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A BRIEF ANALYSIS OF POLICY AND LITIGATION
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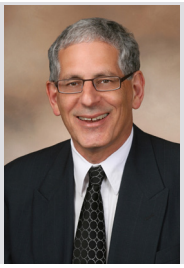
Department of Justice Clears Merger of CVS and Aetna

Robert D. Stoner



EI Principal Robert Stoner has provided expert assistance on several drug store mergers and cases involving vertical issues.

The Department of Justice (DOJ) recently cleared the merger of CVS Health Corporation (CVS) and Aetna Inc. (Aetna), only requiring divestiture of Aetna's horizontally overlapping Medicare Part D prescription drug plan business. Aetna is primarily a health insurer, while CVS primarily has significant businesses in pharmacy benefit management (PBM) and retail pharmacy. DOJ approved the overall deal, citing benefits of the creation of an integrated pharmacy and health benefits company that could lower health care costs. For example, the merging parties claimed Aetna's insurance customers would have access to more local healthcare options through CVS's expanding health related services (such as its MinuteClinics). DOJ found no vertical competitive problems arising from the companies' significant operations at different points in the health care supply chain.

This approval, despite possible vertical concerns, is perhaps not surprising given that DOJ had shortly before approved the vertical merger of health insurer Cigna Corporation with PBM Express Scripts Holding Co. With respect to the CVS/Aetna merger, DOJ stated that while it considered whether the combined entity might try to raise the cost of PBM services or retail pharmacy services to other health insurers in order to favor Aetna's health insurance business, it concluded that such a result was unlikely due to what it characterized as sufficient competition from other PBMs and retail pharmacies. DOJ also found that the combined entity would not have an incentive to raise costs to Aetna's health insurance rivals, because it would lose PBM (or retail pharmacy) business that it would not be able to offset through capturing additional health care insurance customers.

These findings differ from those argued by DOJ in its recent challenge of AT&T's purchase of Time Warner. In the AT&T/Time Warner merger, DOJ specifically maintained that there was an incentive for the combined entity to raise distribution rivals' costs. DOJ argued that Time Warner's programming is unique, giving it the ability to raise distribution rivals' costs without incurring offsetting programming losses. By contrast, in the CVS/Aetna merger, DOJ found that CVS's PBM services are not unique and face sufficient competition from other suppliers of PBM services (despite recent PBM consolidation). Thus, CVS would not be able to raise Aetna's insurance rivals' costs. In sum, DOJ is continuing to examine vertical issues, and case specific facts likely will determine which mergers will raise vertical concerns.

Also In This Issue

Ex Ante versus *Ex Post:* Janis Joplin's Yearbook Revisited

Paul E. Godek discusses Franklin Fisher and Craig Romaine's 1990 article, "Janis Joplin's Yearbook and the Theory of Damages." Dr. Godek considers their argument for evaluating damages from an *ex ante* perspective and compares it to the *ex post* perspective. Dr. Godek considers the possibility that the plaintiff would have held the asset, absent the alleged violation. In this scenario, the violation denied the plaintiff the asset as well as the resolution of the uncertainty associated with ownership. Dr. Godek finds that calculating damages at the time of trial, an *ex post* analysis, may not be inferior from an economic perspective.

Efficient Adoption of Energy Storage: Key Considerations for the Appropriate Compensatory Framework

Amparo Nieto discusses the key role energy storage is expected to play globally in the transition to low-carbon energy sectors, by facilitating a smoother integration of renewable generation into the grid. Battery storage adds flexibility to the system by providing unique ramping capability, as well as grid benefits. Dr. Nieto argues that pricing frameworks for energy storage services should be comparable to those of other distributed energy resources (DERs). Payments should reflect how effectively energy storage is able to perform specific services and deliver incremental cost savings to the grid.

