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UTILITY MERGERS AND THE MODERN (AND FUTURE) POWER GRID

By Scott Hempling
Reviewed by Joshua C. Macey*

Abstract: Scott Hempling's *Regulating Mergers and Acquisitions of U.S. Electric Utilities* provides a comprehensive history of electric utility mergers in the United States since the 1980s. Hempling documents the dramatic consolidation the industry has seen in the past fifty years, and he convincingly argues that electric utility mergers present unique problems for regulators. This Review considers how utility acquisitions (a) allow holding companies to leverage the utilities' creditworthiness to cross-subsidize non-utility affiliates, and (b) exacerbate informational asymmetries between regulators and utilities. It argues that utility mergers generate negative spillovers outside of the utility's service territory that have potentially significant environmental consequences, and argues that FERC and state energy regulators have been overly reluctant to respond to these challenges, even compared to regulators that oversee other heavily regulated industries.

I. INTRODUCTION

Scott Hempling's *Regulating Mergers and Acquisitions of U.S. Electric Utilities* traces the wave of mergers and acquisitions that transformed the electric power industry at the end of the twentieth and beginning of the twenty-first century.¹ Hempling's book is the latest in a long line of scholarship, much written by Hempling himself, exploring how market power remains a pervasive problem in restructured electricity markets.² As Hempling documents, since the 1980s, "a stream of mergers and acquisitions has cut the number of local, independent electric retail utilities in the U.S. by more than half."³

Regulating Mergers and Acquisitions offers a powerful and persuasive argument that utility mergers raise unique challenges for energy regulators. Elec-

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1. See SCOTT HEMPLING, *REGULATING MERGERS AND ACQUISITIONS OF U.S. ELECTRIC UTILITIES: INDUSTRY CONCENTRATION AND CORPORATE COMPLICATION* xxiii (2020) [hereinafter *REGULATING MERGERS AND ACQUISITIONS*].

2. See Scott Hempling, *Inconsistent with the Public Interest: FERC's Three Decades of Deference to Electricity Consolidation*, 30 *ENERGY L.J.* 233 (2018); Ari Peskoe, *Is the Transmission Syndicate Forever?*, 42 *ENERGY L.J.* 1 (2021) (critiquing investor-owned utilities control over transmission planning); Joshua C. Macey & Robert Ward, *MOPR Madness*, 42 *ENERGY L.J.* 67 (2021) (critiquing buyer-side market power mitigation rules); Joshua C. Macey & Jackson Salovaara, *Rate Regulation Redux*, 168 *U. PA. L. REV.* 1181, 1184 (2020) (arguing that resource adequacy reforms revise principles of public utility regulation); David Spence & Robert Prentice, *The Transformation of American Energy Markets and the Problem of Market Power*, 53 *B.C. LAW REVIEW* 131, 131-32 (2012).

3. See HEMPLING, *REGULATING MERGERS AND ACQUISITIONS*, *supra* note 1, at xxiii.

tric utilities, at least those Hempling analyzes,⁴ enjoy a government-granted monopoly franchise. In ordinary markets (by which I mean markets that are not dominated by rate regulated monopolists), competition disciplines firm behavior. Acquirers pursue targets because they believe the merger or acquisition will generate scale economies, or because they believe that the acquirer can improve the target's performance. Either way, mergers in ordinary markets at least theoretically benefit consumers as increased efficiencies allow firms to provide less expensive or superior goods.⁵ Utilities that possess a monopoly franchise, by contrast, are controlled by state and federal energy regulators but not by market forces.

To a casual observer, it might not be clear why utility mergers pose a problem for the electricity industry. Utilities already enjoy monopoly franchises. Why, then, should we be concerned when two monopolists join forces? One argument, commonly put forth by utilities themselves, is that utility mergers have helped the electric industry realize economies of scale and scope.⁶ Alternatively, a naïve observer of energy markets may feel that utility mergers have a neutral effect on energy markets. Mergers and acquisitions do not increase the acquirer's market power in the utility market. Before the merger, the acquirer and the target companies each enjoyed a monopoly. Since both acquirer and target returns are closely supervised by a regulatory body, one could plausibly conclude that utility mergers are neither harmful nor beneficial, since public utility commissions continue to scrutinize the price and services utilities offer after two utilities merge.⁷

