

ANALYSIS OF PROPOSED CONSENT ORDER TO AID PUBLIC COMMENT

I. Introduction

The Federal Trade Commission (“Commission”) has accepted for public comment from the El Paso Energy Corporation (“El Paso”) and PG&E Corporation (“PG&E”) (collectively the “Proposed Respondents”) an Agreement Containing Consent Order (“the Proposed Consent Order”). The Proposed Consent Order remedies the likely anticompetitive effects in the natural gas transportation markets in the Permian Basin production area, the San Antonio – Austin area, and the Matagorda offshore production area. El Paso has also reviewed a proposed draft of complaint (the “Proposed Complaint”) that the Commission contemplates issuing. The Proposed Consent Order is designed to remedy the likely competitive effects arising from the El Paso acquisition of all of the outstanding voting shares of PG&E Gas Transmission Teco, Inc., and PG&E Gas Transmission Texas Corporation, from PG&E (the “Acquisition”).

II. Description of the Parties and the Proposed Acquisition

El Paso Energy Corporation is an integrated energy company producing, transporting, gathering, processing, and treating natural gas. With over \$21 billion in assets, El Paso Energy Corporation is one of the largest integrated natural gas-to-power companies in the world. El Paso Energy not only owns North America's largest natural gas pipeline system, but also has growing operations in merchant energy services, power generation, international project development, gas gathering and processing, and gas and oil production.

El Paso has an interest in five pipeline systems in Texas: the Oasis pipeline, running from west Texas, through the San Antonio and Austin areas, to the Katy natural gas trading area (near Houston, Texas); the Channel Pipeline, extending from south Texas to the Houston Ship

Channel; the Shoreline and Tomcat gathering systems, carrying gas from the Texas Gulf Coast to other larger transmission pipelines, and the Gulf States Pipeline, which runs from the Texas border to Ruston, Louisiana. In addition, El Paso owns the El Paso Natural Gas Pipeline that carries large volumes of gas from the Permian Basin gas gathering area to New Mexico, Arizona and Southern California.

PG&E is a California holding company that provides energy services throughout North America. During 1999, PG&E's annual revenues were \$20.8 billion. One of PG&E's divisions, PG&E Gas Transmission, provides natural gas transmission and distribution through three subsidiaries. PG&E Gas Transmission operates natural gas transportation in the northwestern United States through its wholly-owned subsidiary PG&E Gas Transmission Northwest and in Texas through two wholly-owned subsidiaries PG&E Gas Transmission Texas Corporation ("PG&E GTT") and PG&E Gas Transmission Teco, Inc. ("PG&E Teco").

Together PG&E GTT and PG&E Teco own 8,000 miles of intrastate pipelines in Texas. PG&E's Texas pipeline capacity is about 3 billion cubic feet of gas per day ("Bcf/d."). One PG&E pipeline system connects a prolific gas supply area of western Texas and southeastern New Mexico (the Permian Basin) to the cities of San Antonio and Austin and a major market trading area near Houston, called Katy. This is the Trans Texas pipeline. The Tufco pipeline, a second PG&E system, jointly owned with TXU Corporation connects the Permian Basin to another trading area near Dallas. A third PG&E system connects producing areas in southern Texas to the trading area of Agua Dulce.

El Paso proposes to acquire all of the outstanding stock of PG&E Teco and PG&E GTT, owned by PG&E, for \$840 million.

III. The Investigation and the Proposed Complaint

The Proposed Complaint alleges that consummation of the Acquisition would violate Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, and Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18. The Proposed Complaint alleges that the Acquisition will lessen competition in each of the following markets: (1) the transportation of natural gas out of the Permian Basin; (2) the transportation of natural gas into the gas consuming area of Central Texas, which includes San Antonio, Austin, and the surrounding metropolitan area; and (3) the transportation of natural gas out of the Matagorda Island Offshore production area (“Matagorda”), located in waters off of the Texas coast near Galveston.

To remedy the alleged anticompetitive effects of the Acquisition, the Proposed Consent Order requires Proposed Respondents to divest: (1) all of El Paso’s share of the Oasis Pipe Line Company; (2) a 50 percent interest in the pipeline segment from Waha to New Braunfels; (3) all of PG&E’s interest in the pipeline segment running from New Braunfels to Dewville, Texas; (4) all of PG&E’s interest in the pipeline segment running from Dewville to Katy; and (5) all of PG&E’s assets in Matagorda.

The Commission accepted for public comment the Agreement Containing Consent Order after an extensive investigation in which the Commission examined competition and the likely effects of the acquisition in the markets alleged in the Proposed Complaint and in several other areas. The Commission conducted the investigation in coordination with the Attorney General of the State of Texas. Proposed Respondents have entered into an agreement with the State of Texas settling charges that the Acquisition would violate state antitrust law.

