

## Cautious about Collaboration: Antitrust Scrutiny in Oil and Gas Exploration

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### I. Introduction

Oil and gas exploration in the continental United States boomed in the 2000's and into 2010's through the revolutionary use of horizontal drilling and hydraulic fracturing of shale and other rock formations. Unlike traditional vertical wells, which effectively operated to extract oil and gas from a single geographic point (possibly at multiple depths), horizontal wells could run for miles across a geography, extracting mineral rights across a much larger area. The nature of the drilling, which necessitated the aggregation of large and contiguous tracts of oil and gas rights, intensified the need and desire to create partnerships or other forms of cooperation between oil and gas companies who might be trying to put together sufficient rights to drill in an area.

Various cooperation forms had long been in use in the exploration business, including broad exploration and production joint ventures, areas of mutual interest, and farm-out contracts. In his book about the rebirth of oil and gas exploration in the continental United States, The Frackers: The Outrageous Inside Story of the New Billionaire Wildcatters, Gregory Zuckerman described the initial competitive contact and collaboration between two of the pioneers, Aubrey McClendon, and Tom Ward, that would ultimately lead to the formation of one of the country's leading oil and gas exploration companies.

McClendon searched for leases in prime areas of the region, persuading landowners to lease acreage that he flipped to larger oil companies, just like Tom Ward was doing. McClendon dug up information about successful wells and became familiar with the area. Then he'd find available leases and cobble them together to enable a more lucrative sale to a larger company.

"What Aubrey would do, in essence, he was out there picking up a lot of crumbs . . . getting in everybody's deal," Jacobs says. "He put enough crumbs together to where he was able to put together a whole loaf of bread."

In the spring of 1983, Ward and McClendon began bumping into each other while vying for the same oil and gas leases, many near Will Rogers World Airport. One day, McClendon called Ward with a proposal.

"Why don't we just join forces?" McClendon asked.

Ward agreed. They decided to keep their companies apart, with offices in separate locations, but to work as fifty-fifty partners with only a handshake binding the twenty-three-year-olds. For the next six years, Ward and McClendon put together deals, often

holding on to the leases instead of flipping them, while mustering enough cash to participate in drilling done by others.

Surprisingly, very little guidance was available as to how government agencies would analyze competitor agreements in this industry. The lack of specific guidance to the industry presents unique challenges because both the pro-competitive benefits and the anti-competitive risks of collaboration can be substantial – in a traditional rule of reason analysis their weighing can be complicated and confusing. Companies often undertake massive and risky projects that require the resources and investments of more than one company. Such collaboration allows competitors to create substantial cost savings and make an innovative but cumbersome project feasible. Indeed, depending on the state regulatory regime, competing oil and gas companies can block each other from drilling by acquiring strategically located oil and gas rights (such as the acquisition of the mineral rights under a railroad or utility that will prevent, delay or drive up the cost of drilling of a horizontal lateral across the thin property). The strategic blocking will at minimum result in some sort of cooperative asset swap which will likely delineate where the companies will lease and drill in the future. In the anecdote from The Frackers above, it is clear that the driver for these young entrepreneurs was to pool their limited capital to allow them to put together better, larger and more attractive “plays” that they could later sell to the larger operating companies. They were also competing for the leases with these operators, but undoubtedly there was a landowner or two who would have preferred that the two compete for his lease and drive up the value of its terms.

Into the relative vacuum of antitrust guidance and near the end of the exploration boom, the Justice Department’s Antitrust Division (“DOJ”) has stepped in with enforcement actions seeking to establish boundaries for the collaboration among competitors that commonly occurs in these complex markets.<sup>1</sup> At a time when oil and gas prices are rising and a new Administration has announced that is seeking to promote domestic oil and gas exploration, this paper considers how antitrust authorities will likely scrutinize both seemingly synergistic competitor collaborations and collaborations that lack compelling procompetitive effects in the oil and gas exploration space.

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<sup>1</sup> Federal Trade Commission and U.S. Department of Justice, Antitrust Guidelines for Collaborations Among Competitors (Apr. 2000), [https://www.ftc.gov/sites/default/files/documents/public\\_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf](https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf).