Ex Ante versus *Ex Post*: Janis Joplin's Yearbook Revisited

Paul E. Godek

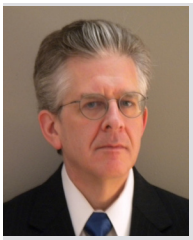
It has been almost 30 years since the publication of Franklin Fisher and Craig Romaine's widely-cited 1990 article, "Janis Joplin's Yearbook and the Theory of Damages." Fisher and Romaine argue that, in disputes over a lost asset or opportunity the value of which can change over time, commercial damages should be measured as of the time the wrongful act occurred. However, calculating damages as of the time of trial – an *ex post* analysis as opposed to Fisher and Romaine's *ex ante* analysis – may not be inferior from an economic perspective.

A substantial amount of time may pass between when a wrongful act occurs and when a damage amount is determined. In cases involving a lost asset or opportunity, Fisher and Romaine argue that damages should be measured as of the time the wrongful act occurred. They offer the following evocative hypothetical scenario:

> Janis Joplin, the rock star, went to high school in Port Arthur, Texas. Suppose that when she graduated she signed one copy of her high-school yearbook. ... Assume that signed high-school yearbooks were being bought and sold for $5.00 in Port Arthur, regardless of whose signature they contained.
>
> Assume that the thief stole and destroyed a copy of the yearbook with Janis Joplin's signature. The legal proceedings that followed took considerable time, and, by the time a damage award is to be made, Janis Joplin is known to have been a star, with her autograph selling for $1,000. ... [W]hat damage award will make the plaintiff (the book's owner) whole?
>
> The temptation, of course, is to use hindsight and award $1,000. The other answer – $5.00 plus interest at the risk-free rate – seems somehow very unfair. That perception is incorrect, however, and the temptation should be resisted.

The logic of their argument is presented as follows:

> Suppose that the asset destroyed was the opportunity to enter into a long-term contract thought at the time to be valuable. Suppose, however, that, with the benefit of hindsight, we now know that the contract would have been a disaster, losing money for the plaintiff. Surely, one would not assess negative damages, having the plaintiff pay the defendant.
>
> The two cases are symmetric, however. The reader who finds it hard to accept our argument should attempt to enunciate a principle on which the use of hindsight leads to paying a high award when the asset turns out to have been unexpectedly valuable and does not lead to negative damages when the asset turns out to be a loser.



EI Senior Vice President Paul E. Godek has worked on numerous matters involving the computation of damages. This article is based on the author's Law 360 article, published July 22, 2015.

The two cases are symmetric, but the symmetry does not favor one approach over the other. When the asset's value increases, damages will be higher under an *ex post* approach; when the asset's value decreases, damages will be higher under an *ex ante* approach. The Fisher and Romaine critique of the *ex post* approach is compelling only if it were to be applied inconsistently, depending on the change in value.

"...the symmetry does not favor one approach over the other."

Evaluating damages as of the time of trial can generate negligible or even negative damages, as Fisher and Romaine point out. But negative damages can occur when calculated as of the time of the wrongful act as well. Consider the loss of an "asset" that has a negative value due to encumbrances placed upon it. In either case, the prospect of negative damages does not cause a legal conundrum. With negative damages neither party would have a claim: the party saved from losses by the wrongful act suffers no harm; the party committing the wrongful act has no claim to the economic profits generated thereby, because the legal system does not allow someone to profit from a violation of the law.

To bolster their argument, Fisher and Romaine state:

> The violation did not merely deprive the plaintiff of the stream of returns that would have accompanied the asset. It also relieved the plaintiff of the uncertainty surrounding the stream.

That is correct, but at the time of the violation the plaintiff had not chosen to be deprived of either the asset or the uncertainty. Suppose that, absent the violation, the plaintiff would have held the asset. In that scenario the violation denied the plaintiff the asset as well as the resolution of the

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Efficient Adoption of Energy Storage: Key Considerations for the Appropriate Compensatory Framework

Amparo Nieto

EI Senior Vice President Amparo Nieto provides expert advice to utilities and regulatory commissions on regulatory and pricing models for distributed energy resources and reforms to electricity market rules.

