ORAL ARGUMENT NOT YET SCHEDULED

Nos. 20-1016, 20-1017 (Consolidated)

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

ENVIRONMENTAL DEFENSE FUND,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for Review of Orders of the Federal Energy Regulatory Commission

CORRECTED BRIEF OF AMICUS CURIAE THE AMERICAN ANTTRUST INSTITUTE IN SUPPORT OF PETITIONER THE ENVIRONMENTAL DEFENSE FUND AND REVERSAL

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to Circuit Rule 28(a)(1), amicus curiae certifies as follows:

A. Parties and Amici Curiae

Except for the following, all parties, intervenors, and amici appearing before the district court and in this court are listed in the Brief for the Environmental Defense Fund and Brief of Dr. Susan Tierney:

The American Antitrust Institute

B. Rulings Under Review

References to the rulings at issue appear in the Brief for the Environmental Defense Fund.

C. Related Cases

The cases now pending before this Court were not previously before this Court or any other court. Counsel is not aware of any related case pending before this Court or any court.

/s/Randy M. Stutz
Randy M. Stutz

CORPORATE DISCLOSURE STATEMENT

Pursuant to Circuit Rule 26.1, amicus states:

The American Antitrust Institute is a non-profit, non-stock corporation. It has no parent corporation and no publicly held corporation has any ownership interest in it.

TABLE OF CONTENTS

Page

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES i

CORPORATE DISCLOSURE STATEMENT ii

TABLE OF AUTHORITIES iv

INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 1

ARGUMENT 4

FERC ERRED BY ISSUING A CERTIFICATE OF NEED BASED ON AMBIGUOUS EVIDENCE 4

A. Parents and Subsidiaries Share a Unitary Economic Interest 6

B. Regulated Monopolists May Have an Incentive to Evade Rate Regulation Through a Vertically Integrated Affiliate 8

C. FERC Assumed Away Anticompetitive Explanations for the Spire Project and Failed to "Assess the Project's Benefits" 13

D. FERC's Secondary Arguments Are Bootstrapping and Are Unavailing 19

CONCLUSION 26

CERTIFICATE REGARDING SEPARATE BRIEF

CERTIFICATE OF COMPLIANCE

CERTIFICATE OF SERVICE

TABLE OF AUTHORITIES

Cases

Appalachian Voices v. FERC,
No. 17-1271, 2019 WL 847199 (D.C. Cir. Feb. 19, 2019) 2, 14

City of Oberlin v. FERC,
937 F.3d 599 (D.C. Cir. 2019) 21

Copperweld Corp. v. Indep. Tube Corp.,
467 U.S. 752 (1984).. 3, 7, 8

Envtl. Action, Inc. v. FERC,
939 F.2d 1057 (D.C. Cir. 1991) 15, 16, 17, 18

FPC v. Hope Natural Gas Co.,
320 U.S. 591 (1944).. 4

FTC v. Phoebe Putney Health Sys., Inc.,
568 U.S. 216 (2013).. 5

Gulf States Utils. Co. v. Fed. Power Comm'n,
411 U.S. 747 (1973).. 5

In re Entergy Corp. & Entergy-Koch, LP,
Fed. Trade Comm'n No. C-3998, 2001 WL 268074 (Jan. 31, 2001)........... 12, 25

In re Independence Pipeline Company,
89 FERC ¶ 61,283 (Dec. 17, 1999) 20

IRS v. FLRA,
963 F.2d 429 (D.C. Cir. 1992) 18

Jones v. Perez,
550 F. App'x 24 (2d Cir. 2013)... 25

Laro, Inc. ex rel. Bay Prop. Assocs. v. Chase Manhattan Bank,
866 F. Supp. 132 (S.D.N.Y. 1994) 25

Millennium Pipeline Co. & L.P. Columbia Gas Transmission Corp.,
100 FERC ¶ 61,277 (2002) 20, 21

Minisink Residents for Envtl. Pres. & Safety v. FERC,
762 F.3d 97 (D.C. Cir. 2014) 2, 13, 14

NAACP v. Fed. Power Comm'n,
425 U.S. 662 (1976) 5

Nat'l Soc. of Prof'l Eng'rs v. United States,
435 U.S. 679 (1978) 14, 15

Nat'l Treasury Emps. Union v. FLRA,
466 F.3d 1079 (D.C. Cir. 2006) 18

Pennell v. City of San Jose,
485 U.S. 1 (1988) 4

Reiter v. Sonotone Corp.,
442 U.S. 330 (1979) 4

United States v. AT&T Co.,
524 F. Supp. 1336 (D.D.C. 1981) 3, 11

U.S. Info. Agency v. FLRA,
960 F.2d 165 (D.C. Cir. 1992) 18

Wash. Post Co. v. U.S. Dep't of Health & Human Servs.,
690 F.2d 252 (D.C. Cir. 1982) 15

Administrative Orders

Certification of New Interstate Natural Gas Pipeline Facilities,
88 FERC ¶ 61,227, *modified by*, 89 FERC ¶ 61,040 (1999), *Order Clarifying Statement of Policy*, 90 FERC ¶ 61,128, *Order Further Clarifying Statement of Policy*, 92 FERC ¶ 61,094 (2000) 4, 21, 22