The analysis applied in each market follows the analysis of the Federal Trade Commission and Department of Justice *Horizontal Merger Guidelines* (1997) (“*Merger Guidelines*”). The Proposed Complaint alleges in three counts that the Acquisition would violate the Federal antitrust laws in natural gas transportation in three separate geographic markets in Texas. The proposed Acquisition, if consummated would result in highly concentrated markets and allow Proposed Respondents to raise prices unilaterally. The Proposed Complaint also alleges that entry into any of the three markets would not be timely, likely, or sufficient to prevent a price increase. The efficiency claims of the Proposed Respondents, to the extent they relate to the markets alleged in the Proposed Complaint, are small compared to the magnitude and likely harm, and would not restore competition lost as a result of the acquisition even if the Proposed Respondents achieved the claimed efficiencies.

A. Count I – Loss of Competition in the Permian Basin

The Permian Basin is a natural gas producing area in western Texas and southeastern New Mexico. As alleged in the Proposed Complaint, producers and marketers of Permian Basin gas have no alternative but to transport their gas to consuming areas on natural gas pipelines located in the Permian Basin. El Paso and PG&E today are two of the largest holders of natural gas pipeline capacity out of the Permian Basin, and El Paso would be the largest holder of capacity in this region if the Acquisition were completed.

As alleged in the Proposed Complaint, the market for natural gas transportation from the Permian Basin would be highly concentrated after the Acquisition. For most times of the year, Permian Basin natural gas producers prefer to sell their gas to the San Antonio and Austin area (“Central Texas”). At other times, California is a desirable destination. The Proposed Complaint

alleges that Proposed Respondents own or control most of the capacity from the Permian Basin to Central Texas. Proposed Respondents own almost all the capacity from the Permian Basin to California. The Acquisition is likely to eliminate actual and direct competition in this market between Proposed Respondents with the likely effects of increased rates and reduced output of transportation in the market, and diminished production of natural gas in the Permian Basin.

B. Count II – Loss of Competition in Central Texas

Central Texas, which includes the metropolitan areas of San Antonio and Austin, is an important natural gas consuming area. Buyers of natural gas, gas and electric utilities and merchant power plants, have no alternative to using pipelines located near metropolitan San Antonio and Austin. These Central Texas customers also do not have economic alternatives to using natural gas to fuel all or a significant number of their power plants. El Paso's Oasis pipeline and PG&E's Trans Texas pipeline account for almost all of the natural gas pipeline capacity into Central Texas.

Today, the market is highly concentrated and would become more so if the Acquisition were to occur, absent the proposed divestitures. Certain Central Texas transportation customers must use either Oasis or Trans Texas for all or a significant portion of their transportation needs. Other pipelines in the area have insufficient capabilities to offset the anticompetitive effects of the Acquisition. Absent relief, the Acquisition would enable El Paso unilaterally to raise prices to these customers, which would also raise the price of electricity to Central Texas consumers.

C. Count III – Loss of Competition in Matagorda

El Paso and PG&E own the only two pipeline systems that transport gas from the Matagorda off-shore production areas to on-shore processing facilities. The Proposed Complaint alleges that the Acquisition will eliminate actual and direct competition between Proposed Respondents, with the likely effects of increased rates and reduced output of transportation in the market, and diminished production of natural gas in the Matagorda area.

IV. The Proposed Consent Order

The Commission accepted for public comment an Agreement Containing Consent Order with Proposed Respondents, which would settle allegations contained in the Proposed Complaint. The Agreement Containing Consent Order contemplates that the Commission would issue the Proposed Complaint and enter the Proposed Order.

The Proposed Consent Order requires the Proposed Respondents to divest all of El Paso's interest in Oasis Pipe Line Company to Aquila Gas Pipeline Corporation ("Aquila," a subsidiary of Utilicorp United Ltd.), Dow Hydrocarbons and Resources, Inc. ("Dow," a subsidiary of Dow Chemical Company) and the Oasis Pipe Line Company (the corporate owner of the Oasis pipeline). Aquila, Dow and El Paso currently own Oasis Pipe Line Company. The Proposed Consent Order also requires the Proposed Respondents to divest: (1) a 50 percent interest in the Trans Texas pipeline segment from Waha to New Braunfels; (2) all of PG&E's interest in the Trans Texas pipeline segment running from New Braunfels to Dewville, Texas; *and* (3) all of PG&E's interest in the Trans Texas pipeline segment running from Dewville to Katy. Prior *to* PG&E's Acquisition in 1997, these three pipeline segments were known as the Teco Pipeline. The Proposed Respondents must divest the Teco Pipeline to Duke Energy Field Services, LLC

(“Duke,” a subsidiary of the Duke Corporation). The Proposed Consent Order also requires Proposed Respondents to divest all of PG&E’s pipeline assets in Matagorda to Panther Pipeline. The Proposed Respondents must divest these assets to these approved buyers not later than 10 days after the Commission places the Agreement Containing Consent Order on the public record or the closing of the Acquisition, whichever is later.

