UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA U.S. Department of Justice Antitrust Division 325 Seventh Street, N.W. Suite 500 Washington, DC 20530 Plaintiff, **v.** **ENOVA CORPORATION** 101 Ash Street San Diego, CA 92101 Defendant.	))))))))))))))))	Case Number: 98-CV-583 (RWR) Judge Richard W. Roberts

PLAINTIFF'S RESPONSE TO PUBLIC COMMENTS

Pursuant to the requirements of the Antitrust Procedures and Penalties Act ("APPA"), 15 U.S.C. § 16 (b)-(h) ("Tunney Act"), the United States hereby responds to the two public comments received regarding the proposed Final Judgment in this case.

I. THE COMPLAINT AND PROPOSED JUDGMENT

The United States filed a civil antitrust Complaint on March 9, 1998, alleging that the proposed merger of Pacific Enterprises ("Pacific"), a California natural gas utility, and Enova Corporation ("Enova"), a California electric utility, would violate Section 7 of the Clayton Act, 15 U.S.C. § 18. The Complaint alleges that as a result of the merger, the combined company ("PE/Enova") would have both the incentive and the ability to lessen competition in the market for electricity in California and that consumers would be likely to pay higher prices for electricity.

The Complaint further alleges that prior to the merger, Pacific's wholly owned subsidiary, Southern California Gas Company, was virtually the sole provider of natural gas transmission and storage to natural gas-fueled electric generating plants in Southern California ("gas-fired plants"). As a consequence and without regard to the merger, it had the ability to use that market power to control the supply and thus the price of natural gas available to the gas-fired plants. Prior to the merger, however, Pacific did not own any electric generation plants, so it did not have the incentive to limit its gas transportation, sales or storage or to raise the price of gas to electric utilities in order to increase the price of electricity.

The Complaint alleges that in early 1998, the California electric market experienced significant changes as the result of a legislatively mandated restructuring. In this new competitive electric market, gas-fired plants, which are the most costly electric generating plants to operate, set the price that all sellers receive for electricity in California in peak demand periods. Thus, if a firm could increase the cost of the gas-fired plants by raising their fuel prices, it could raise the price all sellers of electricity in California receive, and increase the profits of owners of lower cost sources of electricity.

Based on these facts, the Complaint alleges that the merger violated Section 7 of the Clayton Act because the acquisition of Enova's low-cost electric generating plants gave Pacific a means to benefit from any increase in electric prices. The Complaint challenges the acquisition of these specific plants:

> Once Pacific's pipeline is combined with Enova's low cost electricity generation facilities, PE/Enova would have the ability to raise the pool price of

> electricity either by (a) limiting the availability of natural gas to competing gas-fired plants that supply the most expensive units of electricity into the pool, or (b) by limiting gas or gas transportation to gas-fired plants that are more efficient and would otherwise have kept the pool price for electricity down. PE/Enova would have the incentive to raise the pool price after the merger because, *through its ownership of low cost generation facilities,* it could profit substantially from any increase in the pool price of electricity and its incremental profits would more than offset any losses of gas transportation sales that would result from withholding gas from competing gas-fired plants. PE/Enova thus will have the incentive and ability to lessen competition substantially and increase the price of electricity in California during periods of high demand.

(Compl. ¶ 24 (emphasis added).)

The proposed Final Judgment directly remedies this harm by requiring Enova to divest its low-cost generating units to a purchaser or purchasers acceptable to the United States in its sole discretion. These divestiture assets are the Encina and South Bay electricity generation facilities owned by Enova and located at Carlsbad and Chula Vista, California, and include all rights, titles and interests related to the facilities.[1] By requiring this divestiture, the incentive *that was created by the merger* for PE/Enova to raise electricity prices is removed, providing a full remedy to the harm alleged in the Complaint.[2]

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[1] The Final Judgment provides that the approvals by the United States required by this decree for sale of these assets are in addition to the necessary approvals by the California Public Utilities Commission ("CPUC") or any other governmental authorities for the sale of such assets. Enova must submit required applications to divest the assets no later than ninety days after entry of the Final Judgment, and complete the divestiture as soon as practicable after receipt of all necessary government approvals, in accordance with the proposed Final Judgment.

[2] As explained in the Competitive Impact Statement ("CIS"), the decree does not require the divestiture of the merged company's nuclear assets, as the price of electricity from those assets will be regulated during the critical first years of the decree, which means that ownership of those assets will not give the merged firm an incentive to raise prices. In 2001, if the nuclear power prices become deregulated, the decree provides for safeguards to ensure that any incentive to use these assets to raise price is minimized or eliminated.