In re Utah Power & Light Co.,
45 FERC ¶ 61,095 (Oct. 26, 1988) 15, 16

In the Matter of Occidental Petroleum Corp.,
109 F.T.C. 167 (1986) 12

Notice of Inquiry, Certification of New Interstate Natural Gas Facilities,
163 FERC ¶ 61,042, 2018 WL 1896448 (2018) 4, 5, 6

Spire STL Pipeline LLC, 164 FERC ¶ 61,085, (2018),
("Certificate Order") 2, 19, 26

Spire STL Pipeline LLC, 164 FERC ¶ 61,085, (2018), *order on reh'g*,
169 FERC ¶ 61,134 (2019) ("Rehearing Order")
....2, 3, 13, 14, 19, 20, 22, 24, 25, 26

Other Authorities

Comment of the Staff of the Bureau of Economics, Fed. Trade Comm'n,
In re Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities,
Dkt. Nos. RM95-8-000 & RM94-7-001 (Aug. 7, 1995),
https://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comment-federal-energy-regulatory-commission-matter-promoting-wholesale-competition./v950008.pdf 9

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Douglas H. Ginsburg, V*ertical Restraints: De Facto Legality Under the Rule of Reason*, 60 Antitrust L.J. 67 (1991) 8

Jonathan B. Baker et al., *Five Principles for Vertical Merger Enforcement Policy*, 33 Antitrust 12 (2019) 10

Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 Antitrust L.J. 513 (1995) 9, 23

Paul L. Joskow & Roger G. Noll, *The Bell Doctrine: Applications in Telecommunications, Electricity, and Other Network Industries*, 51 Stan. L. Rev. 1249 (1999) 9, 23

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Robert H. Bork, The Antitrust Paradox (1978) 10

Steven C. Sunshine, Dep. Asst. Att'y Gen., Dep't of Just., Antitrust Div., Address Before the American Bar Association Section of Antitrust Law Spring Meeting: Vertical Merger Enforcement Policy (May 11, 1995) 10

Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 Yale L.J. 209 (1986) 8

Timothy J. Brennan, *Trinko v. Baxter: The Demise of U.S. v. AT&T*, 50 Antitrust Bull. 635 (2005) 11

U.S. Dep't of Justice, Non-Horizontal Merger Guidelines (1984) 10, 11

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INTEREST OF AMICUS CURIAE[1]

The American Antitrust Institute (AAI) is an independent nonprofit organization devoted to promoting competition that protects consumers, businesses, and society. It serves the public through research, education, and advocacy on the benefits of competition and the use of antitrust enforcement as a vital component of national and international competition policy. AAI enjoys the input of an Advisory Board that consists of over 130 prominent antitrust lawyers, law professors, economists, and business leaders. See http://www.antitrustinstitute.org.[2]

AAI submits this brief because the shared goals of antitrust law and the Natural Gas Act will be seriously undermined if the Federal Energy Regulatory Commission (FERC) is permitted to authorize construction of new energy infrastructure without assessing its likely effects on competition and consumers.

SUMMARY OF ARGUMENT

This case comes before the Court because FERC authorized a 65-mile pipeline project (Spire Project) based solely on an affiliate precedent contract between

[1] Petitioner and Respondent indicated their consent to AAI's brief. Petitioner Steck also consents. Intervenors Spire STL Pipeline LLC and Spire Missouri do not consent. Pursuant to Fed. R. App. P. 29(c)(5), amicus states no counsel for a party has authored this brief in whole or in part, and no party, party's counsel, or any other person—other than amicus or its counsel—has contributed money that was intended to fund preparing or submitting this brief.

[2] Individual views of members of AAI's Board of Directors or Advisory Board may differ from AAI's positions.

Spire STL Pipeline LLC (Spire STL) and Spire Missouri, two wholly owned subsidiaries of Spire Inc. (Spire).

FERC's authorization was arbitrary and capricious because the affiliate precedent contract alone does not permit a reasonable inference of need under the Natural Gas Act, which seeks to promote competition and protect consumers. Whether an affiliate precedent contract reflects need, or instead reflects a vertically integrated monopolist's anticompetitive incentive to evade rate regulation, depends on market conditions that FERC failed to address. To reasonably infer that Spire's affiliate precedent contract is likely to create benefits rather than harms, FERC needed to evaluate, at a minimum, the implications of flat demand for new capacity in the region, the absence of buy-side competition for new capacity, and the state regulator's ability to detect inflated transfer prices.

Instead of weighing the potential procompetitive and anticompetitive effects of the Spire Project, FERC supported its order with this Court's opinion in *Minisink Residents for Envtl. Pres. & Safety v. FERC*, 762 F.3d 97 (D.C. Cir. 2014), which provides that FERC is not required to look "behind" precedent contracts to establish need. *Spire STL Pipeline LLC*, 164 FERC ¶ 61,085, ¶ 75 (2018) ("Certificate Order"), *order on reh'g*, 169 FERC ¶ 61,134, ¶ 14 (2019) ("Rehearing Order"). It also relied on this Court's opinion in *Appalachian Voices v. FERC*, No. 17-1271, 2019 WL 847199 (D.C. Cir. Feb. 19, 2019) (per curium), which provides

that FERC is permitted to rely on precedent contracts with affiliates. Rehearing Order, 169 FERC at 61,989 & n.38, ¶ 14. But those cases are inapposite. Permission to credit affiliate precedent contracts does not convey permission to issue arbitrary decisions.