## II. Common Collaboration Forms

Oil and gas companies commonly memorialize agreements to collaborate using three types of agreements: joint ventures (“JV”), areas of mutual interest (“AMI”), and joint bidding.

- Joint venture: A joint venture is typically executed through a Joint Operating Agreement (“JOA”) and provides for two or more parties to explore, develop, and produce an area together.
- Area of Mutual Interest: An AMI is a geographic region, as determined by the agreeing parties, in which two or more parties have an interest. The AMIs may provide for exclusivity in leasing, obligations or options to participate in leases, and designation of which company will operate or drill in the area. AMIs also commonly appear as a part of a JOA, providing a practical region within which the JOA will govern.
- Joint bidding: A joint bid occurs where two parties agree in advance to purchase and submit a single bid on a lease with shared interests, which are often predetermined.

Government agencies may consider any of these collaborations permissible if they contemplate significant efficiencies or if they are disclosed to the relevant parties. However, agencies may also seek to pursue antitrust violations where the collaborations do not seem to create sufficient procompetitive effects or appear to be a guise for anticompetitive actions. To complicate matters, the oil and gas industry often conflates the terms or otherwise includes one type of collaboration within another. For example, it is not uncommon for AMIs to be included within a JOA. The titles of these agreements will not be dispositive of how it is treated, but it is useful to think of them as a spectrum of collaboration with increasing levels of antitrust risk, as the extent of integration, both operationally and financially, decreases.

### A. Joint Ventures

Outside of the exploration area, the Supreme Court case, *Texaco Inc. v. Dagher*, provides guidance on lawful joint ventures in oil and gas.<sup>2</sup> In this case, Texaco and Shell Oil created a joint venture called Equilon to refine and sell gasoline in the western United States. Under the joint venture, gasoline was sold using the two company’s brand names and the joint venture set

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<sup>2</sup> 547 U.S. 1 (2006).

the price for both brands of gasoline. Service station owners sued alleging that Texaco and Shell had fixed prices thereby violating § 1 of the Sherman Act.<sup>3</sup> The Court found that the pricing decisions of a legitimate joint venture were not *per se* illegal and instead considered the pricing policy to be price setting by a single entity, noting that the companies were working as investors and not competitors.<sup>4</sup> The case demonstrated that competitors could decrease antitrust risk with a clear integration of finances or a structure that makes clear that the parties are engaged as investors and not competitors.

### *B. AMIs*

AMIs present a delicate issue for oil and gas collaborations because they may be permissible in some contexts and impermissible in others. For example, an AMI may be permissible when it is ancillary to a broader agreement to jointly develop an area but may not be permissible as a standalone agreement that allows two parties to parse out exploratory areas and cease head-to-head competition. Antitrust officials will scrutinize the use of an AMI that allows a competitor to pursue one geographic area without the worry of a competitor simultaneously attempting to lease land in the same area.

### *C. Joint Bidding*

Joint bids can be permissible under several circumstances, particularly where the joint bid is disclosed to the selling entity prior to the sale. For example, a standard Bureau of Land Management (“BLM”) bid form allows for a submission of a joint bid.<sup>6</sup> However, knowingly failing to disclose a joint bid on BLM lease sale form may be an additional federal crime under the Mineral Leasing Act and Amendments (“MLA”) if the failure to disclose a joint bid were considered to affect “the value of any lease or portion thereof.”<sup>7</sup> Regardless of the bidding rules of the BLM or other auctioning agency or landowner, joint bids will be assessed under the

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<sup>3</sup> *Id.* at 3.

<sup>4</sup> *Id.* at 6-8.