But that is not the story Hempling tells. On his account, utility mergers support the interests of utility shareholders to the detriment of their captive ratepayers. In the absence of competition, acquirers do not pursue companies that will improve their own operations. Instead, they seek to take advantage of state government decisions granting distribution companies a monopoly over a physical distribution territory. The recurring theme is that utility acquisitions reflect an attempt to exploit what Hempling calls the "unearned advantage" that utilities obtain as result of their exclusive franchise.⁸

4. The Federal Power Act defines "public utility" broadly to mean any energy company subject to the jurisdiction of the Federal Energy Regulatory Commission. See 16 U.S.C. § 824(e). Hempling is analyzing utilities that enjoy a monopoly privilege. In this Review, I use the word utilities to refer to these rate regulated utilities—not as utility as defined in the FPA.

5. This assumes, of course, that the acquisition is not anticompetitive. See, e.g., Colleen Cunningham, Florian Ederer & Song Ma, *Killer Acquisitions*, J. POL. ECON. 3, 19 (2020) (analyzing the practice of "acquir[ing] innovative targets solely to discontinue the target's innovative projects and preempt future competition.>").

6. See HEMPLING, REGULATING MERGERS AND ACQUISITIONS, *supra* note 1, at 87, 195 (describing these potential benefits).

7. See David Spence, *Can Law Manage Competitive Energy Markets*, 93 CORNELL L. REV. 765, 769 (2008) ("Traditional regulation guaranteed that licensed monopoly energy service providers would be able to charge administratively established rates that allowed the companies a 'fair' return on their prudently made investments. In return, these 'public utilities' agreed to meet a variety of service obligations to the general public, including the obligation to serve all eligible customers and provide a reliable source of supply. State public service commissions regulated retail rates, and the Federal Energy Regulatory Commission (FERC) regulated wholesale rates.>").

8. See HEMPLING, REGULATING MERGERS AND ACQUISITIONS, *supra* note 1, at 154.

Regulating Mergers and Acquisitions is a terrific book, but its importance is not in showing that electric utility mergers have harmed electricity markets. We already know that, in no small part because of Hempling's prior work. Its contribution lies in its analysis of *why* utility mergers are harmful. Hempling makes a convincing case that acquirers leverage a utility's unearned advantage to subsidize non-utility affiliates. Doing so exposes utility customers to the affiliate's risks and gives the affiliate an advantage that was never intended to be used in the non-affiliate's market.

This Review focuses on two concerns raised by *Regulating Mergers and Acquisitions of U.S. Electric Utilities*⁹: (1) that utility mergers allow corporate affiliates to obtain advantages despite the fact that there is no reason to protect these affiliates from competition, and (2) that utility mergers exacerbate informational asymmetries and, in doing so, make it difficult for regulators to adequately supervise the operations of the firms they are charged with regulating.

Hempling is correct that acquisitions allow firms to use utility revenues to provide credit enhancements to non-utility affiliates. These credit enhancements are best understood as subsidies that flow from ratepayers to affiliates that do not enjoy monopoly franchises. That, in turn, allows non-utility affiliates to secure more favorable financing than their competitors. Hempling is also correct that utility mergers make it difficult for energy regulators, who face jurisdictional constraints and have access to limited resources, to manage the firms they are charged with regulating.

A recurring theme in *Regulating Mergers and Acquisitions* is that the behemoths that now dominate the retail electricity markets have managed to leverage their utility businesses to give themselves substantial advantages in related markets. These spillovers not only harm utility customers, but they also give utilities' affiliates an advantage over their competitors and hamper implementation of environmental policies.

This Review considers precisely how electric utility mergers differ from mergers in other industries in which the government has granted some market participants a valuable franchise. As described below, electric utilities are not entirely unique. Railroads, financial institutions, and telecommunications have long been afforded special government protections, and they have sought to use these protections to support their affiliates.¹⁰

Still, Hempling is right that the approach FERC and state public utility commissions have adopted to regulate utility mergers and acquisitions is remarkable even compared to these other highly regulated industries.¹¹ Regulators in these industries have long been aware that firms that enjoy these protections might be able to leverage them to their advantage in related industries.¹² For example, bank regulators have responded to some of the problems Hempling ana-

9. These are far from the only distortions Hempling analyzes.

10. See Lina M. Khan, *The Separation of Platforms and Commerce*, 119 COLUM. L. REV. 973, 1037-51 (2019).

11. See *infra* Part III.

12. The electric industry had similar requirements until Congress repealed the Public Utility Holding Company Act of 1935 (PUHCA). See HEMPLING, *REGULATING MERGERS AND ACQUISITIONS*, *supra* note 1, at 67-68.

lyzes by strictly limiting banks' ability to lend to affiliates and insisted that loans be negotiated at arm's length.¹³ Other industries have adopted similarly strict merger policies to prevent regulated businesses from leveraging their franchise to support non-regulated affiliates.