FERC's errors are plain when the Spire Project's likely competitive effects are considered under well accepted antitrust principles, consistent with the Natural Gas Act's goals. Those principles require that a parent and its wholly owned subsidiary are to be treated as a single economic enterprise for purposes of a competitive effects analysis, under *Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752 (1984). They also require recognition that a vertically integrated monopolist subject to cost-based rate regulation may have an incentive to inflate transfer prices, consistent with the seminal *United States v. AT&T* case and an enduring consensus among government and academic experts.

Here, application of those principles shows that FERC could not have known from the evidence on which it relied whether its prediction regarding the competitive effects of the Spire Project is likely to be correct. Economically and analytically, FERC's approval of the Spire Project is therefore indefensible. Its order granting a certificate of public convenience and necessity should be vacated, and this inquiry should be remanded so that FERC may issue a ruling based on evidence from which reasonable inferences of need may be drawn.

ARGUMENT

FERC ERRED BY ISSUING A CERTIFICATE OF NEED BASED ON AMBIGUOUS EVIDENCE

The antitrust laws and the Natural Gas Act share the common goal of protecting consumer welfare. *See Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) ("Congress designed the Sherman Act as a 'consumer welfare prescription.'") (citations omitted); *Pennell v. City of San Jose*, 485 U.S. 1, 13 (1988) (noting that "a legitimate and rational goal of price or rate regulation is the protection of consumer welfare" and "'[t]he primary aim of the Natural Gas Act was to protect consumers against exploitation at the hands of natural gas companies'") (quoting *FPC v. Hope Natural Gas Co*., 320 U.S. 591, 610 (1944) (alteration omitted)).

FERC's 1999 natural gas pipeline certification policy makes clear that fostering competitive markets and protecting captive consumers are among the policy's key objectives. *See Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227, 61,743 [hereinafter "Certificate Policy Statement"], *modified by*, 89 FERC ¶ 61,040 (1999), *Order Clarifying Statement of Policy,* 90 FERC ¶ 61,128, *Order Further Clarifying Statement of Policy*, 92 FERC ¶ 61,094 (2000) ("An effective certificate policy … [i]n particular … should be designed to foster competitive markets [and] protect captive customers …."); *see also Notice of Inquiry, Certification of New Interstate Natural Gas Facilities*, 163 FERC ¶ 61,042, ¶ 29, 2018 WL 1896448, at *11 (2018) [hereinafter "Certificate Policy

NOI”] (noting that the Commission “has historically taken a pro-competitive approach” and approved new pipelines that “would benefit consumers through increased competition”).

Accordingly, antitrust principles are useful and relevant in evaluating requests for new pipeline certifications under the Natural Gas Act. *See, e.g., NAACP v. Fed. Power Comm’n*, 425 U.S. 662, 670 n.6 (1976) (consideration of conservation, environmental and antitrust issues are “undoubtedly” among the purposes contained in the Power and Gas Acts); *Gulf States Utils. Co. v. Fed. Power Comm’n*, 411 U.S. 747, 760 (1973) (“Consideration of antitrust and anticompetitive issues by the Commission, moreover, serves the important function of establishing a first line of defense against those competitive practices that might later be the subject of antitrust proceedings.”); *see also FTC v. Phoebe Putney Health Sys., Inc.*, 568 U.S. 216, 231, 234 (2013) (regulatory authorizations are issued “against the backdrop of federal antitrust law” and interpreted “in light of our national policy favoring competition”).

Here, applying antitrust principles to the evidence on which FERC relied, it is impossible to conclude, without more, that the Spire Project will have a procompetitive effect that benefits consumers. FERC failed to grapple with the well-established principles that parents and subsidiaries share a unitary economic interest, and that regulated monopolists may have an incentive to evade rate regulation

through contracts with vertical affiliates. As a result, FERC failed to evaluate the probative value of the affiliate precedent contract and relied upon ambiguous evidence of need.

To assess a project's likelihood of creating benefits rather than harms, antitrust principles require, at a minimum, an evaluation of basic market conditions. Here, at least three market factors preclude a reasonable inference that Spire STL's affiliate precedent contract alone evinces need: flat demand for new pipeline capacity, the absence of buy-side competition for new capacity, and the state regulator's inability to detect inflated transfer prices.

A. Parents and Subsidiaries Share a Unitary Economic Interest

In a recent, pending Notice of Inquiry, FERC asks the question it failed to ask here: "Should the Commission consider distinguishing between precedent agreements with affiliates and non-affiliates in considering the need for a proposed project?" Certificate Policy NOI, 163 FERC ¶ 61,042, ¶ 54, 2018 WL 1896448, at *19. Under antitrust law, the distinction is not only advisable but required.

A central tenet of antitrust analysis under Section 1 of the Sherman Act is that intra-firm agreements, whether between parents and wholly owned subsidiaries or among divisions within a single corporate entity, do not change a corporation's firm-wide incentive to maximize profits. Unlike unaffiliated entities, "[a] parent and its wholly owned subsidiary have a complete unity of interest.

Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one." *Copperweld*, 467 U.S. at 771. Accordingly, the Supreme Court has created an irrebuttable presumption that a parent and wholly owned subsidiary are incapable of entering a cognizable "agreement" under antitrust law. *Id.* ("[T]he coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single enterprise for purposes of § 1 of the Sherman Act.").

Indeed, the Court has explained that "the very notion of an 'agreement' in Sherman Act terms between a parent and a wholly owned subsidiary lacks meaning." *Id.* "If a parent and a wholly owned subsidiary do 'agree' to a course of action, there is no sudden joining of economic resources that had previously served different interests." *Id.* Such agreements do not alter competitive incentives because the contracting entities are not the "independent centers of decision-making that competition assumes and demands." *Id.* at 769–70.