Under the terms of the Proposed Consent Order, in the event that El Paso does not divest the assets required to be divested under the terms and time constraints of the Proposed Consent Order, the Commission may appoint a trustee to divest those assets, expeditiously, and at no minimum price.

For a period of ten (10) years from the date the Proposed Consent Order becomes final, the Proposed Consent Order prohibits El Paso from acquiring, directly or indirectly, any of the assets that are to be divested or altering the governance provisions of the Teco pipeline without obtaining the prior approval of the Commission. PG&E’s obligations under the Proposed Consent Order terminate after completing the Acquisition.

The Proposed Consent Order also requires the Proposed Respondents to provide the Commission with a report of compliance with the terms of the Proposed Consent Order within thirty (30) days after the Order becomes final. Proposed Respondents must also file annual compliance reports detailing their compliance with the notice provisions under the Proposed Consent Order.

A. Resolution of the Competitive Concerns

The Proposed Consent Order, if finally issued by the Commission, would settle all of the charges alleged in the Commission's Proposed Complaint.

1. The Proposed Order Resolves Competitive Concerns in the Permian Basin and Central Texas

Under the terms of the Proposed Consent Order, Respondent El Paso will divest all of its interest in the Oasis Pipe Line Company to Aquila, Dow, and the Oasis Pipe Line Company.

Proposed Respondents also have agreed to divest to Duke all of the Teco Pipeline.

El Paso will sell its Oasis Pipe Line Company stock to Dow, Aquila and the Oasis Pipe Line Company. Oasis Pipe Line Company will retire its El Paso stock. Oasis currently operates as a single pipeline with three owners, Aquila, Dow and El Paso. After the proposed divestitures are completed, El Paso will no longer have any interest in the Oasis Pipe Line Company, and current owners will continue to own and operate Oasis. The divestiture therefore enables Oasis to compete with El Paso and Duke to serve Permian Basin producers and marketers of natural gas.

The Teco Pipeline is being divested to Duke, a firm that is not presently in the market. Under the Proposed Consent Order, Duke will be able to sell gas on or expand the Teco Pipeline without obtaining the approval of El Paso. These protections will afford Duke the opportunity to compete with El Paso to serve the Permian Basin. In 1999, Duke had annual revenues of \$21.7 billion. Duke currently owns and operates natural gas and other pipelines throughout the United States.

The proposed divestitures resolve competitive concerns in the Permian Basin by giving Permian producers two new options for transportation. The proposed divestitures lower Permian

Basin concentration levels below pre-Acquisition concentration levels. The proposed divestitures also give Permian producers new options for shipping natural gas to the most desirable destination. Before the Acquisition, Permian producers had two companies competing to deliver gas to Central Texas, PG&E and Oasis (owned by El Paso). After the divestitures, they will have three alternatives, Duke, Oasis (independent of El Paso) and El Paso.

In Central Texas, the divestiture creates a market less concentrated than before the proposed Acquisition. Presently, firms that need natural gas transportation have two primary options, Oasis and PG&E. After the divestiture these firm will have a third option in Duke.

2. The Proposed Order Resolves Competitive Concerns in the Matagorda Area

Under the terms of the Proposed Consent Order, Proposed Respondents will divest PG&E's Matagorda area pipeline assets to Panther Pipeline Company. Panther has substantial experience operating pipeline and gathering systems. By divesting all of the PG&E assets, Matagorda producers will continue to have two pipelines with which they may contract for natural gas transportation.

B. Opportunity for Public Comment

The Proposed Consent Order has been placed on the public record for thirty (30) days for receipt of comments by interested persons. Comments received during this period will become part of the public record. After thirty (30) days, the Commission will again review the Proposed Consent Order and the comments received and will decide whether it should withdraw from the Proposed Consent Order or make it final.

By accepting the Proposed Consent Order subject to final approval, the Commission anticipates that the competitive problems alleged in the Proposed Complaint will be resolved. The purpose of this analysis is to invite public comment on the Proposed Consent Order, including the proposed divestitures, to aid the Commission in its determination of whether it should make final the Proposed Consent Order. This analysis is not intended to constitute an official interpretation of the Proposed Consent Order, nor is it intended to modify the terms of the Proposed Consent Order in any way.