FTC v. Western Ref., Inc.,* No. 07-352, 2007 U.S. Dist. LEXIS 47606 (D.N.M. May 29, 2007).

[3] The Pennsylvania Public Utility Code (the "Code") grants the PUC broad authority to regulate public utilities in the state, including regulation of safety standards, rates, competition, services and facilities, and enforcement of the Code. The Code grants the PUC the authority to reject any transaction upon a finding of discriminatory or anticompetitive effects. In addition, the Natural Gas Choice and Competition Act directs the PUC not to approve such a transaction if it would have "anticompetitive or discriminatory" effects on the "retail natural gas market."

of the state action doctrine. The Third Circuit Court of Appeals has prohibited the parties from consummating the merger pending resolution of the appeal.

**The State Action Doctrine**

The state action doctrine originated with the U.S. Supreme Court's decision in *Parker v. Brown*, which held that the Sherman Act does not apply to anticompetitive restraints undertaken by a state.[4] Later cases extended this antitrust immunity to acts undertaken by private parties if (1) the challenged restraint is "clearly articulated and affirmatively expressed as state policy" and (2) the policy is "actively supervised" by the state itself.[5] In this case, the main point of disagreement between the FTC and the defendants relates to the first prong of the test.

The FTC contends that the Commonwealth of Pennsylvania did not clearly articulate a policy authorizing natural gas distribution companies to consummate anticompetitive acquisitions. The FTC also argues that state action immunity should apply only when a state intends to displace competition with regulation and the state's regulatory policy clearly conflicts with federal antitrust laws. Where state law promotes competition, there is no conflict with federal antitrust laws and the state action doctrine should not apply. According to the FTC, this case does not actually involve a conflict between state and federal law, but merely a factual disagreement between a state agency and a federal agency about the competitive effects of the acquisition. Thus, no immunity should apply and the FTC should be able to challenge the merger.

However, the district court found that the state legislature has clearly displaced competition with regulation and the immunity should apply. The court found that, "quite frankly, it is hard to imagine a more thorough 'articulation' of a state policy of regulation meant to take the place of free market competition than the overall comprehensive and pervasive governmental regulatory scheme set forth in the Code by the General Assembly of Pennsylvania."[6] The court said that while the state policy may not be in conflict with federal antitrust law "on some theoretical level, the real world application herein is 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."[7] The court indicated that the proper forum for challenging the merger would be an appeal to the state courts, where any party adversely affected by an agency decision has standing to appeal.[8]

**Implications Of The *Equitable Resources* Decision**

This case represents a broad application of the state action doctrine. According to the FTC's brief in the case, no prior court has pre-empted federal antitrust review of a merger of two private parties based on state action immunity. Moreover, this decision appears to be consistent, at least in theme,

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[4] 317 U.S. 341 (U.S. 1943).

[5] *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 937, 943 (U.S. 1980).

[6] *Equitable Resources*, No. 07-490, 2007 U.S. Dist. LEXIS 35061, at *21.

[7] *Id.* at *25.

[8] Newspaper reports showed that on May 9, 2007, the office of the Small Business Advocate filed such an appeal under state law. *Id.* at *25-26.

with the recent Supreme Court decision *Credit Suisse Securities v. Billing*, dated June 18, 2007. In *Credit Suisse*, the Supreme Court held that United States securities laws precluded application of the antitrust laws to certain conduct. While that case did not involve facts implicating the state action immunity, it held that, where a private party's conduct is regulated and policed by a government agency and its regulations, albeit a federal agency and federal regulations, application of the federal antitrust laws may be precluded.

**2. *FTC v. Western Refining, Inc.***

**Background**

On April 10, 2007, the FTC approved the filing of a complaint challenging the approximately $1.4 billion acquisition by Western Refining, Inc. ("Western Refining") of rival energy company Giant Industries, Inc. ("Giant"). The FTC sought a temporary restraining order and preliminary injunction in federal district court to halt the deal pending an administrative trial on the merits.

Both Giant and Western Refining operate petroleum refineries in the Southwest United States that serve among other areas, Albuquerque, New Mexico. The transaction originally was announced in August 2006. According to the FTC, Western Refining's proposed acquisition of Giant would lead to reduced competition for the bulk supply of light petroleum products to northern New Mexico, an area of the country where the two companies are direct and significant competitors.

Following a one week hearing, on May 29, 2007, the U.S. District Court for the District of New Mexico concluded that the transaction was not likely to harm competition and that a preliminary injunction to block the transaction was not warranted.

**The District Court's Decision**

The district court disagreed with the FTC on facts that were critical to the FTC's theory of the case. While the FTC convinced the court that the current market was concentrated and that the merger would increase market concentration, the court was not convinced that the market was significantly more concentrated than other inland markets or that the merger would significantly increase concentration in the relevant market. Although the FTC made a weak prima facie case that the merger would have anticompetitive effects, the defendants rebutted that presumption by showing low barriers to entry.

Moreover, the court found that the FTC's proposed geographic market definition was too narrow and excluded significant suppliers and potential suppliers that are not physically located in the relevant market but can and do supply gasoline there. Although the court agreed with the FTC that the relevant geographic market was limited to firms that provide bulk gasoline in northern New Mexico, the FTC's proposed market did not include all current suppliers of bulk gasoline to Albuquerque that the court believed should be included.

Finally, based on the evidence brought forth by Giant and Western Refining, the court found that the companies did not have the ability to affect market prices (either up or down) in the manner the FTC claimed. The court particularly believed that the pricing of the combined entity would be constrained by alternative transportation methods and sources of supply, including gasoline trucked

to New Mexico from El Paso or the Gulf Coast. The court also found that the FTC should have considered the entry of new competitors in the relevant market, which could be sufficient to obviate any anti-competitive effects of the acquisition such as an increase in prices in Albuquerque.

The court denied the FTC's request for a preliminary injunction and concluded that "the FTC has not shown that, if this matter moves to an administrative proceeding, there is a substantial likelihood it will be able to prove the merger may lessen competition in violation of Section 7 of the Clayton Act."[9]

**Implications Of The *Western Refining* Decision**

After the Tenth Circuit Court of Appeals denied the FTC's motion for an injunction pending appeal, the parties consummated the merger on May 31, 2007, and asked the FTC to withdraw the case from adjudication so that the FTC could assess the public interest in further litigation. The FTC agreed to withdraw the matter from adjudication on June 1, 2007.

The primary failing of the FTC was to convince the court that the facts supported its proposed market definition and theory of competitive effects. It remains to be seen whether this case is an anomaly or whether mergers involving bulk suppliers of gasoline may prove to be as difficult for the FTC to challenge successfully as mergers between hospitals have proven in recent years.

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[9] *Western Refining,* No. 07-352, 2007 U.S. Dist. LEXIS 47606 at *150.