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Takeaways From Ex-Chesapeake CEO Antitrust Case

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Every oil and gas exploration and production company acquires oil and gas properties either directly from landowners or from other lessees. These transactions come in many forms and sizes but occur daily in good times and bad times.

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At the same time, E&P companies typically do not act alone in developing their oil and gas properties, and often enter into agreements of various kinds with other companies to jointly explore, develop and produce oil and gas properties. Many such relationships do not raise any legal issues concerning anti-competitive conduct, but some recent high-profile cases have emphasized the need to observe some basic concepts.

The late Aubrey K. McClendon, the former CEO of an active E&P company, was recently indicted for alleged violations of antitrust laws in bidding to acquire oil and gas leases during a period from 2007 to 2012.[1] While this particular case involved criminal charges, improper conduct also raises the possibility of civil charges by the government and private actions by injured parties.

According to the indictment, McClendon "and his co-conspirators knowingly entered into and engaged in a combination and conspiracy to suppress and eliminate competition by rigging bids for certain leasehold interests and producing properties. The combination and conspiracy engaged in by the defendant, Aubrey K. McClendon, and his co-conspirators was in unreasonable restraint of interstate commerce in violation of Section 1 of the Sherman Act (15 U.S.C. § 1)." According to the press release[2] issued by the U.S. Department of Justice:

[t]he indictment alleges that McClendon orchestrated a conspiracy between two large oil and gas companies to not bid against each other for the purchase of certain oil and natural gas leases in northwest Oklahoma. During this conspiracy, which ran from December 2007 to March 2012, the conspirators would decide ahead of time who would win the leases. The winning bidder would then allocate an interest in the leases to the other company. McClendon instructed his subordinates to execute the conspiratorial agreement, which included, among other things, withdrawing bids for certain leases and agreeing on the allocation of interests in the leases between the conspiring companies.

The indictment contains few details, but apparently executives from two companies agreed that only one of them would bid to acquire leases and producing properties and, if successful in that bid, would share the properties with the other company at cost. The arrangements were kept secret and the selling party was not informed of the arrangement.

While the criminal indictment against a well-known CEO is certainly newsworthy, another civil case from a few years ago holds more practical lessons for E&P companies. In a 2012 Colorado federal court case called United States vs. SG Interests I Ltd., et al., the government considered antitrust issues in arrangements for the joint bidding to acquire federal oil and gas leases. This was the first time that the United States challenged under antitrust laws a joint bidding arrangement for mineral rights leases administered by the U.S. Bureau of Land Management.

In that case, the government alleged that two companies — SG Interests ("SGI") and Gunnison Energy Corporation ("GEC") — violated the antitrust laws by agreeing not to compete at BLM auctions to be held beginning in February 2005. The government specifically alleged that, prior to the auctions, "[b]oth SGI and GEC were independently interested in certain of the tracts that would be auctioned and both likely would have bid — and bid against each other — at the February auction."[3] The defendants, however, executed a memorandum of understanding two days before the first auction.[4] Under the MOU, only SGI would bid at the upcoming auctions; if successful, SGI would assign a 50 percent interest in the acquired leasehold interests to GEC.[5] The arrangement had the desired effect as GEC did not bid. The government determined that SGI's and GEC's agreement not to compete pursuant to the MOU constituted a per se violation of Section 1 of the Sherman Act.[6]

Bid-rigging agreements generally are among the types of restraints on competition that courts have condemned as per se unlawful. The government has the discretion to decide whether to bring criminal or civil charges when dealing with per se antitrust offenses. In the SG Interests case, the government stated that it chose to pursue the conduct as a civil violation, noting that it was "the first time that the United States has challenged a joint bidding arrangement for BLM mineral rights leases" and that the joint bidding "was performed under the written MOU drafted by attorneys."[7] The government recognized that the decision to proceed civilly or criminally can require "considerable deliberation."[8]

The government entered into a settlement agreement with the defendants that called for a monetary payment to the government. This payment would compensate the government for the loss of revenue it suffered as a result of BLM receiving lower lease payments because of the unlawful agreement.

In its public settlement papers, the government drew a distinction between the illegal bids made pursuant to the MOU and another set of joint bids between the same defendants that were made pursuant to a later-negotiated area of mutual interest agreement ("AMIA"). The AMIA established a framework for the parties to jointly acquire and develop leases and pipelines in the relevant area. The government found that the AMIA joint bids were not contrary to the antitrust laws in that they were "ancillary" to this "broader joint development and production collaboration." In its "Response of Plaintiff United States to Public Comments on the Proposed Final Judgment,"[9] the government articulated the application of this "ancillary restraints" exception to the per se rule:

Applying this analysis to an auction setting, a naked agreement between competitors not to bid against each other is properly treated as per se unlawful. On the other hand, a joint bidding agreement that is ancillary to a procompetitive or efficiency-enhancing collaboration may be lawful under the rule of reason. Significantly, lawful joint bidding "contemplates subsequent joint productive activity, which

entails a measure of risk sharing or joint provision of some good or service." 12 PHILLIP E. AREEDA & HERBERT HOVENKAMP, Antitrust Law ¶ 2005d, at 75 (2d ed. 2005). For example, if a firm, which cannot or might not otherwise compete on a particular bid, joins with another firm to pool resources or share risk, their joint bidding might increase competition by increasing the number of bidders.