Energy storage is expected to play a key role globally in the transition to low-carbon energy sectors by facilitating a smoother integration of renewable generation into the grid. Maintaining the power balance in the transmission grid will become a challenge in regions with expected high penetration of renewable distributed generation, as well as in states that have committed to ambitious carbon-reduction targets. Intermittent generation exacerbates net load variability, which traditionally has been addressed by flexible generation such as natural gas combustion units, dispatchable demand response, or pumped-hydroelectric energy storage. Recent improvements in technology have strengthened the business case for using electrochemical battery storage to address net load variability. Battery storage is a fast start-up resource that adds flexibility to the system by providing unique ramping capability. With the right financial incentives, battery storage will be charged during low-load conditions, absorbing excess generation from renewable resources. It then may be discharged at peak times, lowering the risk of energy shortages and subsequently high market prices in those hours. Energy storage also may potentially replace the addition of new peaking gas-based generation units. In the United States, state wide energy storage adoption targets have been mandated in California, New Jersey, New York, Massachusetts, Oregon, and Washington D.C., and other states also are beginning to consider energy storage in their resource plans.

Battery storage may be sited anywhere in the transmission and distribution systems, either directly connected to the network (front-of-the-meter) or sited on the customer premises (behind-the-meter) and paired to a rooftop solar facility. Utilities can play a crucial role in providing transparency to customers and third-party storage developers as to when and where deploying a storage solution may be beneficial to the distribution grid. Utilities also will need to develop pricing frameworks that incentivize these customers and third-party storage developers to provide their storage services to the grid. Further, to fully unlock the value of battery storage, rules should be put in place to better enable participation of stand-alone storage, as well as of aggregated small-scale storage systems, in wholesale capacity, energy, and ancillary services markets. The Federal Energy Regulatory Commission (FERC) has requested Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs) to make any required changes to their tariffs and regulations to fulfill this goal. In this effort, special attention should be given to the implications of incorporating any storage resources that currently are funded by clean energy policies. In particular, a key goal is to ensure that the wholesale capacity market continues to send accurate price signals of the cost of new entry to avoid distortions.

Ideally, pricing frameworks for energy storage services should be comparable to those of other distributed energy resources (DERs). Payments should reflect how effectively energy storage is able to perform specific services and deliver specific incremental cost savings to the grid. One approach is for utilities to hold direct procurement of DERs through Non-Wires Alternatives (NWA) solicitations, to address identified distribution upgrade needs at specific congested substations or feeders. NWA solicitations may include energy efficiency, distributed generation, and/or energy storage. Payment for storage contracted through NWA solicitations should align with any wholesale, grid, or environmental benefits effectively provided to the utility, in order to provide costs savings over traditional solutions. The utility will be able to fully account for storage as a capacity resource, particularly if it has dispatch rights or has enforced penalty provisions for underperformance. If energy storage resources procured through NWA solicitations wish to participate directly in the wholesale market, the NWA contract payments should avoid duplicity of compensation for the same services. A clear allocation of dispatch rights among the utility and ISO or RTO will be important to ensure optimization of energy storage deployment for both the bulk and distribution systems.

"Payments should reflect how effectively energy storage is able to perform specific services and deliver specific incremental cost savings to the grid."

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Ex Ante versus *Ex Post*

uncertainty associated with ownership.

It is possible that the plaintiff would have disposed of the asset at any point between the violation and the trial, but that is not likely to be knowable. If there is such evidence indicating when a sale would have occurred, then that but-for sale date becomes the appropriate time at which to value the asset. Absent evidence that the asset would have been sold around the time of the violation, however, there is no economic basis for employing that assumption.