Finally, it is worth emphasizing that there is some hope for reform. Section 203 of the Federal Power Act (FPA) requires that FERC approve mergers only if the merger will "not result in cross-subsidization of a non-utility associate company."¹⁴ Hempling's analytic contribution about the harms caused by utility mergers thus suggests that FERC's merger policy is inconsistent with its statutory mandate.¹⁵

Part II of this Review describes the regulatory landscape that governs utility mergers. Part III focuses on Hempling's claim that utility acquisitions allow acquirers to cross-subsidize non-utility businesses. These cross-subsidies impede innovation, undermine decarbonization policies, and thwart efforts aimed at opening electricity markets up to competition. Part IV considers how utility consolidation exacerbates informational advantages utilities enjoy compared to their regulators. These informational asymmetries further undermine climate policy and efforts to reduce barriers to entry for independent power producers. Part V argues that Hempling's proposal, in which utility regulators adopt a proactive approach and approve utility mergers and acquisitions on the condition that the utility meaningful operational improvements, would also mitigate some (though not all) of these harms.

II. REGULATING UTILITY MERGERS AND ACQUISITIONS

The United States used to have a federal policy that governed electric utility mergers. Under the Public Utility Holding Company Act of 1935 (PUHCA), the Securities and Exchange Commission (SEC) could approve utility mergers and acquisitions only if the transaction created economic benefits and involved geographically contiguous utilities.¹⁶ PUHCA ensured that electric utilities remained relatively small, limited the amount of debt utilities could take on, and prevented utilities from expanding into riskier businesses.¹⁷

Today, FERC and states generally both have jurisdiction over utility mergers. After Congress repealed PUHCA's restrictions on utility mergers as part of the Energy Policy Act of 2005,¹⁸ it made FERC responsible for regulating mergers and acquisitions that involve two or more electric utilities.¹⁹ And, Congress

13. See *infra* Part III.

14. Federal Power Act of 1935 § 203, 16 U.S.C. § 824b(a). If the merger does result in a cross-subsidy, FERC can approve of it if it provides evidence that the merger is nevertheless "in the public interest." *Id.*

15. Hempling has previously made this argument in these pages. See Hempling, *Inconsistent with the Public Interest*, *supra* note 2, at 239.

16. Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 *et seq.*

17. See HEMPLING, REGULATING MERGERS AND ACQUISITIONS, *supra* note 1, at 67-68.

18. Interestingly, the pattern of utility mergers Hempling describes began in the 1980s, more than twenty years before PUHCA's repeal.

19. Federal Power Act of 1935 § 203, 16 U.S.C. § 824b.

gave FERC wide discretion to determine the best policy for regulating utility mergers.²⁰

Section 203 of the FPA is the statutory basis of FERC's authority to regulate utility mergers.²¹ Section 203(a)(4) instructs the Commission to approve proposed mergers and acquisitions "if it finds that the proposed transaction will be consistent with the public interest."²² Notably, FERC must find that the merger will "not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company unless the Commission determines that the cross-subsidization, pledge or encumbrance will be consistent with the public interest."²³

As Hempling observes, FERC has never adequately defined this "public interest" standard.²⁴ However, in 1996, the Commission issued Order No. 592, which outlines the Commission's merger review policy.²⁵ Order No. 592 establishes a five-step process that the Commission uses to analyze utility mergers.²⁶ FERC considers, among other things, if the transaction "would significantly increase concentration," if the merger "raises concern about potential adverse competitive effects," and if the merger will lead to "efficiency gains that reasonably cannot be achieved by other means."²⁷ According to FERC, this screen "identif[ies] proposed mergers that clearly will not harm competition."²⁸ Though FERC has repeatedly updated its merger review policy,²⁹ it has continued to permit mergers and acquisitions that cause no harm, which means simply that the identifiable costs do not exceed the benefits.³⁰

And this standard has proven to be highly accommodating of mergers and acquisitions and, according to Hempling, fails on its own terms.³¹ When FERC

20. FERC must make sure that the merger is in the "public interest," though it did not define this standard, and that the utility not be used to cross-subsidize non-utility affiliates. *See id.*

21. Federal Power Act of 1935 § 203, 16 U.S.C. § 824b(a).

22. *Id.* § 824b(a)(4).