The irrebuttable presumption that a parent and its wholly owned subsidiary must be viewed as a single economic enterprise does not change even if the subsidiary is given free rein to operate independently from the parent company. The law recognizes, "in reality a parent and a wholly owned subsidiary *always* have a 'unity of purpose or a common design,'" because "the parent may assert full control at any moment if the subsidiary fails to act in the parent's best interests." *Id.* at

771–72 (emphasis added). "With or without a formal 'agreement,' the subsidiary acts for the benefit of the parent, its sole shareholder." *Id*. at 771. "They cannot overcome the basic fact that the ultimate interests of the subsidiary and the parent are identical, so the parent and the subsidiary must be viewed as a single economic unit." *Id*. at 772 n.18.

B. Regulated Monopolists May Have an Incentive to Evade Rate Regulation Through a Vertically Integrated Affiliate

In general, the proper antitrust treatment of vertical agreements is a contested issue in antitrust law. *Compare, e.g.*, Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 Antitrust L.J. 67, 69 (1991) (Where question is whether interests of manufacturer imposing vertical restraint diverge from consumers' interest in efficient distribution, "the answer will usually be no."), *with* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 Yale L.J. 209, 213–14 (1986) ("[W]e do not believe that economic theory or antitrust policy suggests that virtually all exclusion claims are chimerical.").

But this disagreement evaporates, and gives way to consensus, in the context of vertically integrated monopolists subject to rate regulation. When a regulated, monopoly access provider enters a vertical agreement with an affiliate—such that the same unitary, firm-wide profit-maximizing incentive exists on both sides of the

contract—the monopolist "can charge supracompetitive prices to its regulated affiliates for inputs …, thereby setting a higher cost base for regulated prices in the monopoly market that simply serve to generate excess profits in input manufacturing." Paul L. Joskow & Roger G. Noll, *The Bell Doctrine: Applications in Telecommunications, Electricity, and Other Network Industries*, 51 Stan. L. Rev. 1249, 1260 (1999); *see also* Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 Antitrust L.J. 513, 520 (1995) ("[A] regulated firm [can] evade cost-based, maximum price regulation by setting an artificially high transfer price on inputs sold by the upstream division to the downstream division and, as a result, shift profits from the regulated to the unregulated market.").

The harm to competition and consumers from a regulated monopolist's inflated transfer prices is straightforward. *See, e.g.*, Comment of the Staff of the Bureau of Economics, Fed. Trade Comm'n, *In re Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Proposed Rulemaking & Supplemental Notice of Proposed Rulemaking Before the FERC*, Dkt. Nos. RM95-8-000 & RM94-7-001 (Aug. 7, 1995),[3] (When "[c]osts of the shared inputs … are assigned to the regulated business to justify higher cost-

[3] Locations of authorities available online are shown in the Table of Authorities.

based rates there," "[t]his shifting distorts competition and produces inefficiencies in the unregulated business as well."); *see also* Jonathan B. Baker et al., *Five Principles for Vertical Merger Enforcement Policy*, 33 Antitrust 12, 16 (2019) ("The regulated downstream firm could raise the price of the input supplied to it by its upstream merger partner, increasing upstream profits and downstream prices.").[4]

As a theory of vertical harm, anticompetitive regulatory evasion "has perhaps the purest academic pedigree and has been explored in depth." Steven C. Sunshine, Dep. Asst. Att'y Gen., Dep't of Just., Antitrust Div., Address Before the American Bar Association Section of Antitrust Law Spring Meeting: Vertical Merger Enforcement Policy 13 (May 11, 1995). And "[t]here is little dispute that this theory is a plausible basis for finding anticompetitive effects under appropriate circumstances." *Id.*

Notably, the Department of Justice used inflated transfer pricing by a vertically integrated utility as "the clearest example" of such harm in its 1984 Non-Horizontal Merger Guidelines. U.S. Dep't of Justice, Non-Horizontal Merger

[4] Even among the most extreme defenders of vertical restraints, who maintain that such restraints essentially never harm competition, there is no disputing that regulated monopolists have strong incentives to evade rate regulation. Such commentators point out that avoiding rate regulation can actually benefit consumers by facilitating price *cuts* when regulated rates are too high, but they concede that circumvention of laws cannot create a legally cognizable benefit. *See, e.g.*, Robert Bork, The Antitrust Paradox 376, 381 (even if "evasion is probably beneficial to consumers, … courts cannot countenance violation of law on that account").

Guidelines 30 (1984).[5] "After the merger," the guidelines explain, "the utility would be selling to itself and might be able arbitrarily to inflate the prices of internal transactions. Regulators may have great difficulty in policing these practices, particularly if there is no independent market for the product (or service) purchased from the affiliate. As a result, inflated prices could be passed along to consumers as 'legitimate' costs." *Id*.

The same kind of harm animated the government's successful prosecution and breakup of AT&T in the 1980s. As Judge Greene's opinion summarized:

> [The government's] experts have testified that a combination of vertical integration and rate-of-return regulation has tended to generate decisions by the Operating Companies to purchase equipment produced by Western that is more expensive or of lesser quality than that manufactured by the general trade. The Operating Companies have taken these actions, it is said, because the existence of rate of return regulation removed from them the burden of such additional expense, for the extra cost could simply be absorbed into the rate base or expenses, allowing extra profits from the higher prices to flow upstream to Western rather than to its non-Bell competition.

