FRIEND OR FOE: DEALING WITH COMPETITORS IN THE OIL & GAS INDUSTRY

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Houston Bar Association
Oil, Gas & Mineral Law Section
Session Roadmap

- Dangerous Liaisons: Criminal Enforcement
- Joint Ventures, Joint Bidding and Other Collaborative Efforts with Competitors
- Sharing Proprietary Information with Competitors
Why Worry About Antitrust?

- Criminal penalties:
  - Enormous fines: hundreds of millions of $$
  - Jail: average sentence 31 months
- Follow-on civil lawsuits:
  - Costs millions to defend, win or lose
  - Settlements often larger than criminal fines
- Disruption, distraction to the company and to you personally
U.S. Fines and Criminal Penalties

- Maximum **statutory** fine for corporations: $100 million
- But, fines may be increased to as much as twice the pecuniary gain derived from the offense or twice the loss suffered by the victims of the offense
- Maximum sentence for individuals: 10 years imprisonment and $1 million fine
  - DOJ believes jail time greatest deterrent
  - 80% + of defendants serve time
  - Average sentence 2 to 3 years
U.S. Criminal Antitrust Fines Growing

Source: U.S. Dep't of Justice Antitrust Division
## Recent Major U.S. Antitrust Fines

<table>
<thead>
<tr>
<th>Defendant (FY)</th>
<th>Product</th>
<th>Fine (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AU Optronics Corp. of Taiwan (2012)</td>
<td>Liquid crystal display (LCD) panels</td>
<td>$500,000,000</td>
</tr>
<tr>
<td>F. Hoffmann-La Roche, Ltd. (1999)</td>
<td>Vitamins</td>
<td>$500,000,000</td>
</tr>
<tr>
<td>Yazaki Corp. (2012)</td>
<td>Automotive parts (wire harnesses, instrument panel clusters, fuel senders)</td>
<td>$470,000,000</td>
</tr>
<tr>
<td>LG Display Co., Ltd /LG Display America (2009)</td>
<td>Liquid crystal display (LCD) panels</td>
<td>$400,000,000</td>
</tr>
<tr>
<td>Société Air France and Koninklijke Luchtvaart Maatschappij, N.V. (2008)</td>
<td>Air transportation (cargo)</td>
<td>$350,000,000</td>
</tr>
<tr>
<td>British Airways PLC (2007)</td>
<td>Air transportation (cargo &amp; passenger)</td>
<td>$300,000,000</td>
</tr>
<tr>
<td>Korean Air Lines Co., Ltd. (2007)</td>
<td>Air transportation (cargo &amp; passenger)</td>
<td>$300,000,000</td>
</tr>
<tr>
<td>Samsung Electronics Company, Ltd. /Samsung Semiconductor, Inc. (2006)</td>
<td>Memory chips</td>
<td>$300,000,000</td>
</tr>
<tr>
<td>BASF AG (1999)</td>
<td>Vitamins</td>
<td>$225,000,000</td>
</tr>
<tr>
<td>CHI MEI Optoelectronics Corporation (2010)</td>
<td>Liquid crystal display (LCD) panels</td>
<td>$220,000,000</td>
</tr>
</tbody>
</table>

Source: U.S. Dep't of Justice Antitrust Division
Today, antitrust/competition laws are enforced in over 100 countries worldwide
### E.U. - Ten Highest Cartel Fines

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
<th>Case</th>
<th>Amount in €*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>Saint Gobain</td>
<td>Car glass</td>
<td>800,000,000</td>
</tr>
<tr>
<td>2012</td>
<td>Philips</td>
<td>TV and computer monitor tubes</td>
<td>705,296,000</td>
</tr>
<tr>
<td>2012</td>
<td>LG Electronics</td>
<td>TV and computer monitor tubes</td>
<td>687,537,000</td>
</tr>
<tr>
<td>2001</td>
<td>F. Hoffman-La Roche AG</td>
<td>Vitamins</td>
<td>462,000,000</td>
</tr>
<tr>
<td>2007</td>
<td>Siemens AG</td>
<td>Gas insulated switchgear</td>
<td>396,562,500</td>
</tr>
<tr>
<td>2008</td>
<td>Pilkington</td>
<td>Car glass</td>
<td>357,000,000</td>
</tr>
<tr>
<td>2010</td>
<td>Ideal Standard</td>
<td>Bathroom fittings</td>
<td>326,091,196</td>
</tr>
<tr>
<td>2009</td>
<td>E.ON</td>
<td>Gas</td>
<td>320,000,000</td>
</tr>
<tr>
<td>2009</td>
<td>GDF Suez</td>
<td>Gas</td>
<td>320,000,000</td>
</tr>
<tr>
<td>2007</td>
<td>ThyssenKrupp</td>
<td>Elevators and escalators</td>
<td>319,779,900</td>
</tr>
</tbody>
</table>

