Merger Proceedings I:
Do Commissions Make Themselves Marginal?

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Merger applicants work to make regulation marginal. Last month's essay described their three-stage strategy: Pour the concrete early, distract with "benefits," and create deadline pressure. Adding momentum to the applicants' efforts are certain actions and inactions by commissions. This essay describes three.

Policy Voids Invite Self-Interest Proposals

Picture a state commission with a three-part policy: A merger transaction may not (a) pay a premium to the target company, (b) reduce actual or potential competition, or (c) mix utility and nonutility businesses. The only mergers possible would be ones that increased efficiencies. States that lack these three policies attract mergers that have all three features: premiums, reduced competition and nonutility businesses—each one a negative for the public interest.

Those three policies reflect traditional concerns, ones we've known about since the 1930s, ones for which most states still have voids. Modern mergers add new concerns. Consider market structure for "smart grid" (e.g., whether non-incumbents can offer new distribution-level services to historically captive customers). A state with no policy is an open field for merger applicants to tout the incumbent's "advantage"—to the practical exclusion of new entrants. In a state with no policy for broadband (e.g., whether it should be available to all, which entities should be obligated or invited to provide it), telecommunications mergers can claim as a merger benefit the applicants' willingness to invest in broadband voluntarily. When commissions accept this offer by making broadband investment a condition of merger approval, they are not condemning the companies to charity work. They are granting a first-mover advantage, aided further by the government imprimatur, in a developing market that could have been available to non-incumbent competitors.

In place of a merger policy, most states have "filing requirements." Applicants first fill in the blanks: the names of the merging companies, the transactional mechanics, the sources of financing. Then comes the essay question: "How does this transaction serve the public interest?" The question is right, but if the state has a void in place of a policy, the applicants use the space to argue their case, reciting benefits without committing to achieve those benefits. We read that the transaction "will make us more efficient and more competitive," and it "will combine Company's A skills with Company B's experience," or "will leverage Company A's assets with Company B's market presence." These are claims without accountability, stated with language so generic that any company could make the same claims. That is the result when policy void precedes proposal.

Hearing Procedures Make Commissions Passive

Hearing issues: On receiving a merger application, the commission publishes a "hearing order" establishing the issues to be addressed. If the commission has a merger policy, the hearing order lists the questions that test the transaction against the policy: What is the predicted benefit–cost ratio? Who bears the risk that the actual benefits and costs vary from the predicted? What utility resources are being diverted, from which activities, to make one company out of two? What are better uses for those resources? What transactions are precluded by this one? What markets will be made less competitive, at whose expense? What new acquisitions will follow? Does the commission have the resources to induce the merged company to perform?

But the commission without a policy has only one question: "Should we approve the merger?" The intervening party that recommends "Let's first establish a policy" is told "That is not this case." (When I urge commissions to create a merger policy, I often get one of two responses: "We have no merger pending, so we don't care about it" or "We have a merger pending, so we can't talk about it." That doesn't leave a lot of alternatives.)

Hearing sequence: In a newspaper story, the most important material comes first, the least important last. A hearing is not a newspaper story, but typical procedure makes it feel that way. The applicants' witnesses always appear first. When the commissioners' attention is at maximum, these witnesses have a chance to tell their story. True, the opponents can cross-examine. But the cross is constrained by the transaction. Its purpose is to narrow or undermine the applicant witnesses' arguments; it is not a vehicle to advance a different vision.

By the second week, when the opposing witnesses appear, ready to present alternative approaches to merger policy, commission attention has diminished. It's not intentional, but it's natural. Somehow a witness appearing on Day 9 seems less important than one appearing on Day 1, especially if the Day 9 witness is arguing something that seems abstract, like the need to put aside the specific proposal pending and create a general merger policy.

"Yes-or-No" Bipolarity Constricts Creativity

Lacking a policy, a commission sees only a choice between poles: "Do we approve the merger, yes or no?" It skips the central question: "What market structure and corporate structure will produce the best performance?" Without answering the second question first, there is no context; we can neither compare the proposal with alternatives, nor know if the proposal is precluding alternatives. With the case thus constricted, commissions tend to ask only: "Is there harm?" and "Are we at least getting something?"

Psychology plays a role, too. Because "no" is negative and "yes" is positive, decisionmakers tend to emphasize positives over negatives, especially if the positives are tangible and near-term while the negatives are abstract and long-term. Short-term offerings made concurrently with the merger are viewed as caused by the merger, even though

concurrence is not causation. Near-term offerings like the new downtown headquarters building, new renewable energy purchases and charitable contributions—these are all possible without a merger and therefore are not produced by the merger. But they become hard to turn down. And they distract: The question becomes "Do we want these benefits or not?" rather than "What service improvements, innovations and efficiencies do customers need, and is this merger the most cost-effective way to produce them?"

Saying "no" is a negative act. Rejections are "hostile to business." "We shouldn't tell utilities how to run their companies." And it is natural to substitute personal trust for fact-based analysis. I often hear a version of "Bad outcomes arise only from bad actors; the company that keeps our lights on can't be a bad actor." In fact, bad outcomes don't need bad actors. As Garrett Hardin described in his famous *Tragedy of the Commons*, bad outcomes can happen when good people pursue what is good for them, unconstrained by the regulator's vision of what is good for the public.

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Those are three ways in which applicant efforts to marginalize commissions are aided by the commissions themselves. My essay, "Merger Proceedings II: Do Commissions Make Themselves Marginal?" will add more.