Joint bidding arrangements are quite common in the upstream business. Why was joint bidding under the MOU illegal but the agreement not to compete under the AMIA a permissible ancillary restraint? As with most antitrust cases, the facts matter. The government stressed that it had conducted an extensive investigation into the competitive effects of both the MOU and the AMIA, including issuing civil investigative demands for documents and interviewing market participants.[10]

After considering "all relevant circumstances," the government found that the MOU was an illegal agreement.[11] The complaint described how the defendants used the MOU to avoid a bidding war. It alleged that the defendants "[r]ecognized that they would be the primary competitors" for the leases at the February auction, entered into discussions on the eve of the auction "to forestall competing against one another," and executed the MOU to effectuate the agreement.[12] According to the government's settlement papers, the MOU had the desired effect:

Contemporaneous GEC business documents demonstrate [] that after the February 2005 auction, senior GEC executives congratulated each other on having successfully avoided a bidding contest with SGI."[13] Importantly, the government specifically found that the MOU "was not part of a procompetitive or efficiency enhancing collaboration.[14]

Moreover, the government stressed the importance of timing to the analysis. While the unlawful bidding arrangement under the MOU took place against the backdrop of discussions among the parties about a broader agreement, any such broader collaboration remained just a "vague possibility." The fact that the defendants "ultimately established" a broad collaboration through the AMIA did not "transform their prior agreement not to compete into a lawful ancillary restraint."[15]

However, the facts surrounding the second joint bidding arrangement were quite different. That agreement took place later, as part of the more concrete collaborative arrangement memorialized in the AMIA. The government described several factors that were relevant to the finding that this arrangement reflected a lawful, efficiency-enhancing collaboration. For example, the AMIA:

- was formed "after significant negotiations";
- "provided for joint exploration and development of lands" located within the defined area covered by the joint bidding arrangement;
- was specifically designed to facilitate the efficient production of gas;
- included provisions for the joint acquisition and ownership of leases in the area, conducting joint operations, and building and operating a pipeline system to transport gas, which required substantial capital investment; and

- aligned the parties' "incentives to cooperate in achieving the goals of the collaboration" and discouraged any one party from "appropriating an undue share of the collaboration's benefits."[16]

In short, the government found that the AMIA collaboration allowed the two companies "to pool their resources and share the risks of exploration for, and development of, the natural resources, which provided an opportunity to realize significant production efficiencies."[17]

As the SG Interests case suggests, when used properly in the context of collaborative efforts, joint arrangements would be deemed to be in compliance with the antitrust laws. The U.S. antitrust agencies, in their "Antitrust Guidelines for Collaborations Among Competitors," recognize that "competitive forces are driving firms toward complex collaborations to achieve goals such as expanding into [new] markets, funding expensive innovation efforts, and lowering production and other costs."[18]

The antitrust laws encourage pro-competitive collaborations that help achieve these goals, as is often the case with joint bidding and development arrangements among E&P companies. Indeed, in SG Interests, the government specifically recognized that such arrangements are an established and accepted industry practice: "Because it usually involves a collaboration through which pro-competitive efficiencies arise, joint bidding at BLM auctions is both common and appropriate."[19] The agreement reflected in the MOU, however, was an aberration in that it "reflected a deviation from common industry practice, as the MOU was merely a naked restraint that allowed Defendants to avoid a bidding war."[20]

Parties must be careful to utilize these arrangements only in the context of a larger collaboration that will withstand antitrust scrutiny from the government or private parties. The government will examine the facts, such as those described above, to see if the collaboration is one in which, to use the government's language from SG Interests, "pro-competitive efficiencies arise."

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[1] See Indictment in re United States of America vs. Aubrey K. McClendon, filed with The United States District Court for the Western District of Oklahoma.

[2] See U.S. Department of Justice's Press Release dated March 1, 2016, available at https://www.justice.gov/opa/pr/former-ceo-indicted-masterminding-conspiracy-not-compete-oil-and-natural-gas-leases, last checked on March 8, 2016.

[3] Complaint, U.S. v. SG Interests I, Ltd., et al., 12-CV-0395 (D. Colo.), at ¶ 15.

[4] Id.

[5] Id., at ¶¶ 15-16.

[6] Plaintiff's Memorandum in Support of Its Motions for Entry of Final Judgment ("Mem."), March 6, 2013 (Dkt. 28), at 8.

[7] Response of Plaintiff United States to Public Comments on the Proposed Final Judgment, U.S. v. SGI Interests I, Ltd., et al., Case No. 1:12-CV-00395 (D. Colo. 2012), available at https://www.justice.gov/atr/case-document/file/510586/download, last checked on March 8, 2016. (hereinafter "RTC"), at 13 n.10.

[8] Id.

[9] Id. at 16.

[10] Id. at 3.

[11] Id.

[12] Complaint, at Introduction and ¶ 11.

[13] RTC at 18, n.12.

[14] Complaint, at ¶ 20.

[15] RTC at 16 & n.13 (noting that competitive effects are assessed at the time of possible harm to competition).

[16] RTC at 17.

[17] Id.

[18] US Dep't of Justice and Federal Trade Commission, "Antitrust Guidelines for Collaborations Among Competitors" (April 2000) at 1, available at https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf.

[19] Mem. at 17.

[20] Id.

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