United States v. AT&T Co., 524 F. Supp. 1336, 1373 (D.D.C. 1981); *see also* Timothy J. Brennan, *Trinko v. Baxter: The Demise of U.S. v. AT&T*, 50 Antitrust Bull. 635, 644 n.27 (2005) (illustrating how "a regulated firm that operates in related markets may have an incentive to overinvest in shared facilities").

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[5] The 1984 Guidelines were superseded by new Vertical Merger Guidelines issued June 30, 2020.

Regulatory evasion concerns also have animated several antitrust enforcement actions in the natural gas pipeline industry in particular. *See, e.g.*, *In re Entergy Corp. & Entergy-Koch, LP*, Fed. Trade Comm'n No. C-3998, 2001 WL 268074, at *3 (Jan. 31, 2001) (Joint venture's acquisition of pipeline assets created ability and incentive for merged firm to purchase levels of transportation service "above what is necessary for effective operation of [the joint venture's] utilities," and prices were "likely to rise as a result of [the joint venture] passing on inflated costs for natural gas transportation to consumers."); *In the Matter of Occidental Petroleum Corp.*, 109 F.T.C. 167 (1986) (requiring divestiture in merger between large natural gas producer and large pipeline company based on risk that combined companies could exercise market power to evade rate-of-return regulation).

Of course, not all affiliate precedent contracts are profitable for anticompetitive reasons. In many or even most cases, affiliate precedent contracts may be created to achieve legitimate economic goals. For example, there may be savings from the combined enterprise's ability to engage in joint planning at different levels of the supply chain; savings associated with the avoidance of contracting costs; or savings in the coordination of joint production costs. *See* William F. Baxter, *Conditions Creating Antitrust Concern with Vertical Integration by Regulated Industries—"For Whom the Bell Doctrine Tolls"*, 52 Antitrust L.J. 243, 245 (1983).

Or here, as FERC found, there may be benefits from potential quality improvements, which can be a cognizable non-price benefit of increased competition. *See* Rehearing Order, 169 FERC at 61,991, ¶ 24 (Spire Project would locate supply point close to distribution system and away from seismic zone, and enhance system reliability).

The point is not that affiliate precedent contracts are never procompetitive; the point is that they may *also* be an instrument of strategic anticompetitive behavior, consistent with a firm's rational, profit-maximizing incentives. As former Assistant Attorney General William Baxter has explained, "[t]his leaves us in a real quandary: How does one know whether the possible cost-savings associated with the vertical integration are greater than or less than the wasteful possibilities?" Baxter, *supra*, at 245–46. The problem is that there is "no easy answer, conceptual much less empirical, to that question. It requires case-by-case inquiry, and one of great difficulty." *Id*. at 246.

C. FERC Assumed Away Anticompetitive Explanations for the Spire Project and Failed to "Assess the Project's Benefits"

Confronted squarely with this question of "great difficulty" that "requires case-by-case inquiry," FERC unapologetically ignores it. FERC's only rejoinder is to cite this Court's opinion in *Minisink* for the proposition that there is "nothing in the policy statement or in any precedent construing it to suggest that it requires, rather than permits, the Commission to assess a project's benefits by looking beyond

the market need reflected by the applicant's existing contracts with shippers." Rehearing Order, 169 FERC at 61,989-90, ¶ 14 (citing 762 F.3d at 112 [sic] n.10). It also adds, quoting this Court's unpublished opinion in *Appalachian Voices*, 2019 WL 847199, at *3 (per curium), that "the fact that the agreements are with corporate affiliates does not render [the Commission's] decision to rely on these agreements arbitrary and capricious." Rehearing Order, 169 FERC at 61,989, ¶ 14. However, the quoted statements are beside the point. Obviously, this Court's cases do not relieve FERC of its obligation "to assess a project's benefits." And if an affiliate precedent contract facilitates an anticompetitive regulatory evasion strategy, it reflects no benefits and evinces no need.

FERC's approach rests on a broken chain of logic. It concludes that, because reliance on affiliate precedent contracts is not necessarily arbitrary and capricious, *exclusive* reliance on affiliate precedent agreements is *never* arbitrary and capricious. The unstated premise is that a pipeline company never enters precedent contracts with affiliates for anticompetitive reasons, but rather only procompetitive reasons, and therefore FERC *never* needs to evaluate possible anticompetitive incentives underlying the formation of affiliate precedent contracts. This assumption is at odds with more than a century of antitrust enforcement under Section 1 of the Sherman Act, where "the purpose of the analysis is to form a judgment about the competitive significance of the restraint." *Nat'l Soc. of Prof'l*

Eng'rs v. United States, 435 U.S. 679, 692 (1978). To ignore even the possibility of strategic anticompetitive behavior, as FERC does, is "to adopt an ostrich-like approach" to regulation. *Wash. Post Co. v. U.S. Dep't of Health & Human Servs.*, 690 F.2d 252, 282 (D.C. Cir. 1982).