Source: European Commission
Cartels and Other "Hard Core" Antitrust Agreements

- Some competitor agreements viewed as blatantly harmful to competition, prosecuted as crimes:
  - Price Fixing
    - Prices, including the level and timing of price increases or decreases
    - Level of discounts/rebates
    - Terms and conditions of sale
  - Bid Rigging
    - Alternating bids
    - Agreeing not to bid
    - Setting bid prices
  - Market Allocation
  - Customer Allocation
Renewed Focus on Energy Sector

- Joint Bidding – Natural Gas Leases
  - Justice Department obtained $1 million settlement from Gunnison Energy and SG Interests, charged with conspiring not to compete with one another for natural gas leases on BLM land in western Colorado (Apr. 2013)
    - This was "the first time the Department of Justice has challenged an anticompetitive bidding agreement for mineral rights leases."
    - Federal judge rejected initial settlement of $550,000 as too low to deter future violations, noting that such agreements are "common" in the industry.
  - Chesapeake Energy and Encana Corp. reportedly being investigated for agreeing not to bid against each other in Michigan land auctions
  - February 23, 2014 "Sand Ridge Energy, Inc. announced DOJ was investigating it for possible violations of antitrust laws in connection with purchase or lease of land, oil or natural gas rights." (Sand Ridge's founder and former CEO had been a co-founder of Chesapeake Energy.)
Renewed Focus on Energy Sector

- Market Manipulation
  - Federal Trade Commission investigation of potential antitrust conspiracies or market manipulation by refiners, oil producers, transporters, marketers, physical and financial traders.
  - European antitrust authorities investigating oil companies’ alleged manipulation of Platt’s indices; coordinating with US authorities.
  - *Oil and Gas Price Fraud Working Group* formed in 2011 by Justice Department and other federal and state agencies: "aggressively focused on identifying civil or criminal violations in the oil and gasoline markets."
Other Collaborations with Competitors

- While "hard core" cartel agreements are criminal in nature, many other collaborations with competitors are not only permissible, but often pro-competitive.

- This is expressly recognized by the DOJ and FTC:
  - In order to compete in modern markets, competitors sometimes need to collaborate. Competitive forces are driving firms toward complex collaborations to achieve goals such as expanding into foreign markets, funding expensive innovation efforts, and lowering production and other costs. Such collaborations often are not only benign but procompetitive.
Collaborations with Competitors (continued)

- Agreements with competitors that, on their face, are designed to restrict competition or decrease output are viewed as automatically *(i.e., "per se")* unlawful under the competition laws.

- BUT, most joint ventures and other competitors collaborations, when legitimate in nature, are judged under a balancing test *(i.e., "rule of reason")* where the benefits are weighed against potential competitive harm.
  - These violate the antitrust laws only if they "unreasonably restrain trade"
  - As a practical matter, rule of reason conduct is difficult to challenge in court
Collaborations with Competitors
(continued)

- What About E&P And Oilfield Service Companies?
  - Often have need to work together
    - At request of customers -- JVs, Joint Operating Agreement; Joint Development Agreement; Areas Of Mutual Interest Agreement; etc.
    - JVs and alliances for exploration, technology
    - Many function at different levels, *e.g.*, prime/subcontractor relationships
    - Joint bidding to spread risk

- Competitors at one level are frequently suppliers at another

- Need to develop industry standards may require sharing of proprietary information, often through trade associations
Collaborations with Competitors
(continued)

- Joint Ventures With Competitors
  - The best single source for evaluating JVs are joint DOJ/FTC Antitrust Guidelines For Collaboration Among Competitors (2000)
  - Guidelines:
    - Far from perfect
    - Difficult to apply (even for antitrust lawyers)
    - Require a fact intensive and fact specific analyses
Joint Ventures and Other Collaborations with Competitors

- Joint Guidelines apply a 4-step analysis:
  - Is the joint venture acting as a single economic entity? (Pooled capital; shared profit and loss; corporate form not controlling)
  - Independent competitors (i.e., no single entity) – Is conduct the type that always raises prices or reduces output? (strict scrutiny)
  - Not per se conduct -- Does it have obvious anti-competitive effects? – "Quick Look" Analysis (NCAA/College Football 1994)
  - No obvious anticompetitive effects – Flexible Rule of Reason analysis (also two safe harbors – Market Shares/R&D)
Joint Ventures and Other Collaborations with Competitors (continued)

- Businesses would like simple, bright line rules
  - Relying on the "form" of relationship however can be dangerous
Let's look at typical Area of Mutual Interest Agreements ("AMI") such as ones that are at play in Gunnison and Chesapeake/Encana.