23. *Id.*

24. *See* HEMPLING, REGULATING MERGERS AND ACQUISITIONS, *supra* note 1, at 65-72, 102, 109.

25. *See* Order No. 592, Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, 77 F.E.R.C. 61,263 (Dec. 18, 1996). FERC's policy is based on the Department of Justice and Federal Trade Commission's 1992 Horizontal Merger Guidelines. *See* 138 F.E.R.C. ¶ 61,109, at 2 (Feb. 16, 2012) (citing U.S. Dept. of Justice & Federal Trade Commission, "Horizontal Merger Guidelines" (1992)).

26. *See* Order No. 592, 77 F.E.R.C. at 3.

27. *Id.* at 3-4.

28. *Id.* at 4.

29. Order No. 642, Revised Filing Requirements under Part 33 of the Commission's Regulations, 65 Fed. Reg. 70,983 (Nov. 28, 2000) (revising data requirements); Order No. 667, Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, 113 F.E.R.C. ¶ 61,248, at 4, 6 (2005) (stating that "PUHCA 2005 [the merger requirements Congress passed in 2005] is primarily a 'books and records access' statute and rejecting requests to "reimpose particular requirements in PUHCA 1935 that Congress chose not to include in PUHCA 2005."); Order No. 669, Transactions Subject to FPA Section 203, at 6 (2005) (explaining the evidentiary basis the Commission would use to establish cross subsidization from a utility to a non-utility affiliate).

30. *See* HEMPLING, REGULATING MERGERS AND ACQUISITIONS, *supra* note 1, at 273; *Entergy & Gulf States, Inc.*, 121 F.E.R.C. ¶ 61,182 at P 71 (2007) (stating that FERC imposes conditions on utility mergers and acquisitions "only when needed to address specific, transaction-related harm").

31. *See* HEMPLING, REGULATING MERGERS AND ACQUISITIONS, *supra* note 1, at 72-73.

reviews mergers, it provides substantial deference to utilities' claims about the economic benefits of the proposed merger and only requires that the utility show that the proposed merger or acquisition does not cause any harm. Hempling objects to FERC's merger review process—rightly, in my opinion—both because it fails to identify many of the harms caused by utility mergers, and because the costs of error seem to be more significant when the Commission is overly accommodating of mergers than when it blocks value-adding transactions. Given the broad discretion the FPA affords the Commission, this seems to be largely a problem of FERC's making.

States, too, oversee utility mergers and acquisitions. Typically, state public utility commissions have jurisdiction only when the target of the merger or acquisition is subject to its jurisdiction.³² FPA Section 203 does not preempt state merger laws.³³ Thus, a state can block a utility merger even if FERC has approved it.

While there are considerable differences among state merger policies,³⁴ states have also failed to pay sufficient attention to the effects of utility mergers. Like FERC, states routinely apply the no-harm standard when approving utility mergers.³⁵ As a result, many utility mergers are approved with only minimal concessions. Sometimes the utility will offer a customer credit, perhaps for \$100, to entice a regulator to approve a merger. Or the utility might commit to investing in new office space in a community. Or it might agree to pursue other policies such as energy efficiency programs.³⁶

But these concessions fail to mitigate the harms Hempling analyzes. While a comprehensive analysis of the ills caused by utility mergers is beyond the scope of this Review,³⁷ it is worth pointing out that the no-harm standard fails even on its own terms: FERC refuses to consider many tangible and quantifiable harms. It is perhaps axiomatic that a no-harm standard should establish that the proposed transaction does not in fact cause harm.

But this is not what FERC does. Hempling shows that, among other things, FERC focuses exclusively on wholesale competition and thus ignores anticompetitive effects utility mergers have on retail competition, reviews mergers in isolation and therefore ignores their cumulative effects and fails to consider whether there is sufficient regulatory capacity to supervise the consolidated company.³⁸

32. *See id.* at 459.