As part of the settlement, the United States also obtained the Defendant's agreement to protections that are beyond those needed to remedy directly the harm created by the acquisition. The proposed decree includes limitations on PE/Enova's ability in the future to acquire other low cost gas-fired generating assets that could give the merged firm the same incentive and opportunity to raise electricity prices that the acquisition of the divested Enova assets would have presented. Recognizing that PE/Enova would have numerous acquisition opportunities over the next few years as a consequence of the State of California's orders that many generating assets be divested (see CIS at 13), the proposed decree requires PE/Enova to seek prior approval from the United States before acquiring ownership or ownership-like rights to other low-cost, California generating assets. The United States can, at its sole discretion, disallow any acquisition of such assets, without incurring the costs and risks of litigation.[3] The types of transactions subject to this prior approval process include outright acquisition of any existing California Generating Assets (Final Jmt. § V.A.1); any contract that allows PE/Enova to control such assets (Final Jmt. § V.A.2); any contract for the operation and sale of the output from generating facilities owned by the Los Angeles Department of Water and Power ("LADWP"), the second largest generator of electricity in California and an entity owning more generation

[3] The Final Judgment does not prevent PE/Enova from building new capacity in California, or from acquiring capacity built in California after January 1, 1998. New capacity will only be built in California if the output is inexpensive enough to be sold in many hours. By increasing the amount of less expensive power available to meet demand, new, low-cost capacity will reduce the number of hours in which the most costly gas-fired capacity is needed. This in turn will limit PE/Enova's ability to raise the pool price since it is more costly and difficult for PE/Enova to restrict gas to more numerous low-cost plants. For the same reasons, the Final Judgment allows the merged company to acquire or gain control of plants that are rebuilt, repowered, or activated out of dormancy after January 1, 1998. Output from such plants is the equivalent of output from new-build capacity. CIS at 13-14.

than Enova even prior to the divestiture) (Final Jmt. §§ V.A.2, II.B); power management contracts of California Generating Facilities with the LADWP (Final Jmt. §§ V.C.4, II.C); and future tolling arrangements of the type that would most clearly mimic true ownership of the tolled facilities (Final Jmt. §§ V.A.2, V.C.3).

In addition, the United States has the ability to monitor PE/Enova's entry into many power management contracts not subject to prior approval (Final Jmt. § V.C.5). The United States thus has the opportunity to review these contracts, which are relatively new in the deregulated California market, and determine whether they would give PE/Enova the same incentive to raise electricity prices that ownership of the divested Enova assets would have created. The United States can then challenge any contracts that would do so.

In sum, the decree provides two types of relief for the United States. First, it achieves a direct remedy for the harm caused by Pacific's acquisition of Enova's low-cost generating assets by ordering divestiture of those specific assets. Second, it provides the additional benefits of the prior approval and contract monitoring provisions. These additional provisions are not meant to (nor can they) prevent PE/Enova from entering any transaction or acquiring any asset that could give it the incentive to exploit Pacific's pipeline market power in the electricity market. Instead they provide the United States with a check on potentially anticompetitive transactions, where the acquisition of such assets would again create incentives similar to these created by the assets acquired (and divested) in the transaction before this Court.

The United States and Enova have stipulated that the proposed Final Judgment may be entered after compliance with the APPA.

II. RESPONSE TO PUBLIC COMMENTS

On June 8, 1998, the United States filed the CIS in this docket and on June 18, 1998, the Complaint, Final Judgment and CIS were published in the Federal Register. The Federal Register notice explained that interested parties could provide comments to the Department for a period of 60 days. Two parties filed comments with the Department: Edison International ("Edison") and the City of Vernon.

A. Edison's Comments

Edison's primary comment is that the decree does not strip PE/Enova of the ability or incentive to increase electricity prices, but only eliminates one opportunity to do so. Despite the decree, Edison argues, PE/Enova still can use Pacific's market power over natural gas transmission and still can enter into transactions that will give it the incentive to exercise that power and raise electricity prices. Edison enumerates and discusses particular transactions that would give Pacific that incentive:

1. Building or acquiring new or repowered generating facilities;
2. Entering into tolling agreements;
3. Entering into power generation management contracts; and
4. Entering into financial contracts (derivatives) tied to prices in the California Electric market.