Definition: AMI is a contract that describes the geographic area in which one or more oil/natural gas companies has a stake. The AMI will typically define the geographic area, the rights that each party owns (i.e., percentage interest), the length of the time during which the contract will be in effect and how the contract terms are to be implemented.

1st Question: Is the contract executed? (Gunnison: Ready to be executed.)

2nd Question: Is the JV acting as single economic entity (pooled capital, sharing profits and losses, sharing respective knowledge)? If so, do we stop here?

What about the parties -- are they the only parties in area that likely bid (e.g., Chesapeake/Encana in Michigan)? Does AMI take only bidders out?

Term? Area, Length, Percentages.

Disclosure to landowner or state and federal governments.
Joint Ventures and Other Collaborations with Competitors (continued)

- Let's look at another typical situation involving two oilfield service companies, where one would be prime and the other a sub.
  - Prime would make all decisions regarding price and output.
  - Sub -- strictly a vertical, vendor/vendee with prime.
  - Okay?
Joint Ventures and Other Collaborations with Competitors (continued)

- Key Questions for prime/sub situations:
  - How many viable bidders would there be for the project?
  - But for prime/subcontractor relationship would subcontractor have bid independently?
  - Is the prime/subcontractor relationship disclosed to the customer?
  - Was there any quid pro quo for deal?
  - How would subcontractor pricing information be used in future?
  - What do the emails say?
Sharing Proprietary Information with Competitors

- Competitors often share proprietary information. Some of the more common forms of such sharing involve:
  - Premerger exchanges of information
  - Industry or trade groups -- exchange statistical information either directly or through third parties
  - Unilateral, but reciprocal, exchanges of information by competitors through public sources (analyst calls or conferences)
  - Direct sharing information with competitors in joint ventures, etc.
Sharing Proprietary Information with Competitors (continued)

- The Supreme Court has stated that the "exchange of price data and other information among competitors does not invariably have anti-competitive effects; indeed such practices can in certain circumstances increase economic efficiency and render markets more, rather than less, competitive." *Gypsum*, 438 U.S. at 443 n. 16 (1978).
Sharing Proprietary Information with Competitors (continued)

- What makes information sharing with competitors unlawful, as opposed to being potentially procompetitive, is evidence of a "conscious commitment to a common scheme designed to achieve an unlawful objective." *Monsanto*, 465 U.S. at 764
  - In other words, the exchange has to involve an agreement among the competitors to unlawfully use the information
  - An agreement can be inferred from the circumstances
  - Parallel conduct by competitors "must be placed in a context that raises a suggestion of a preceding agreement." *Twombly*, 550 U.S. at 557 (2007).
Sharing Proprietary Information with Competitors (continued)

- Certain proprietary information is riskier to exchange than other types of information
  - Current or future price information is the most sensitive data
  - Price information is riskier than cost and other non-price information
  - Detailed information is riskier than aggregated information
    - Multiplicity of sources
    - Granularity of content
Sharing Proprietary Information with Competitors (continued)

- Information exchanges are viewed with even greater suspicion in Europe than the U.S. What is perfectly permissible in the U.S. may be quite suspect in Europe.
  - The exchange of sensitive information can violate EC law even absent any agreement
- Very hot area in U.S. with more activity likely
  - Recent investigations/cases:
    - **DOJ Investigation of Delta/AirTran Bag Fees**: AirTran announces in an earnings call that it will initiate a $15 bag fee in Atlanta if arch competitor Delta imposes such a fee first. Delta subsequently establishes a bag fee; AirTran follows.
Sharing Proprietary Information with Competitors (continued)

- **FTC Litigation Against Iron Pipe Fittings Manufacturers (McWane):**
  - Exchanges of aggregated U.S. shipment information by three competitors. Reports prepared by third party accounting firm represented by antitrust counsel.
  - FTC alleges that information exchange improperly facilitated price coordination even if facts show prices were actually reduced.
  - FTC lost at administrative trial level but matter proceeds.

- **Detroit Nurses Wages Case – Private Litigation:**
  - Five lawsuits alleged various hospitals improperly exchanged wage information for nurses in Detroit.
  - Direct contacts by HR employees.
  - Health care industry meetings.
  - Third party surveys.
  - Case proceeding to trial.
Sharing Proprietary Information with Competitors (continued)

- **Bottom line:**
  - Sharing proprietary information with competitors, whether through *direct* exchanges, through *third parties* or even through *public announcements*, is closely scrutinized today.
  - Private parties and governmental agencies are bringing cases even when the net effect of the information exchange is competitively neutral and may arguably lower price or increase output.