Merger Strategy: Make Regulators Marginal

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When a merger's private aims conflict with regulation's public interest mission, the promoters have a strategy: make regulators marginal. The strategy, common to many merger applications, has three components: Pour the concrete early, distract with "benefits," and create pressure with deadlines. This essay explains how the promoters do it. Next month's essay will explain how regulators help.

Pour the Concrete Early

Merger planners don't ask regulators "What corporate structure will best serve the public?" They design the transaction themselves: who gets which businesses and which assets; who pays what, to whom and in what form (e.g., cash, debt retirement, stock); who bears which risks; who gets which executive positions and board seats; which agencies will have rate jurisdiction and what the post-transaction rates will be. Then they package it—with press releases, "expert" testimony, and political endorsements. They make the mold, mix the cement, and pour the cement into the mold.

If merging companies had placed customer service first, they would have approached the commission first, asking: What do customers need and want? What type of company can best serve those needs and wants? How should we, the promoters, be held accountable for the benefits we project and the costs we estimate?

Instead, the deal comes to the commission with the concrete hardened. And it is brittle. Those with different ideas are deemed deal-killers; the applicants resist any reallocation of benefit and cost because "it's all been painstakingly negotiated."

Distract with "Benefits"

Merger applicants always offer benefits. The types of benefits reveal the promoters' motivation.

A merger designed to help the consumer would offer enforceable promises—promises made possible only by the merger: promises about new products or services, permanent cost savings, new forms of responsiveness to customers, reductions in outages. One tip-off that a merger is not customer-motivated is this: Instead of promises, there are only aspirations (e.g., "We will adopt each other's 'best practices,'" as if it took a merger to learn best practices). Another tip-off is that the benefits that are offered fall into one or more of four categories, addressed next.

a. Benefits that are unrelated to the merger, i.e., are not made possible by the coupling of two companies and thus were achievable without the merger: Examples are renewable energy purchases; a new headquarters building downtown; a $100 check to each resident (this is for real); contributions to local charities (never anonymous, thus preserving the value of the incumbent's government-protected status); and hiring of and contracting with minorities, women and veterans. This last "merger benefit" should be an obligation (see the essay "Promoting Diversity and Prohibiting Discrimination: Is There a Regulatory Obligation to Society?"), not something withheld until needed as a merger sweetener.

b. Benefits that are among the utility's existing obligations, so should not depend on a merger: Examples are investing in energy efficiency, coordinating capacity and energy supplies with neighbors, improving reliability, joining a regional transmission organization, completing specified transmission projects, and maintaining operational support systems for competitive local exchange companies.

c. Benefits designed to satisfy specific constituencies whose purposes may be public-spirited, but are outside the regulator's statutory responsibilities: The list is as varied as the type of intervenor. How about the commitment to continue convening the "Environmental Forum"? Or to install, at all thermal generation plants, "environmental management systems ... that are self-certified to ISO 14001 standards"? Another common example is a temporary commitment to avoid worker layoffs. (The layoffs issue is a difficult one. Workers are the bedrock of our economy. Their fair treatment by employers and the public is essential to a civil, decent society. Worker salaries, benefits, and opportunities for professional growth are all relevant to utility regulation, because a thoughtful policy on employment stability is necessary to attract and retain the best. But a broad-brush protection from layoffs, without regard to need or competence, has no place in regulation—except in merger cases, to distract regulators.)

d. Benefits that customers will have to pay for: Examples are the renewable energy procurement and energy efficiency investments noted above. Broadband is another example. These are not benefits to the customers; they are business opportunities for the merged company. The applicants frame them as favors to the community, but the favor works in the other direction. The incumbents receive a government imprimatur that provides a first-mover advantage unavailable to other market entrants.

Create Deadline Pressure

"We need a decision by September 1 because the merger agreement expires then." Nothing better exemplifies the regulated regulating the regulator than when applicants insist that a commission created to advance the public interest rearrange its schedule and resources to address a proposal created by private interests.

Deadlines do have a legitimate purpose. The negotiated transaction price (what the acquirer pays and what the acquiree receives) is based on each party's predictions of the relevant stock values, and other economic conditions, at closing. The longer the wait, the greater the risk that actual values will depart from predicted. That is how investors lose money. These are

legitimate concerns for transacting parties. But basing a procedural schedule on those private concerns, rather than on the regulators' legal responsibility to gather, organize and deploy the necessary expertise, is evidence that the main motivation behind the deal is investor benefit, not consumer benefit. For if a merger is sought for consumer benefit, designed to produce efficiencies and innovations, those efficiencies inhere in the coupling of the companies; they do not depend on market timing.

Deadlines make regulators rush the proceedings. The chronic differential in resources becomes a squeeze, with multiple negative effects. Remember that prior to filing the application, the merger parties have had, literally, as long as they needed to prepare their case. After the filing, the statutory and/or contractual deadline takes over. The commission and the intervenors have limited months to master and respond to a transaction that applicants had unlimited months to conceive and create. The differential plays out in ways both macro and mundane. The utility applicants have multiple cross-examiners who divvy up the witnesses, easing the per-person workload and raising its quality; while commission and intervenor staff must carry heavier loads to meet the deadlines. The utility applicants even can cater lunches on-site, whereas intervenors need to wait on line at the local diner (this actually happens). The applicants can staff an off-site boiler room that prepares mid-hearing pleadings during the day, whereas intervenors can do so only at night. These differentials make a difference in the quantity and quality of information coming to the commission.

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These three efforts to marginalize regulators—pouring concrete early, distracting with "benefits," and creating deadline pressures—do not have to succeed. When they do succeed, it is because regulators help. How regulators help is next month's subject.