<sup>6</sup> Alaska’s BLM office provides an example bid form and envelope allowing for joint bids. BLM, Alaska State Office (2011), [https://www.blm.gov/style/medialib/blm/ak/aktest/energy/2011\\_NPR-A\\_Lease\\_Sale\\_Docs.Par.21193.File.pdf/2011\\_ExhibitI\\_Bid\\_Form\\_and\\_Envelope.pdf](https://www.blm.gov/style/medialib/blm/ak/aktest/energy/2011_NPR-A_Lease_Sale_Docs.Par.21193.File.pdf/2011_ExhibitI_Bid_Form_and_Envelope.pdf)

<sup>7</sup> 30 U.S.C. § 181 et seq. It is “unlawful for any person: (1) to organize or participate in any scheme, arrangement, plan, or agreement to circumvent or defeat the provisions of this Act or its implementing regulations, or (2) to seek to obtain or to obtain any money or property by means of false statements of material facts or by failing to state material facts concerning: (A) the value of any lease or portion thereof issue or to be issued under this Act . . .” 30 U.S.C. § 195(a).

antitrust laws and viewed as problematic where the purpose of the joint bid is to suppress competition. The fact that the bidding rules themselves are either silent on joint bids or permit them will not obviate the need for an antitrust assessment.

### **III. Antitrust Analysis of Collaboration Forms**

Like any competitor collaboration, cooperation agreements between companies acquiring oil and gas leases will be evaluated either on a *per se* basis (and likely pursued criminally) or under a traditional rule of reason analysis if there is a pro-competitive justification. Because the rule of reason analysis is a balancing test that weighs the anticompetitive effects and procompetitive benefits of the conduct, most uncertainty lies here. A miscalculation by an exploration and production company in their efforts to collaborate with a competitor might lead to a civil action by an agency or civil litigation. For example, a company might be subject to a civil action in a situation where there is some contemplated benefit by the competitors but where that contemplated benefit is not deemed to be sufficiently related to the restriction placed on competition.

The key questions in the analysis will likely be:

- Are operational integration and efficiencies being achieved?
- Is there risk-sharing or risk-reduction?
- How are restrictions on leasing like to affect lease competition?
- Are the restrictions on leasing reasonably necessary to achieve the benefits of the collaboration?

How these questions are likely to be answered (particularly the last one) may well depend on the state regulatory framework for oil and gas drilling. State regulations address issues around the difficulty of acquiring all of the oil and gas rights in a drilling area and the problems of hold-outs in a wide variety of mechanisms. Some states provide a mechanism by which parties do not necessarily need to collaborate to explore and develop oil and gas while other states do not provide any such mechanism. For example, the Oklahoma Corporation Commission (“OCC”) organizes land in Oklahoma into uniform 640-acre units, within which one operator may be designated and given rights to force other right holders in the unit to participate in the well or to

sell their rights. Within the units, the OCC provides for forced pooling, a mechanism by which a proposed operator can pursue drilling in a unit even if all parties in the unit do not want to participate by leasing their interest to the operator.<sup>10</sup> The proposed operator must attempt to reach an agreement with all interest holders, but if an operator is unable to do so, an administrative law judge will provide the unleased owners with a fair market value cash bonus and royalty and allow the operator to drill. In states without this structure, parties could become beholden to holdout landowners without otherwise being able to collaborate. Texas' Mineral Interest Pooling Act has weak pooling provisions that do not provide a practical avenue for mineral owners to drill in the face of holdout interest owners.<sup>11</sup> To complicate matters, Texas is organized into irregularly shaped tracts in contrast to Oklahoma's uniform units allowing for a landowner with a sliver of land potentially to hold up an entire project. Identical collaborative conduct might be considered procompetitive in Texas but anticompetitive in Oklahoma where there is a regulatory scheme by which the parties could continue to pursue drilling operations.

#### **IV. Recent Enforcement Actions**

The DOJ has taken two important enforcement actions that help set the outer boundaries of what oil and gas exploration companies can do as far as collaborating in their leasing activities. The key messages in both actions are that it is critical that companies are able to demonstrate the procompetitive justification for any coordinated bidding strategy. In the case of the indictment of Aubrey McClendon, the government made clear that it will pursue aggressively with criminal sanctions conduct that it views a naked bidding arrangement even where the competitors agree to split the oil and gas rights. In the *SG Interests* matter, the government also pursued as per se a bidding agreement that also contemplated, at least on paper, collaborative infrastructure development to exploit the jointly obtained oil and gas rights.