33. *See id.* at 463.

34. *See id.* at 85-102 (describing state and FERC merger reviews).

35. *See id.* at 65-73 (discussing the no-harm standard).

36. HEMPLING, REGULATING MERGERS AND ACQUISITIONS, *supra* note 1, at 78-79; 85-102.

37. Readers are advised to go directly to the source and read Hempling's book.

38. *See id.* at 192-93 (describing an exception to this rule in which California denied a Southern California Edison-San Diego Gas & Electric merger application in part because it would make it more difficult for regulators to supervise the utilities).

III. CROSS-SUBSIDIZING NON-UTILITY AFFILIATES

A distinctive feature of utility mergers and acquisitions is that companies pay to control a utility's monopoly franchise.³⁹ Hempling calls this their "un-earned advantage."⁴⁰

The utility's exclusive franchise confers substantial benefits on the consolidated firm. For example, a holding company may try to "hide" one of its non-subsidiary's costs in the utility's rate base. Non-utility affiliates often participate in competitive generation markets. If the affiliate manages to recover some of the costs of generating electricity by including them in the utility's rate base, it will be able to sell electricity at a lower price, potentially pushing some of its competitors out of the market. This is a form of predatory pricing. But unlike traditional forms of predatory pricing, the firm does not incur a loss when it is predating, because it is able to use its utility to recover the losses incurred by the non-utility affiliate.

But perhaps the most insidious advantage that acquirers enjoy is that the utility's monopoly franchise can be used to create financing advantages for non-utility affiliates. Utilities have captive customer bases. Their rates are controlled by state utility commissions. Utility franchises therefore generally allow utilities to enjoy stable earnings. Historically, the primary risk pure-play utilities faced arose when they invested in new technologies that proved more expensive than expected.⁴¹

When a utility's holding company also owns non-utility subsidiaries, the holding company can use the utility's earnings to support non-utility affiliates. As Hempling explains, a holding company can use revenues generated from utilities "(a) . . . to finance the operations of non-utility affiliates, (b) lend money directly to those affiliates, or (c) pledge the utility's assets as collateral for third-party loans to affiliates."⁴²

These are cross-subsidies. The holding company uses the utility's assets as a credit enhancement to support non-utility affiliates. Doing so renders the utility less financially secure. When a utility guarantees non-utility affiliates' debt, creditors of non-utility affiliates can pursue the utility's assets directly. Such guarantees benefit non-utility affiliates by lowering their financing costs. In doing so, however, they make the utility less financially secure. A utility's cost of debt will increase as it becomes exposed to its affiliates' business risks. As a result, its captive customers' costs will increase as the utility has to pay more to finance its own operations.⁴³ In other words, market consolidation has exposed electric utilities to some of the risks incurred by non-utility affiliates.

It is worth noting that these credit enhancements are unusual even in highly regulated industries. For example, the Federal Reserve strictly limits the amount

39. This is not to say acquirers are motivated exclusively, or even primarily, by this unearned advantage. An acquisition may create economies of scale, or a utility may also be trying to exercise more prosaic forms of anticompetitive conduct such as refusing to deal with competitors.

40. See HEMPLING, *REGULATING MERGERS AND ACQUISITIONS*, supra note 1, at 154.

41. See *id.* at 283-84.

42. *Id.* at 287.

43. Hempling discusses these arrangements in detail in Chapter 7. See *id.* at 283-89.

that insured depository institutions are allowed to loan to their affiliates.⁴⁴ The Fed also requires that inter-affiliate loans be negotiated on an arms-length basis.⁴⁵ Insured depository institutions are therefore prohibited from making favorable loans to their affiliates. These limitations make it difficult for banks to lend to their non-FDIC-insured affiliates and thus ensure that the protection afforded by FDIC insurance cannot be used to support high-risk (and less closely regulated) activities. Similar arrangements have historically been used in other regulated industries.⁴⁶ In fact, until PUHCA's repeal, electric utilities were unable to enter into complex financing arrangements whereby a non-utility affiliate used a utility's profits to secure more favorable financing.