Indeed, in a different context, this Court has already held that FERC's failure to consider or address a firm's ability and incentive to skirt a cost-based-rate regime is arbitrary and capricious. In *Envtl. Action, Inc. v. FERC*, intervenors objected to FERC's approval, under § 203 of the Federal Power Act, of the proposed merger of Utah Power and Light Co. and Pacific Power and Light Co, two firms that generated, sold, and transported electric power in the western United States. 939 F.2d 1057, 1059 (D.C. Cir. 1991) (Ginsburg, J.). The merged firm, "Pacificorp," would control transmission assets that created a bottleneck between power generators located in the northwest and bulk sellers serving customers located to the south. *Id*. at 1061. FERC had approved the merger subject to a behavioral remedy that attempted to address the risk of foreclosure. *See In re Utah Power & Light Co*., 45 FERC ¶ 61,095, 61,288 (Oct. 26, 1988).

FERC identified foreclosure risks associated with both monopoly power and monopsony power. *Envtl. Action*, 939 F.3d at 1059–60. The monopoly problem was that the merged firm could harm rival utilities in the south by denying access

to transmission service, thereby preventing competition in bulk sales at the southern interconnection and raising prices to consumers. *Id*.

The monopsony problem was that the merged firm could harm rival generators to the north by withholding transmission and then buying their power at artificially depressed prices. *Id*. Because rival generators without transmission access would have nobody else to sell to, the merger created an anticompetitive arbitrage opportunity. The merged firm could buy low in the north and then sell high in the south, pocketing the difference. *See id*. Even if consumers did not pay excessive prices in the short run, the exercise of monopsony power would reduce output, and so consumer welfare would be harmed over time.

FERC's solution was to impose, as a condition for approving the merger, a cost-based-rate regime for transmission services, not unlike the cost-based regime that governs pipeline transmission. *Compare In re Utah Power & Light Co*., 45 FERC at ¶ 61,290 ("[W]e are imposing an absolute obligation on the merged company to provide firm wholesale transmission service at cost-based rates."), *with* Fed. Energy Reg. Comm'n, *Cost-of-Service Rate Filings*, Ferc.gov (last updated June 17, 2020) ("The basic methodology we use to establish just and reasonable rates [under Section 7(c) of the Natural Gas Act] is cost-of-service ratemaking").

On appeal, the petitioners challenged FERC's merger authorization for failing to adequately address the merged firm's ability and incentive to circumvent the

cost-based-transmission requirement. *Envtl. Action, Inc.*, 939 F.2d at 1061 (submitting that the remedial order was "not based upon a reasoned analysis" where it was "inadequate to counter the anticompetitive effects of the merger"). The petitioners observed that, although the remedy required the merged firm to "wheel" (i.e. transmit) power at cost-based rates for rival utilities, it failed to require the merged firm to wheel power at cost-based rates for "Qualifying Facilities" (QFs) (i.e. small power producers and co-producers), which also engaged in bulk sales. *Id.* at 1062. FERC countered that QFs did not stand to be harmed because they had a guaranteed market for their power. *Id.*

In an opinion by Judge Ginsburg, the Court rejected FERC's argument for "mak[ing] no sense from the consumer welfare point of view reflected in the antitrust laws." *Id.* at 1062. The Court observed: "PacifiCorp can buy the QF's power and then sell its own power to a distant purchaser with a higher decremental cost. In this way PacifiCorp can capture for itself the difference between the price it pays the QF and the distant market resale price while confining the QF to the price available in its local market (*viz.*, PacifiCorp's avoided cost)." *Id.* Just as it should do here, the Court held that FERC's order was arbitrary and capricious because it failed to consider or address the merged firm's ability and incentive to evade its "absolute obligation" to provide cost-based transmission service. *See id.* at 1064 (granting petition in part and remanding for further consideration).

The *Envtl. Action* Court's refusal to credit the merger remedy's procompetitive benefits without accounting for countervailing risks of anticompetitive harm is consistent with an enduring principle under this Court's administrative rulings: it will not sanction regulatory findings based on inferences that may not reasonably be drawn from available evidence, including economic inferences. *See Nat'l Treasury Emps. Union v. FLRA*, 466 F.3d 1079, 1081 (D.C. Cir. 2006) ("We will uphold the [Federal Labor Relations] Authority's decision 'if, but only if, we can discern a reasoned path from the facts and considerations before the [agency] to the decision it reached.'" (quoting *U.S. Info. Agency v. FLRA*, 960 F.2d 165, 169 (D.C. Cir. 1992)); *Am. Fed'n of Gov't Emp., Local 2924 v. FLRA*, 470 F.3d 375, 380 (D.C. Cir. 2006) ("Certainly, if the result reached is 'illogical on its own terms,' the Authority's order is arbitrary and capricious.") (quoting *IRS v. FLRA*, 963 F.2d 429, 439 (D.C. Cir. 1992)).

The same principle applies here. The Court should clarify that, when there is no reasonable basis to predict need without looking behind or beyond an affiliate precedent agreement, *Minisink* and *Appalachian Voices* do not give FERC license to issue arbitrary decisions.

D. FERC's Secondary Arguments Are Bootstrapping, and Are Unavailing

Like its principal arguments, FERC's secondary arguments depend on the false premise that the procompetitive incentives created by precedent contracts always supersede the anticompetitive incentives created by viable opportunities to evade rate regulation. However, FERC's secondary arguments also fail for the more prosaic reason that none of them can overcome the market facts that foreclose a reasonable inference of need based solely on Spire's contract with itself.