But Edison's criticism misses the mark, because each of the potential transaction it lists is a transaction that *Pacific could engage in whether or not it merges with Enova.* Thus, Edison's comments do not focus on the harm *caused by the merger*, but rather on the harm to competition that might result from Pacific's premerger ownership of a monopoly gas pipeline. In contrast, the United States' Complaint is focused only on the effects that flow from the merger.

Edison's assertion (Edison Comments at 13) that Pacific had no premerger incentive to manipulate electricity prices is simply wrong. As soon as California deregulated retail electricity prices, Pacific had the incentive, among other things, to build or acquire new and/or repower other existing generating assets, purchase derivatives, and make gas tolling agreements in order to exploit its pipeline's market power over gas-fired generators. The ability and incentive of Pacific to exercise its natural gas transmission market power for gain in the electric market in any of these manners does not require acquisition of any of Enova's generating assets or its "electricity expertise."[4]

Nevertheless, Edison argues that the Final Judgment is defective because the United States did not also "understand[], anticipat[e], and then prohibit[] all the various means by which the merged company could seek to retain or create incentives to earn profits through electricity price manipulations." (Edison Comments at 20.) To the extent that Edison means to suggest that, once any merger transaction is found to violate the Clayton Act, a merger decree should enjoin any and all other means by which the defendant might violate the antitrust laws in the future, the suggestion plainly is incorrect.[5] Contrary to Edison's suggestions, enforcement of the merger laws, Section 7 of the Clayton Act, is aimed at remedying the competitively harmful

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[4] Edison's comments, which mention Enova's "electricity expertise" in one sentence, do not define this term, identify where in Enova it resides, or assert that Pacific, the pipeline's parent company, did not already have such expertise prior to the merger or have the ability to obtain it by a number of means, including hiring employees with electric experience.

[5] See Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 133 (1969) (explaining that a court may not enjoin "all future violations of the antitrust laws, however unrelated to the violation found by the court"); Hartford-Empire Co. v. United States, 323 U.S. 386, 409-10 & n.7 (1945) (citing NLRB v. Express Publ'g Co., 312 U.S. 426, 433, 435-36 (1941)).

changes in market structure or other conditions *that result from the merger*. Here, the merger takes Pacific's ability to profitably raise electric prices and adds the incentive provided by Enova's low cost generating assets. The proposed decree severs those assets from the merged company, *remedying the change* in incentive and ability from the status quo ante. The Final Judgment requires these assets to be sold to a party that will not own the monopoly pipeline and removes the *new* incentive *provided by the acquired Enova assets* for PE/Enova to use the pipeline's already existent market power.[6]

Just as Edison's critical comments do not address the merger-related harms alleged in the Complaint, its comments do not address whether the parties' proposed decree is adequate to remedy the harms alleged in that Complaint. Instead, Edison proposes its own alternative remedies that either do not address the harm caused by the merger, or are not as effective as the decree. Edison suggests that: (1) the merger be rescinded, (2) the pipeline be divested, (3) the pipeline be controlled by an independent system operator, or (4) the merged company be barred from trading in financial instruments for Southern California electricity markets (Edison Comments at 6).[7]

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[6] Edison also makes the same argument from the opposite perspective -- that competition is separately harmed because *Enova* has gained an ability via the merger to raise price. (Edison Comments at 5.) Again, there is no additional pipeline monopoly power created by the merger. The proposed remedy is effective against the harm caused by the combination (the pipeline and Enova's low cost generating assets), whether the Southern California Gas Company pipeline's monopoly power is wielded by Enova or by Pacific.

[7] Edison compares its preferred options with the proposed Final Judgment, calling the remedy in the proposed Final Judgment "the least attractive option" from Edison's perspective. (Edison Comments at 3 ("The last but least attractive option is to try to lessen the merged firm's incentive to exercise its monopoly power in order to profit from higher electric prices.").) Edison finds this course less attractive because "it requires a complex latticework of provisions . . . [that is] difficult to write and even harder to administer." Id. The alternative it

Two of Edison's proposed remedies -- the independent system operator and the bar on trading -- are aimed at controlling the preexisting market power of the gas pipeline rather than remedying any harm created by the merger. And, ironically, the Edison remedies aimed most closely at the merger -- recission or divestiture of the pipeline -- would not place any limits on the pipeline's new owner's ability to raise the price of electricity or limit the pipeline owner from acquiring assets or contracts that would give it the incentive to do so, even though this incentive and ability is purportedly the gravamen of Edison's concern. The Proposed Final Judgment, in contrast, gives this emerging electric market more protection than Edison's suggested remedies through prior notice and market monitoring provisions.[8]

In the end, Edison's preference for a different remedy is not relevant to the Court's inquiry. Under the Tunney Act, the Court may not chose or fashion a remedy that is "better" in someone's opinion than the one negotiated and agreed to by the parties. To the contrary, "a

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suggests, creating an independent system operator for the pipeline system, has never been done anywhere in the United States and, while possible, cannot be assumed to be easy to write and easier to administer.