FERC, too, ostensibly scrutinizes transactions between utilities and non-utility affiliates,⁴⁷ but in reality the Commission has proven highly deferential to utility requests to support the financing needs of their non-utility affiliates.⁴⁸ According to a Jones Day memorandum, "[m]any applicants now request a waiver from the competitive bidding obligations that otherwise would apply, which is typically granted."⁴⁹

As a result of this lenient treatment, utility mergers have likely allowed carbon-intensive generation facilities to gain an advantage in restructured energy markets and introduced distortions in markets that are ostensibly competitive. Consider, for example, American Electric Power (AEP), which is the fifth largest electric utility in the United States.⁵⁰ According to AEP's website, coal accounts for approximately 45% of AEP's generating capacity, with natural gas accounting for an additional 28%.⁵¹

44. See Fed. Res. Act § 23A (limiting the amount banks can lend to covered affiliates); See also Saule T. Oumarova, *From Gramm-Leach Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N.C.L. REV., 1683, 1692-1701 (2011) (describing the scope of these restrictions).

45. Fed. Res. Act § 23B (requiring transactions between banks and affiliates be negotiated at arm's length).

46. See Lina M. Khan, *The Separation of Platforms and Commerce*, 119 COLUM. L. REV. 973, 1037-51.

47. See 8 C.F.R. § 34.2(a).

48. See, e.g., *AEP Tex. Cent. Co.*, 126 F.E.R.C. ¶ 62,156, at P 1 (2009) (granting a waiver from the Commission's competitive bidding requirements and authorizing AEP Texas Central to issue more than \$300 million in long-term debt securities, including \$200 million that can be issued to its corporate parent). FERC has established conditions for utilities that extend debt to non-utility affiliates. These are known as the Westar conditions. *Westar Energy, Inc.*, 102 F.E.R.C. ¶ 61,186 at PP 20-21 (2003), *order on reh'g*, 104 F.E.R.C. ¶61,018 (2003) ("First, public utilities seeking authorization to issue debt backed by a utility asset must use the proceeds of the debt for utility purposes. Second, if any utility assets that secure debt issuances are divested or 'spun off,' the debt must follow the asset and also be divested or 'spun off.' Third, if any of the proceeds from unsecured debt are used for non-utility purposes, the debt must follow the non-utility assets. Specifically, if the non-utility assets are divested or 'spun off,' then a proportionate share of the debt must follow the divested or 'spun off' non-utility asset. Finally, if utility assets financed by unsecured debt are divested or 'spun off' to another entity, then a proportionate share of the debt must also be divested or 'spun off.'").

49. JONES DAY, FEDERAL ENERGY REGULATORY COMMISSION REGULATION OF SECURITIES (Nov. 2009), <https://www.jonesday.com/en/insights/2009/11/federal-energy-regulatory-commission-regulation-of-securities>.

50. See STATISTA, LARGEST ELECTRIC UTILITIES BASED ON MARKET VALUE IN THE UNITED STATES AS OF APRIL 2020, <https://www.statista.com/statistics/237773/the-largest-electric-utilities-in-the-us-based-on-market-value/>.

51. See AEP, SUPPLYING ENERGY NATIONWIDE, [https://www.aep.com/about/businesses/generation#:~:text=Today%2C%20coal%2Dfueled%20power%20plants,energy%20efficiency%20\(3%20percent\)](https://www.aep.com/about/businesses/generation#:~:text=Today%2C%20coal%2Dfueled%20power%20plants,energy%20efficiency%20(3%20percent)).

Many of these generation assets are held by AEP Generation Resources, a non-utility affiliate.⁵² AEP's SEC filings list hundreds of millions in transfers from utilities to other affiliates of AEP.⁵³ In 2016, for example, AEP was allowed to borrow nearly \$1.2 billion from its utility money pool and on average borrowed approximately \$579 million.⁵⁴ AEP does have to keep its utility debt obligations separate from its nonutility debt obligations,⁵⁵ but the company's filings suggest that the creditworthiness of AEP's utility subsidiaries is closely linked to the creditworthiness of its non-utility subsidiaries, with the same short-term credit program being used to meet the AEP's utility and non-utility borrowing needs.⁵⁶

The result is that holding companies are able to use government-granted monopoly franchises to enhance the creditworthiness of their non-utility affiliates, and they are able to do so to a greater extent than similarly-situated industries. Hempling returns again and again to the idea of utility exceptionalism. Here, it seems that the relaxed regulatory standard that applies to electric utilities is exceptional even compared to other industries in which one firm could use a government benefit to cross-subsidize its affiliates.