Three market facts in particular prevent the affiliate precedent contract alone from demonstrating need. First, there is no demand for new pipeline capacity in the St. Louis region. Rehearing Order, 169 FERC at 61,992-93, ¶ 30 ("current load forecasts for the region are flat for the foreseeable future"); *see also* Rehearing Order, Comm'r Glick, dissenting, 169 FERC at 62,002, ¶ 4. Second, there are no competing shippers present to create a reasonable-cost benchmark. Certificate Order, 164 FERC ¶ 61,085, ¶ 10 ("Spire Missouri is the only shipper that subscribed for capacity on the project."). Third, there are no processes in place to allow the Missouri Public Service Commission (PSC), which regulates Spire Missouri, to transparently assess Spire Missouri's costs during rate-making proceedings. Rehearing Order, Comm'r Glick, dissenting, 169 FERC at 62005, ¶ 19 (the Missouri PSC's prudence review "takes [FERC]-jurisdictional rates as a given"); *cf.* Press

Release, Fed. Trade Comm'n, FTC Clears Sale of Gulf South Pipeline Co. To Entergy-Koch, LP (Jan. 31, 2001) ("The Commission's order protects consumers by requiring Entergy to implement an open, transparent process to buy natural gas and natural gas transportation that will assist state regulators in determining whether Entergy purchased gas supplies from EKLP at inflated prices.").

In support of its argument that it need never look behind precedent contracts, FERC quotes *Millennium Pipeline Co. & L.P. Columbia Gas Transmission Corp*., which stated, "as long as the precedent agreements are long-term and binding, we do not distinguish between pipelines' precedent agreements with affiliates or independent marketers in establishing the market need for a proposed project." Rehearing Order, 169 FERC at 61,989 n.32, ¶ 14 (citing 100 FERC ¶ 61,277, at P 57 (2002)). But the statement is taken out of context. FERC omits that the basis for the *Millennium* holding is that "there was no necessity in this proceeding, as there was in [*In re*] *Independence* [*Pipeline Company*, 89 FERC ¶ 61,283 (Dec. 17, 1999)], to require that Millennium demonstrate that it had a bona fide market demand for its project." *Millennium,* 169 FERC at 62,141. Here, as discussed above, the absence of bona fide market demand is more than a possibility or risk—the parties *agree* that no such demand exists. Rehearing Order, Comm'r Glick, dissenting, 169 FERC at 62,002, ¶ 4 ("The parties agree that demand for natural

gas in the region is flat and that Spire Missouri is merely shifting its capacity subscription from an existing pipeline to a new one owned by its affiliate."). Because *Millennium* hinged on the absence of any doubt about bona fide demand for the new project, it lends no support to FERC's supposition that affiliate precedent contracts are always sufficient "in establishing the market need for a proposed project."

In support of the same claim, FERC also cites *City of Oberlin v. FERC*, 937 F.3d 599 (D.C. Cir. 2019), but that case proves the opposite of FERC's point. There the Court correctly credited the affiliate precedent contracts as evidence of need *because* it was "firmly established that there was more demand for natural gas in the [new] pipeline's delivery region than existing pipelines could meet." *Id.* at 605 ("*Given that analysis*, the Commission reasonably concluded under the Certificate Policy Statement that the precedent agreements … were the best evidence of project need.") (emphasis added); *see also id.* (Petitioners did not make a self-dealing argument.). Thus, in *City of Oberlin*, the Court relied on the very analysis of demand conditions that was missing here. And far from suggesting that precedent contracts are always probative of need without regard to market analysis, the Court reminded the parties that "the Certificate Policy Statement imposes no bright-line rule about when precedent agreements may be persuasive evidence of market demand." *Id.* at 605.

In further support of its argument that affiliate precedent contracts always demonstrate need, FERC emphasizes that "Spire STL will be at risk for unsubscribed capacity" because "project rates are calculated based on design capacity." Rehearing Order, 169 FERC at 61,991, ¶ 21; *see also id*. at 61,990, ¶ 15 (Affiliate relationship between Spire STL and Spire Missouri will not "diminish Spire Missouri's obligation to pay for its capacity under the terms of its contract."). Affiliates would not enter into precedent contracts without need, FERC reasons, because they will be unable to recover their costs for any unsubscribed capacity. Under different market conditions, FERC would be correct.

But that logic does not obtain here because Spire STL and its only customer for the Spire Project, Spire Missouri, share a unitary economic incentive to maximize profits in a market with flat demand. FERC makes much of the fact that the affiliate precedent contract subscribes a large percentage of the new pipeline capacity—87.5%. Rehearing Order, 169 FERC at 61,989 n.33, ¶ 14 (noting that the 87.5% subscription rate would have satisfied the more stringent requirement prior to the Certificate Policy Statement). But the operative question is how Spire intends to recover its costs on the remaining 12.5% of capacity *other* than through regulatory evasion and inflated transfer prices. Insofar as project rates are based

on design capacity and no other shippers bid, why was Spire undeterred by flat demand despite the Spire Project's unsubscribed capacity? FERC has no answer because it does not ask.

The absence of bids from unaffiliated shippers also belies the probative value of Spire's alleged risk for a different reason: it ensures there is no reasonable-cost benchmark. Without an independent market to measure against, there is nothing to prevent Spire STL from artificially inflating the costs that it imposes on Spire Missouri to raise downstream prices and upstream profits. Riordan & Salop, *supra*, at 562 ("Regulatory agencies … may have difficulty in policing these practices because of the absence of an independent market for comparable transactions. Where there is an independent market, the prices charged by the upstream division can be used as an arm's length pricing benchmark.").