Regardless of whether the passage of time renders the asset more or less valuable, without the violation the plaintiff may well have maintained ownership and that would be a coherent legal presumption. In any case, there is no reason to prefer a rule that implies a coincidental outcome – that the asset would have been disposed of around the time of the violation.

When it comes to awarding damages, the goal of the law is to put the plaintiff in the financial position he would have been in if the wrongful act had not occurred. Economics is not informative as to whether that goal is more likely to be achieved by evaluating damages from an *ex ante* or an *ex post* perspective. There is no a priori reason for preferring the *ex ante* approach. Indeed, unless there is evidence that the asset in question would have been disposed of at some point between the violation and the trial, calculating damages as of the trial may be the more intuitive approach.

Efficient Adoption of Energy Storage

NWA solicitations are not the only possible approach. Mass adoption of small-scale energy storage will be dependent on additional incentives provided through regulated price mechanisms, in principle involving both base electricity rates and export tariffs or rebates. Currently, net metering is the predominant compensation method for rooftop solar generation, and it is not well equipped to properly incentivize battery storage. For example, regulated delivery rate structures often are constrained for reasons other than economic efficiency goals, limiting the ability for volumetric charges to reflect the value of peak-shaving that may be enabled by storage resources and other DERs. As a result, net metering may render suboptimal adoption of energy storage. Enhanced tariff-based mechanisms, in place of net metering, can alleviate these issues by uncovering the economic value stack associated with load reductions or energy injections to the grid throughout the day. For optimal deployment of storage, a tariff-based framework should: 1) reflect marginal cost savings consistent with utility investment needs and peak load projections over the planning cycle; 2) recognize storage's actual performance during critical peak hours with the tightest capacity conditions; 3) price differently by distribution area if needed, reflecting the higher value of storage in constrained locations; and 4) provide sufficient granularity so that aspects such as different durations of battery storage are implicitly considered.

While the objectives of an energy storage compensatory framework may generally be agreed upon, in practice there are a number of practical challenges. Regulators need to ensure that economically-efficient inducing price signals are put in place so that storage is compensated based on ongoing and quantifiable marginal costs. Any interim subsidy provided to support early or accelerated development of storage or other DERs should be fully transparent in order to ensure that market participants and consumers anticipate the implications on future project returns as the subsidy phases out.

EI News and Notes

Report on Copyright Industries

EI Principal Stephen E. Siwek's report, "Copyright Industries in the U.S. Economy: The 2018 Report," was released on December 6, 2018. This report is the 17th in a series issued over the last 28 years by Economists Incorporated. This report confirms once again that the U.S. copyright industries contribute significantly to U.S. GDP and continue to outpace the rest of the economy in real growth.

Fall 2018 Utility of the Future Group Meeting Held

The Fall Utility of the Future Rates Group (UFRG) meeting was successfully held in Atlanta, on October 25-26, 2018. Utility directors and managers from private and publicly-owned utilities from the United States and Canada discussed critical issues and innovative approaches related to electricity rates and programs for Distributed Energy Resources. EI's Senior Vice President Amparo Nieto directed the UFRG meeting. The next UFRG meeting will be held in the Spring, see https://ei.com/utility-future-rates-group/.

Antitrust Source's Roundtable on Antitrust Developments in China

EI Vice President Su Sun was among a panel of practitioners with extensive hands-on experience advising clients on antitrust matters in China. The panel discussed trends observed over the past decade of China's antitrust enforcement and the outlook of future antitrust development in China. The full panel discussions are published in **The Antitrust Source**, August 2018.

Philip Nelson Co-Chair of the ABA Antitrust Section's Content Committee

EI Principal Philip Nelson has been reappointed Co-Chair of the ABA Antitrust Section's Content Committee. In the past, Dr. Nelson has served as Chair and Vice Chair of the Section's Economics Committee, Chair and Vice Chair of its Health Care and Pharmaceuticals Committee, and Vice Chair of its Intellectual Property Committee.

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