And credit enhancements provided by electric utilities to non-utility affiliates undermine the financial strength of the utility. This increases the cost of debt, which forces utility customers to pay more for electricity. At the same time, these credit enhancements give the holding company's other subsidiaries an advantage in their markets. To the extent that these subsidiaries hold mostly carbon-intensive generation facilities, the result is that captive ratepayers are subsidizing fossil generators with a large carbon footprint. This is the case regardless of whether the utility's regulator has adopted decarbonization policies.

IV. INFORMATION ASYMMETRIES

Utility mergers and acquisitions also increase informational asymmetries that make it difficult for energy regulators to supervise utility rates and services. One reason this occurs is epistemic. Public utility commissions with limited resources struggle to monitor the many business lines owned by a large holding company that may implicate the service the utility provides to a community. This challenge is compounded by the fact that the FPA distributes jurisdiction between state and federal regulators such that no sovereign has authority to supervise all facets of a large holding company's energy company's operations.⁵⁷

More surprising, perhaps, is that utility mergers undermine what little competition rate regulated utilities face. This is surprising because rate regulated

52. See *id.*; AEP, OPERATIONAL STRUCTURE, <https://www.aep.com/Assets/docs/investors/fixedincome/AEPOperationalStructure.pdf>.

53. See AEP 2016 Annual Report, Form 10-K, 79 (listing \$25.6 million in transfers in 2015 and \$24.1 in 2016); 92 (listing \$11.7 million in transfers in 2015 and \$12.5 million in 2016); 106 (listing a \$331 million transfer in 2015 and \$24 million in 2016), <https://www.sec.gov/Archives/edgar/data/4904/000000490417000019/aep10kfreq1320164q.htm#sE1B8A9D425C6EC14FC5F51A6D5E00DF8>.

54. See *id.* at 274.

55. See *id.* at 39.

56. See *id.* at 272.

57. See Matthew R. Christiansen and Joshua C. Macey, *Long Live the Federal Power Act's Bright Line*, 134 HARV. L. REV. 1360, 1364-66 (2021) (describing the FPA's allocation of jurisdiction).

utilities possess government-granted monopolies and therefore by definition do not face competition. But as Hempling points out, while utilities do not compete with each other directly, regulators consider the rates set by other public utility commissions when setting utility rates. When utilities apply for rate increases, public utility commissions often consider the rates and services of similarly situated utilities. In other words, fragmented utility markets improve *comparability*. An electricity sector with many different utilities provides substantial data to regulators who want to compare utilities to each other. That, in turn, can be used to encourage utilities to provide more efficient service. Thus, while a utility may not lose customers if it provides inadequate rates and services, regulators may become more skeptical of a utility's management if a nearby utility is able to provide cheaper, cleaner, or more reliable service.

This creates a form of indirect competition that helps regulators monitor utility behavior and push for improved price and service. Public utility commissions look at the rates and services similarly situated utilities provide to establish benchmarks for the utilities under their supervision. For example, Hempling describes how, before Pepco, a utility based in the District of Columbia, merged with Baltimore Gas & Electric (BG&E), BG&E's ability to restore customer power after storms was used as a benchmark to encourage Pepco to improve its emergency services.⁵⁸ After the two companies merged, the two firms stopped being rivals, and such comparisons became less meaningful. Notably, California blocked a proposed merger between Southern California Edison and San Diego Gas & Electric in part out of concern that the merger would undermine "the companies' longstanding across-the-fence rivalry."⁵⁹ While certainly not a perfect substitute for robust competition, across-the-fence rivalry creates at least some accountability for rate regulated utilities.

Hempling is particularly concerned with utility mergers and acquisitions that "eliminate mavericks,"⁶⁰ which are "firm[s] that play[] a disruptive role in the market to the benefit of customers."⁶¹ Mavericks can create benefits by pioneering new technologies, reducing prices, and refusing to engage in collusive tactics.⁶² A maverick can provide important information to utility regulators, since the ability of one utility to cut costs, improve services, or transition to a less carbon-intensive fuel mix could suggest that other utilities would be able to do so as well. Maverick electric utilities can therefore create ambitious benchmarks that push other utilities to improve their own behavior.

Acquisitions reduce the number of utilities that can be used as a benchmark when regulators are setting new rates. The result is fewer data points that can be used to provide baseline data points that energy regulators can use when reviewing utility rates and services.