Moreover, there is no basis on which the Missouri PSC could detect or punish the practice. *See* Joskow & Noll, *supra*, at 1261 ("[R]egulators cannot distinguish between the accounting costs that a regulated firm reports for regulatory purposes and the true economic costs of supplying its services. Hence, when regulators do attempt to force a particular price to roughly its average cost of production, they frequently get the price very wrong."); Baxter, *supra*, at 244 ("If the regulator were able to determine with some degree of precision the prices at which goods or services or equipment were being transferred or supplied to the regulated

enterprise by its 'affiliates' … exploitation of market power through diversification could be controlled…. Unfortunately, control over transactions between affiliates is very, very difficult.").[6]

FERC says the costs of unsubscribed capacity create a "powerful incentive" to market the unsubscribed capacity and serve as a "strong deterrent" *ex ante* to proposing pipeline projects that are unsupported by demand. Rehearing Order, 169 FERC 61,991, ¶ 21. Putting aside that FERC concedes the Spire Project *is* unsupported by demand, *id*. at 61,992-93, ¶ 30, the unsubscribed capacity obviously presents no economic obstacle if the profits from regulatory evasion exceed Spire's losses on unsubscribed capacity.[7] The absence of any corroborating market evidence of need—whether in the form of bona fide demand, capacity subscribed by unaffiliated shippers, plausible cost benchmarks, or a transparent process to assist

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[6] FERC also emphasizes that Spire STL held an open season for capacity on the Spire Project. *See* Rehearing Order, 169 FERC at 61,990-91, ¶ 20. But the open season is of no help to FERC either, because, again, no unaffiliated shippers bid on the capacity. Without this indicator of a possible competitive explanation for adding capacity, the open season only begs the question of why Spire is choosing to go forward with a project that is unsupported by demand. *See* Rehearing Order, Comm'r Glick, dissenting, 169 FERC at 62,006, ¶ 21 ("[T]he fact that Spire STL conducted an open season and only Spire Missouri entered a precedent agreement would, on its face, seem to strengthen EDF's argument, not undermine it.").

[7] If the 14 percent return on equity is excessive, as the Missouri PSC argues, this too could offset losses from unsubscribed capacity. *See* Rehearing Order, 169 FERC at 61,994-95, ¶ 39 (citing Missouri PSC Request for Rehearing at 3–4).

downstream regulators in assessing costs (as the FTC tried to impose in *In re Entergy Corp. & Entergy-Koch, LP*)—only begs the question of whether the unsubscribed capacity creates any risk to Spire's bottom line at all. FERC has no basis to believe that the unsubscribed capacity gives Spire a procompetitive economic incentive, let alone a powerful one.

FERC falls back on the argument that, "without compelling record evidence, we will not speculate on the motives of a regulated entity or its affiliate." Rehearing Order, 169 FERC at 61,990 n.44, ¶ 15; *see also id*. at 61,990 ("The Commission is not in the position to evaluate Spire Missouri's business decision."). But this argument confuses motives with economic incentives. Whereas motives speak to a regulated entity's intentions, economic incentives speak to what would constitute rational, profit-maximizing behavior. Accordingly, when evaluating economic incentives, triers of fact are limited in the inferences they are permitted to draw. *Jones v. Perez*, 550 F. App'x 24, 29 (2d Cir. 2013) (where "view of the facts defies economic reason, it does not yield a reasonable inference") (citation omitted); *Laro, Inc. ex rel. Bay Prop. Assocs. v. Chase Manhattan Bank*, 866 F. Supp. 132, 138 (S.D.N.Y. 1994) ("economic irrationality … precludes a reasonable inference").[8]

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[8] FERC also fails to explain why it treats a firm's "motive" to evade rate regulation differently from its "incentive" to never construct pipelines unsupported by full demand, even though Spire appears to have done just that.

Although FERC was not required to speculate on Spire's motives, it was obligated to evaluate Spire's economic incentives. Spire and its subsidiaries are a single economic unit for purposes of assessing the likely competitive effects of the Spire Project, and as a vertically integrated monopolist, Spire may have the ability and incentive to profitably evade rate regulation by inflating transfer prices. Because FERC failed to evaluate these basic economic realities and the accompanying market facts that illuminate their consequences, it failed to adequately asses need under the Natural Gas Act. Accordingly, FERC's authorization of the Spire Project was arbitrary and capricious.

CONCLUSION

For the foregoing reasons, FERC's Certificate Order and Rehearing Order should be vacated.

Respectfully submitted,

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CERTIFICATE REGARDING SEPARATE BRIEF

Pursuant to D.C. Circuit Rule 29(d), I certify that this separate amicus brief is necessary because it provides unique insights regarding the application of antitrust and competition principles to this Natural Gas Act case and because other amici, who are not consumer antitrust organizations, do not address the same principles and do not have the same expertise.

/s/Randy M. Stutz
Randy M. Stutz

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limit of Fed. R. App. P. 32(a)(7)(B) because, excluding the parts exempted by Fed. R. App. P. 32(f), the brief contains 6,019 words.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(b) because the brief has been prepared in Microsoft Word, using 14-point Times New Roman font, a proportionally spaced typeface**.**

/s/Randy M. Stutz
Randy M. Stutz

CERTIFICATE OF SERVICE

I certify that on July 3, 2020, I caused the foregoing Brief of Amicus Curiae to be filed through this Court's CM/ECF system, which will serve a notice of electronic filing on all counsel for the parties.

/s/Randy M. Stutz
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