[8] For example, Edison argues that the FTC's consent decree in PacificCorp (PacifiCorp/The EnergyGroup, FTC File No. 9710091) provides a superior remedy. It mischaracterizes the FTC decree as equivalent to the divestiture of Pacific's gas pipeline assets that constitute virtually all of the assets Pacific contributed to the merger with Enova. Unlike this case, however, the divesture of coal assets in PacifiCorp was not the equivalent of recission of the merger. PacifiCorp is a large integrated electric utility with coal holdings in the western United States. It was acquiring the Energy Group, an international electric company, the second largest electric distribution company in the United Kingdom, which also held coal reserves in both eastern and western United States. The FTC decree did not require the Energy Group to divest its coal business, much less its primary utility business, as Edison would have the decree in the instant case require divestiture of Pacific's utility pipeline business. Instead, the FTC decree required a specific subset of the Energy Group's western coal mines to be divested. The FTC's PacifiCorp decree stopped with divesture of those specific assets and, unlike the Final Judgment proposed here, did not go further to limit the merged company's reacquisition of assets that would create the same vertical problem as the divested assets.

proposed decree must be approved even if it falls short of the remedy the court would impose on its own, as long as it falls within the range of acceptability or is 'within the reaches of the public interest.'"[9] The proposed Final Judgment meets and exceeds this legal standard.

B. City of Vernon's Comments

The City of Vernon recognizes in its comments that the Proposed Final Judgment focuses entirely on the potential of PE/Enova to reduce competition in the electricity market in Southern California. It comments that the proposed judgment "ignores" the effect of the merger on the natural gas transmission market in Southern California. The case brought by the Department, however, involved the electricity market in Southern California, and the relief addressed in the Proposed Final Judgment remedies the competitive harm posed by the proposed acquisition to that market. The Complaint does not allege violations in the natural gas transmission market, and the City of Vernon's proposed relief is thus not relevant to this proceeding.

III. THE LEGAL STANDARD GOVERNING THE COURT'S PUBLIC INTEREST DETERMINATION

Once the United States moves for entry of the proposed Final Judgment, the Tunney Act directs the Court to determine whether entry of the proposed Final Judgment "is in the public interest." 15 U.S.C. § 16(e). In making that determination, "the court's function is not to determine whether the resulting array of rights and liabilities is one that will best serve society, but only to confirm that the resulting settlement is within the reaches of the public

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[9] United States v. American Tel. & Tel. Co., 552 F. Supp. 131, 153 n.95 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983) (mem.).

interest." United States v. Western Elec. Co., 993 F.2d 1572, 1576 (D.C. Cir.) (emphasis added, internal quotation and citation omitted), cert. denied, 114 S. Ct. 487 (1993).

The Court is not "to make de novo determination of facts and issues." Western Elec., 993 F.2d at 1577. Rather, "[t]he balancing of competing social and political interests affected by a proposed antitrust decree must be left, in the first instance, to the discretion of the Attorney General." Id. (internal quotation and citation omitted). In particular, the Court must defer to the Department's assessment of likely competitive consequences, which it may reject "only if it has exceptional confidence that adverse antitrust consequences will result -- perhaps akin to the confidence that would justify a court in overturning the predictive judgments of an administrative agency." Id.[10] The Court may not reject a decree simply "because a third party

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[10] The Tunney Act does not give a court authority to impose different terms on the parties. See, e.g., American Tel. & Tel., 552 F. Supp. at 153 n.95; accord H.R. Rep. No. 93-1463, at 8 (1974). A court, of course, can condition entry of a decree on the parties' agreement to a different bargain, see, e.g., American Tel. & Tel., 552 F. Supp. at 225, but if the parties do not agree to such terms, the court's only choices are to enter the decree the parties proposed or to leave the parties to litigate.

