

Client Alert

STATES (1) - FEDS (0): FTC's Bid to Block Natural Gas Acquisition Rejected under State Action Immunity Doctrine

On May 15, 2007, a U.S. District Judge for the Western District of Pennsylvania dismissed the U.S. Federal Trade Commission's (FTC) request for a preliminary injunction blocking Equitable Resources Inc.'s proposed acquisition of a Pennsylvania natural gas company. The ruling could have potential implications for federal antitrust authorities challenging mergers or conduct in industries that are subject to comprehensive state regulation. The FTC has appealed the District Court's ruling.

Background

On March 15, 2007, the FTC announced its decision to challenge Equitable Resources, Inc.'s proposed acquisition of The Peoples Natural Gas Company (Dominion Peoples), a subsidiary of Dominion Resources, Inc. The proposed acquisition, which was valued at \$970 million, would merge the only two distributors of natural gas to nonresidential consumers in the greater Pittsburgh area. Equitable contended that the merger would create efficiencies by allowing the distributors to eliminate surplus pipelines. The distributors estimated that these efficiencies would reduce costs by approximately \$145 million, saving customers nearly \$10 million. To further enhance the appeal of the merger, Equitable agreed to refrain from raising rates for three years following approval of the acquisition.

Despite these claimed benefits of the acquisition, the FTC voted 4-1 to issue a preliminary complaint in opposition to the merger. The complaint alleged that consummation of the merger agreement would violate Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Specifically, the FTC argued that the merger would allow Equitable to obtain monopoly power in several Pennsylvania markets, thereby reducing future competition for natural gas distribution and eliminating customer discounts. In the complaint, the FTC noted that "Equitable and Dominion competed vigorously for the business of individual nonresidential natural gas distribution customers in their overlapping service territories by offering discounts from the maximum rates" By reducing the number of distributors in certain markets, the Commission contended that the merger would facilitate coordinated interaction between distributors while also eliminating any incentive to provide customer discounts. On April 13, 2007, the FTC filed a complaint in U.S. District Court to seek a preliminary injunction to prevent the distribution companies from consummating the merger. On May 14, 2007, the Court granted the Respondents' Motion to Dismiss under the State Action immunity doctrine.

Legal Basis and Implications of the Ruling

The court easily applied the two-part legal standard for state action immunity articulated in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97,105 (1980). *See also Parker v. Brown*, 317 U.S. 341 (1943). State action immunity shields private parties from antitrust liability when (1) they act pursuant to "a clearly articulated and affirmative policy of regulation in place of competition" and (2) there exists "active supervision by the state itself." The Court found that both of these prongs were satisfied.

As to the first prong, the Court concluded that the General Assembly of the Commonwealth of Pennsylvania “clearly articulated, in specific Code provisions and in the Natural Gas Choice and Competition Act, a policy to disfavor and displace free market competition in favor of a pervasive regulatory scheme,” and further granted broad authority to the Pennsylvania Public Utility Commission (PUC) to “implement its legislative policies and prerogatives, including requiring the PUC to issue certificates of approval for proposed mergers, consolidations, acquisitions or other dispositions of natural gas distribution companies.” As to the second requirement, the Court found that the General Assembly directed the PUC to take a “very active role in supervising public utilities, including natural gas distribution companies”; and that it “explicitly retained jurisdiction to continue to actively monitor and review the approved merger transaction.”

Additionally, the court noted that the FTC focused on about 500 commercial and industrial natural gas customers who currently benefited from their ability to negotiate prices with both gas suppliers. The PUC said that while those customers benefit from competition, the other 600,000-plus Pennsylvania customers served by only one or another of the companies pay higher prices. As a result, the PUC said the vast majority of customers would benefit from the merger. The Court agreed on this substantive assessment of the relevant geographic market.

The FTC’s Complaint demonstrated that the Commission was not hesitant to challenge acquisitions that involved interstate commerce even where a local state agency also exercised authority to regulate the acquisition. However, consistent with principles of federalism, the Court told the FTC in its ruling that state regulators are entitled to greater deference. This ruling may therefore have implications in future mergers where local oversight, regulation and a resultant industry expertise may be present, thus causing the antitrust agencies to have to choose their cases more carefully.

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