But utility acquisitions are particularly problematic when the target is a maverick, since the acquisition eliminates a company that provided evidence that

58. *Id.* at 193.

59. *Id.*

60. *Id.* at 188.

61. See FTC, HORIZONTAL MERGER GUIDELINES, 2.1.5, <https://www.justice.gov/atr/horizontal-merger-guidelines-08192010>.

62. See *id.*; HEMPLING, REGULATING MERGERS AND ACQUISITIONS, *supra* note 1, at 188.

other utilities could provide better service or lower prices. As a result, the acquisition of a maverick utility can reduce regulatory pressure other utilities face, because it eliminates an important datapoint for utility regulators.

It is worth noting that this harms the market as a whole and not just the customers of the parties to the transaction. When a maverick utility is acquired, it is not just the acquirer that benefits from eliminating a company that was invoked to pressure the acquirer to reduce rates and services. Every utility in the country benefits when a merger or acquisition eliminates a maverick that was an environmental steward or provided low rates.

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This is not a comprehensive list of distortions created by the deferential posture FERC and many state public utility commissions have taken toward utility mergers. Cross-subsidization and information deficits are interesting, perhaps, because they are consistent with the idea, which Hempling emphasizes throughout *Regulating Mergers and Acquisitions of U.S. Electric Utilities*, that utility mergers raise unique issues that do not come up in competitive markets.

It is also worth noting that the two challenges described in this Review compound each other. A regulator with perfect information about a utility's costs might be able to prevent the utility from cross-subsidizing non-utility affiliates. But if it lacks information about the utility's costs, it will be less able to determine when a particular inter-affiliate credit agreement constitutes a cross-subsidy, or when it is a simple credit enhancement negotiated at arm's length and for which the utility received adequate consideration. Similarly, if most electric utilities are owned by large holding companies, a regulator might be less able to detect cross subsidies of the sort described in the previous Part. If similarly situated utilities all cross subsidize their non-utility affiliates, regulators may find it more difficult to determine that a utility is cross-subsidizing its non-utility affiliates.

V. PROACTIVE MERGER REGULATION

To mitigate these distortions, Hempling proposes that energy regulators approach utility mergers and acquisitions more proactively.⁶³ This is a sensible proposal. As discussed, FERC can approve mergers and acquisitions only if it finds that the transaction is in the public interest. But in many situations, FERC and state regulators have no idea if a particular transaction will turn out to be in the public interest. A utility might promise future efficiency improvements, but unless FERC or a state public utility commission extracts concessions at the time of the acquisition, it is difficult to know whether an acquirer will increase operational efficiency, take advantage of the target's utility franchise to subsidize non-utility affiliates, or some combination of those two actions.

To ensure that utility mergers promote the public interest, Hempling argues that utility commissions should impose conditions on the terms of utility mergers and on the utility's post-merger behavior.⁶⁴ He suggests, for example, that regulators require meaningful rate reductions as a condition of merger approval, that

63. See HEMPLING, *REGULATING MERGERS AND ACQUISITIONS*, *supra* note 1, at 407-23.

64. *Id.* at 410.

they require that holding companies treat utilities and non-utility affiliates as completely separate from each other, and that “the utility have the most advanced form of ring fencing” to ensure that the company does not use the utility to cross-subsidize non-utility affiliates.⁶⁵

It is worth noting that this approach would yield benefits beyond the parties to the utility merger and those firms’ customers. If utilities reduced prices, improved service, or shifted to a cleaner resource mix in order to secure merger approval, the utility could become a maverick. Regulators across the country could cite the consolidated firm as evidence that other regulated firms can reduce emissions, lower prices, or improve service. Hempling’s proposal would thus generate useful information that could allow energy regulators to use yardstick competition. In doing so, it would mitigate many of the harms described in this Review and analyzed in *Regulating Mergers and Acquisitions of U.S. Electric Utilities*.⁶⁶

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65. *Id.* at 410-11.

66. For example, energy regulators may be able to reduce holding companies’ ability to hide the costs of non-utility subsidiaries in utility rates by ordering arms-length bargaining and carefully scrutinizing finances, but no amount of oversight will substitute for structural separations, which makes it impossible for non-utility subsidiaries to bury costs in utility rates.