United States v. Thomson Corp., 949 F. Supp. 907 (D.D.C. 1996), cited by Edison (Edison Comments at 9-10), does not support Edison's argument to reject the Proposed Final Judgment. That case involved the Tunney Act review of a proposed final judgment that required one of the merging companies to license a copyright that it claimed but had not licensed prior to the merger. While there was some controversy as to whether the decree's license provisions could have been extracted as the result of a trial, see Thomson, 949 F. Supp. at 927, the Court nevertheless considered comments on the specific terms of the license proposal because of the potential anticompetitive harm that could result from *"the merger of these two publishing giants in conjunction with"* the asserted copyright claim. Id. at 928. The Thomson Court addressed comments on the license provision on that ground, and not because the decree would remedy preexisting wrongs; nor did the court add or alter any provisions to the Final Judgment that had not been agreed to by the parties. Here, in contrast, Edison is not commenting on a specific remedy agreed to by the parties as a means of addressing the harms related to a merger. Instead, Edison is asking this Court to insert an entirely new mechanism for relief into the decree, in order to address Pacific's *preexisting* pipeline market power as it could be exercised in relation to the acquisition of *any* electricity assets, regardless of Pacific's merger with Enova. Edison's proposed approach is completely at odds with Judge Friedman's actions in claims it could be better treated," United States v. Microsoft, 56 F.3d 1448, 1459 (D.C. Cir. 1995), or based on the belief that "other remedies were preferable," id. at 1460.

Further, the Tunney Act does not contemplate judicial reevaluation of the wisdom of the government's determination of which violations to allege in the Complaint. The government's decision not to bring a particular case on the facts and law before it, like any other decision not to prosecute, "involves a complicated balancing of a number of factors which are peculiarly within [the government's] expertise." Heckler v. Chaney, 470 U.S. 821, 831 (1985). Thus, the Court may not look beyond the Complaint "to evaluate claims that the government did not make and to inquire as to why they were not made." Microsoft, 56 F.3d at 1459; see also United States v. Associated Milk Producers, Inc., 534 F.2d 113, 117-18 (8th Cir. 1976).

The government has wide discretion within the reaches of the public interest to resolve potential litigation. See e.g., Western Elec. Co., 993 F.2d 1572; American Tel. & Tel., 552 F. Supp. at 151. The Supreme Court has recognized that a government antitrust consent decree is a contract between the parties to settle their disputes and differences, United States v. ITT Continental Baking Co., 420 U.S. 223, 235-38 (1975); United States v. Armour & Co., 402 U.S. 673, 681-82 (1971), and "normally embodies a compromise; in exchange for the saving of cost and elimination of risk, the parties each give up something they might have won had they proceeded with the litigation." Armour, 402 U.S. at 681. As Judge Greene has observed:

> If courts acting under the Tunney Act disapproved proposed consent decrees merely because they did not contain the exact relief which the court would have imposed after a finding of liability, defendants would have no incentive to consent

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the Thomson case. Judge Friedman, as Edison concedes, was careful not to substitute his judgment for the government's and, further, did not adopt proposed remedies that were unrelated to the merger. (See Edison Comments at 10).

> to judgment and this element of compromise would be destroyed. The consent decree would thus as a practical matter be eliminated as an antitrust enforcement tool, despite Congress' directive that it be preserved.

American Tel. & Tel., 552 F. Supp. at 151. This Judgment has the virtue of bringing the public certain benefits and protection without the uncertainty and expense of protracted litigation. See Armour, 402 U.S. at 681; Microsoft, 56 F.3d at 1459.

Finally, the entry of a governmental antitrust decree forecloses no private party from seeking and obtaining appropriate antitrust remedies. Defendants will remain liable for any illegal acts, and any private party may challenge such conduct if and when appropriate.

IV. CONCLUSION

After careful consideration of the public comments, the United States concludes that entry of the proposed Final Judgment will provide an effective and appropriate remedy for the antitrust violation alleged in the Complaint and is in the public interest. The United States will therefore ask the Court to enter the proposed Final Judgment after the public comments and this Response have been published in the Federal Register, as 15 U.S.C. § 16(d) requires.

Dated: January 11, 1999.

Respectfully submitted,

"/s/"

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<u>**CERTIFICATE OF SERVICE**</u>

I hereby certify that I have caused a copy of the foregoing Plaintiff's Response to Public Comments, as well as attached copies of the public comments received from the City of Vernon, California, and from Southern California Edison Company, to be served on counsel for defendant and for public commentators in this matter in the manner set forth below:

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