##### *A. United States v. SG Interests I, LTD., SG Interests VII, LTD., and Gunnison Energy Corporation*

In the DOJ's February 2012 civil complaint and settlement against SG Interests ("SGI") and Gunnison Energy Corporation ("GEC"), the DOJ alleged that GEC and SGI violated §1 of the

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<sup>10</sup> Oklahoma Corporation Commission, Pooling, <http://www.occeweb.com/ap/pooling.html>.

<sup>11</sup> Tex. Nat. Res. Code Ann. § 102.001 (West 2015).

Sherman Act by reaching an agreement not to compete for four natural gas leases sold at a BLM federal land auction.<sup>12</sup> The settlement required the companies to pay \$550,000 in fines and was the DOJ's first attempt to challenge "an anticompetitive bidding agreement for mineral rights leases."<sup>13</sup>

The complaint alleged that GEC and SGI entered into a Memorandum of Understanding ("MOU") in which they agreed that only SGI would bid at the BLM auctions and then assign a portion of the leases to GEC, thus preventing the leases from being auctioned at a competitive rate. The DOJ further alleged that the MOU was not part of a "procompetitive or efficiency-enhancing collaboration."<sup>14</sup> The DOJ also alleged that prior to 2005, when the MOU was executed, GEC and SGI had been separately exploring and developing natural gas resources in Western Colorado.<sup>15</sup>

It appears that the companies contemplated some benefit in the MOU, but that the DOJ did not view the stated benefit as sufficiently related to the restriction on the auction. These facts create some uncertainty in the civil context. For example, would the MOU have been acceptable if GEC and SGI had been exploring and developing natural gas resources in the same area in Western Colorado in the first place? Would the MOU had been acceptable if GEC and SGI had not begun exploring in the area at all before entering into the agreement? Did the fact that GEC and SGI were in litigation regarding the acquisition of some assets demonstrate that they did not plan to collaborate until absolutely necessary? The answers to these questions are unclear and create ambiguity as to whether the government might pursue a similar collaboration in the future civilly.

The MOU itself stated that "both of the Parties have expressed an interest in acquiring undivided interests in certain oil and gas leases to be issued in the BLM sale" and that the parties believed that development, production, and sale of the oil and gas "can be more efficiently carried out

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<sup>12</sup> Press Release, Department of Justice, Office of Public Affairs, Justice Department Settlement Requires Gunnison Energy and SG Interests to Pay the United States a Total of \$550,000 for Antitrust and False Claims Act Violations (Feb. 15, 2012), <https://www.justice.gov/opa/pr/justice-department-settlement-requires-gunnison-energy-and-sg-interests-pay-united-states>.

<sup>13</sup> *Id.*

<sup>14</sup> Complaint at 6, United States v. SG Interests I, Ltd., No. 1:12-cv-00395-RPM (D. Colo. Feb. 15, 2012), ECF No. 1, <https://www.justice.gov/atr/case-document/file/510616/download>.

<sup>15</sup> Complaint at 2, United States v. SG Interests I, Ltd., No. 1:12-cv-00395-RPM (D. Colo. Feb. 15, 2012), ECF No. 1, <https://www.justice.gov/atr/case-document/file/510616/download>

jointly with one another . . . .”<sup>16</sup> However, the MOU was specific to acquiring leases at the BLM sales, and designated that SGI would bid on behalf of the companies at the auction.<sup>17</sup> The DOJ may have reviewed the facts surrounding the MOU and determined that it appeared to give a façade of efficiency-building collaboration and instead served as a mechanism by which the companies would not have to compete against each other for BLM land.

### *B. United States v. Aubrey McClendon*

The DOJ has investigated two potential *per se* antitrust violations in oil or gas in recent years, both of which involved Chesapeake Energy, the exploration and production company founded by Tom Ward and Aubrey McClendon. In 2012, the DOJ began to investigate press reports of Chesapeake and Encana executives discussing divvying up bidding responsibilities in Michigan.<sup>18</sup> Reuters reported that the late Aubrey K. McClendon spoke with deputies at Chesapeake about Chesapeake and Encana avoiding “bidding each other up” and that Chesapeake contacted Encana about the same.<sup>19</sup> The DOJ ultimately ended its probe into possible violations two years later without pursuing the reported allegations, providing the company a declination letter.<sup>20</sup>

However, on March 1, 2016, McClendon was charged with “conspiring to rig bids for the purchase of oil and natural gas leases in northwest Oklahoma.”<sup>22</sup> The indictment alleged that the conspiracy suppressed prices paid to leaseholders in northwest Oklahoma by allocating interests in leases and agreeing to withdraw bids for certain leases.<sup>23</sup> The allegations again focused on bid rigging and alleged direct attempts to constrain lease prices leading to a *per se* analysis by the DOJ.

