APRIL 2017
VOL. 17-4

PRATT'S

ENERGY LAW REPORT

LexisNexis®

Pratt's Energy Law Report

VOLUME 17 NUMBER 4 APRIL 2017

LexisNexis®

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ISBN: 978-1-6328-0836-3 (print)
ISBN: 978-1-6328-0837-0 (ebook)
ISSN: 2374-3395 (print)
ISSN: 2374-3409 (online)

Cite this publication as:

[author name], [*article title*], [vol. no.] Pratt's Energy Law Report [page number] (LexisNexis A.S. Pratt);
Ian Coles, *Rare Earth Elements: Deep Sea Mining and the Law of the Sea*, 14 Pratt's Energy Law Report 4 (LexisNexis A.S. Pratt)

An A.S. Pratt® Publication

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(2017–Pub.1898)

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POSTMASTER: Send address changes to Pratt's Energy Law Report, LexisNexis Matthew Bender, 121 Chanlon Road, North Building, New Providence, NJ 07974.

DOJ Obtains $600,000 Settlement from Duke Energy for HSR Gun-Jumping Violation

By Ian G. John, Jeffrey Ayer, and Jacob Boyars*

In this article, the authors examine the first case since 2014 in which the U.S. Department of Justice has sued an acquirer for obtaining control of an asset before the end of the Hart-Scott-Rodino Act waiting period.

The U.S. Department of Justice ("DOJ") recently brought a federal antitrust lawsuit against Duke Energy Corporation ("Duke"), alleging that Duke violated the Hart-Scott-Rodino Act of 1976 ("HSR Act") by taking beneficial ownership of assets prior to the expiration or termination of the HSR Act waiting period. Duke's alleged violation consisted of entering into a tolling agreement that gave it control over a power plant's output and profits as part of a broader agreement to acquire the plant. Simultaneous with the filing of its complaint, the DOJ also filed a proposed settlement under which Duke agreed to pay $600,000 in civil penalties to resolve the lawsuit. The case is the first since 2014 in which the DOJ has sued an acquirer for obtaining control of an asset before the end of the HSR Act waiting period (often referred to as "gun-jumping"). It is also noteworthy because Duke openly pursued the challenged conduct as part of a strategy to obtain the approval of electricity regulators for the transaction.

BACKGROUND

The HSR Act requires companies to notify the DOJ and Federal Trade Commission ("FTC") of planned transactions that meet certain size thresholds. The parties must refrain from completing the transaction during a waiting period in which the DOJ and FTC analyze the competitive effects of the transaction and determine whether to further investigate. During the waiting period the acquiring party must also refrain from obtaining "beneficial ownership" of the assets it is seeking to acquire. In the DOJ's view, beneficial ownership may include "assuming the risk or potential benefit of changes in the value of the relevant assets and exercising control over day-to-day business decisions."[1]

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[1] Complaint ¶ 12, *U.S. v. Duke Energy Corp.* (D.D.C. Jan. 18, 2017), *available at* https://www.justice.gov/opa/press-release/file/928781/download.

THE LAWSUIT

The DOJ's lawsuit concerns Duke's acquisition of the Osprey Energy Center ("Osprey"), a natural gas-fired electrical generating plant in Auburndale, Florida. Duke and the seller contemporaneously entered into two agreements in late 2014. First, they agreed that Duke would acquire Osprey. Second, they entered into a tolling agreement that took effect on October 1, 2014 and was to remain in force until the planned closing date in early 2017. Duke and the seller filed HSR Act notification forms and, on February 27, 2015, the antitrust authorities terminated the HSR Act waiting period, which permitted Duke to close the acquisition. The tolling agreement ran its course and Duke completed the acquisition on January 3, 2017.

The tolling agreement provided that Duke would make all competitive decisions related to Osprey's activities: Duke purchased and delivered the natural gas needed to operate Osprey; decided on an hour-by-hour basis how much electricity the plant would produce; and received all the electricity generated by Osprey. The seller's involvement was limited to operating Osprey in accordance with Duke's instructions, for which it was paid a fixed monthly fee and reimbursed for certain variable costs. Duke thus bore the risks of changes in fuel and energy prices and gained the profits or suffered the losses from Osprey's operations. The DOJ alleged that the tolling agreement thereby transferred beneficial ownership of Osprey to Duke and ended Osprey's existence as an independent competitor, months before Duke filed its HSR Act notification form and the waiting period expired.

According to the DOJ, whether a tolling agreement or other commercial arrangement represents a change in beneficial ownership depends on the circumstances. The DOJ acknowledged that "[a] tolling agreement alone does not necessarily confer beneficial ownership" and that tolling agreements similar to the Osprey agreement are "relatively common in the electricity industry." The DOJ stressed, however, that "[a]greements that transfer some indicia of beneficial ownership, even if common in an industry, may violate [the HSR Act] if entered into while the buyer intends to acquire the asset." The DOJ concluded that the tolling agreement here represented a change in beneficial ownership because the parties intentionally structured it as such "as part and parcel of a broader agreement to acquire the plant [that] had no economic rationale independent from the acquisition"—and said so explicitly in submissions to state and federal regulators.[2]

Many of the factual allegations in the DOJ's complaint come from

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[2] *See* Competitive Impact Statement at 5, *U.S. v. Duke Energy Corp*. (D.D.C. Jan. 18, 2017), *available at* https://www.justice.gov/opa/press-release/file/928776/download.

statements made by Duke to the Federal Energy Regulatory Commission ("FERC") and state electricity regulators in their review of the proposed transaction.[3] FERC employs a "screen" for acquisitions that increase market concentration beyond a certain threshold. Duke expected that the Osprey acquisition would fail the FERC screen and therefore be subject to additional scrutiny. Duke argued to FERC that its tolling agreement made the screen inapplicable because Duke "already control[ed]" Osprey such that the formal acquisition of Osprey would have no effect on competition. Duke also said in testimony to state regulators that the tolling agreement was not driven by business strategy but was simply a "mechanism to transfer the acquisition of the plant." Finally, Duke insisted that it was only willing to enter into a tolling agreement in combination with an acquisition agreement, and only if Duke had the right to terminate the tolling agreement without penalty in the event that FERC rejected the acquisition. For those reasons, and "considering the intertwined agreements in their totality," the DOJ concluded that Osprey ceased to be an independent competitive presence in the market after the initiation of the tolling agreement.[4]

CONCLUSION

This case underscores the need for merging parties to ensure they do not unlawfully coordinate their competitive efforts before the HSR Act waiting period has ended. Though the Osprey acquisition apparently presented no substantive antitrust concerns—the DOJ and FTC granted early termination of the HSR Act waiting period and the DOJ's complaint did not claim that competition was harmed by the acquisition—Duke's gun-jumping violation exposed it to a multi-million-dollar fine and ultimately a $600,000 settlement (not to mention the associated negative press reports). Furthermore, the case demonstrates the DOJ's willingness to pursue gun-jumping cases, even those based on relatively untested theories. For example, the DOJ cited no cases or prior enforcement actions in support of its arguments in the Osprey case. Rather, the DOJ referenced a 1996 speech by a DOJ official suggesting that management agreements in the radio industry could potentially lead to gun jumping violations if entered into in connection with an acquisition. Regardless of the enforcement priorities of the Trump administration, the DOJ and FTC will remain on the lookout for instances where the parties cease acting independently prior to the end of the HSR Act waiting period. Merging parties should take care to avoid gun-jumping even in transactions that are otherwise unlikely to merit antitrust scrutiny.

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[3] *See* Complaint ¶¶ 15–16.

[4] *See* Competitive Impact Statement at 5.