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<sup>16</sup> Response in Opposition to Defendants’ Joint Motion for Summary Judgment on All Claims at App’x 5, Memorandum of Understanding pg. 1, *Riviera Drilling & Explor. Co. v. Gunnison Energy Corp.*, No. 1:08-cv-02485-REB-CBS (D. Colo. Dec. 21, 2009), ECF No. 106.

<sup>17</sup> *Id.* at 1.

<sup>18</sup> Brian Grow, Joshua Schneyer, and Janet Roberts, Special Report: Chesapeake and rival plotted to suppress land prices, Reuters, (Jun. 25, 2012), <http://www.reuters.com/article/us-chesapeake-land-deals-idUSBRE8500EI20120625>.

<sup>19</sup> *Id.*

<sup>20</sup> Brian Grow, Justice Department ends antitrust probe of Chesapeake, Encana, Reuters, (Apr. 30, 2014), <http://www.reuters.com/article/chesapeake-doj-idUSL3N0NM7FI20140430>.

<sup>22</sup> Press Release, Office of Public Affairs, Department of Justice, Former CEO Indicted for Masterminding Conspiracy Not to Compete for Oil and Natural Gas Leases, (Mar. 1, 2016), <https://www.justice.gov/opa/pr/former-ceo-indicted-masterminding-conspiracy-not-compete-oil-and-natural-gas-leases>.

<sup>23</sup> The case was later dismissed on March 3, 2016 due to the defendant’s death. Motion to Dismiss, *United States v. Aubrey K. McClendon*, No. 5:16-cr-00043-M (W.D. Okla. Mar. 3, 2016), ECF No. 2.

What is clear from both the *McClendon* and *SGI Interests* actions is that the government rejected the argument that the pooling of capital and sharing of risk, at least on an ad hoc basis, was not going to be viewed as a pro-competitive benefit that was ancillary and reasonably necessary to a joint bidding strategy. Indeed in *SG Interests*, a memorandum of understanding to build infrastructure was insufficient to save the joint bidding strategy. The government's approach may best be seen in a litigated case involving the sale of timber the U.S. Forest Service, *United States v. Champion International Corp.*<sup>25</sup> Timber auctions work similarly to BLM auctions. Bidders often face risk in their purchase price as they do not know exactly how much value their purchase will be worth, and different bidders may place higher and lower values on the portions of the package that is being auctioned. In *Champion*, the government alleged that competitors illegally exchanged information in order to restrict bidding, while the bidders argued that they were simply engaging in the joint bidding because each had different interests in the diverse timber. The defendants were convicted of eliminating competitive bidding for the U.S. Forest Service, thereby fixing prices at the minimum acceptable bid set by the government.<sup>26</sup>

## **II. Conclusion**

It is apparent that antitrust authorities are paying great attention to the industry, and as drilling activity increases again, the industry can expect close scrutiny. Enforcement actions that can be characterized as efforts to ensure that individual land owners, often farmers in rural America, are not deprived of the full value of their oil and gas rights will be extremely attractive to prosecutors. Companies in the oil and gas industry and their counsel will need to scrutinize the details of any collaborative agreement with competitors. Naked restraints on competition will certainly be vigorously pursued. Other collaborations may be subject to a rule of reason analysis. However, in these two enforcement actions, the DOJ has made clear that restrictions on leasing or bidding will draw extreme scrutiny if it does not involve immediate and integrated operational benefits. While other non-operational benefits can should save collaborative arrangements from antitrust condemnation, the benefits will be concrete, well-documented and necessary.

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<sup>25</sup> *United States v. Champion International Corp.*, 557 F.2d 1270 (9th Cir. 1977).

<sup>26</sup> *Id.* at 1273.