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COMMENTARY

U.S. v. Gunnison: Antitrust Risk in Oil & Gas Joint Bidding and Other Collaborations

The chief concern of most oil and gas company counsel is contact with competitors. This is no small concern in an industry in which appropriate and beneficial competitor collaboration is common and therefore contacts frequent. The upstream divisions of oil companies often cooperate through area-of-mutual-interest agreements, joint bidding for exploration and production rights, joint operation of production, farm-out and buy-in agreements, and more. Downstream oil and gas enterprises collaborate in refining or processing and transportation of energy products. A staple of the energy company counsel diet is deciding where to draw the line between procompetitive collaboration and anticompetitive collusion.

This year's leading case study for where to draw this line is *U.S. v. Gunnison*, DOJ's challenge to "joint bidding" between two exploration and production companies that later formed an area-of-mutual-interest agreement. The facts out of which *Gunnison* case arose help us look for where to draw the line.

History of *Gunnison*

In the White River and Gunnison National Forests, not too far from Gunnison, Crested Butte and Aspen, are Colorado's Ragged Mountains. The peaks of the Raggeds' knife-edged ridge runs next to the gorge of the Dark Canyon and Anthracite Creek, dotted with aspen and spruce trees, ending with the Oh-Be-Joyful lovely glacial valley. There you might expect to far away from the long arm of U.S. antitrust enforcement. Not so for these defendants.

Denver-based Gunnison Energy Corporation and Houston-based SG Interests each holds interests in federal leases in the Ragged Mountain Area and is the operator for natural gas pipelines in the Ragged Mountain Area. Much of this area is owned by the federal government, and the Bureau of Land Management ("BLM") manages the natural resources on those federal lands, including oil and gas rights.

Under the program involved in this case, the BLM auctions onshore oil and gas leases to private parties, granting leaseholders the right to explore and develop oil and gas deposits found on their leased land. Private parties may nominate lands for BLM to consider offering at auction by submitting an "expression of interest." In advance of each auction, the BLM publishes a notice identifying lease parcels to be offered for sale. Live auctions are conducted, with each lease starting at a minimum bid. At the conclusion of an auction, a successful bidder must certify that that the bid was "arrived at independently" and "tendered without collusion with any other bidder for the purpose of restricting competition."

In 2001, SGI and Gunnison each began independently acquiring and developing gas leases in different parts of the Ragged Mountain Area. Over the course of 2003 and 2004, their interests began to overlap geographically as the BLM leased out additional parcels. Conflicting efforts by SGI and Gunnison to acquire pipelines and leases held by the third party resulted in litigation between them.

In September 2004, SGI submitted expressions of interest to the BLM for additional lands within the Ragged Mountain Area, including parcels adjacent to leases held by Gunnison. In October 2004, Gunnison and SGI met to discuss the prospect of settling their litigation and entering into a collaboration to develop the Ragged Mountain Area. The potential collaboration contemplated joint acquisition of the third party assets, improvements to the existing third party pipelines, and joint development of new pipelines to serve the area. But these discussions foundered.

In 2004, BLM announced a new lease sale. Both SGI and Gunnison were independently interested in three of the tracts to be auctioned, which included parcels adjacent to Gunnison leases. The government alleged both likely would have bid against each other at the February auction.

A few days before the February 2005 auction, SGI and Gunnison had discussions that resulted in the drafting of an MOU written by their attorneys. Under the MOU, only SGI would bid at the auction for the three leases. SGI and Gunnison would jointly set a maximum price for SGI to bid for the three leases. If SGI successfully acquired the leases, it would assign a 50 percent interest to Gunnison at cost. At the February auction, SGI bid for and obtained the three BLM leases covered by the MOU. Gunnison attended the auction, but did not bid. SGI obtained the three tracts for $72, $30, and $22 per acre.

Again before a May 2005 auction, SGI and Gunnison agreed only SGI would bid, but pay no more than $300 per acre. At the auction, SGI bid for leases, Gunnison did not, and SGI paid only $2 for some acreage.

In Summer 2005, SGI and Gunnison formed an area of mutual interest ("AMI") agreement. A typical AMI agreement defines a geographic area as to which the parties to the agreement agree they will share rights to exploit oil or gas resources. Like their MOU, the SGI-Gunnison AMI agreement identified the leases it covered and controlled which of them would bid for leases and set a cap. Going beyond the MOU, their AMI agreement provided for joint construction of pipelines and joint development of the leases. After forming this AMI agreement, SGI and Gunnison continued to bid in the same manner as they had been under the MOU, through most of 2006.

In 2009, a qui tam or whistleblower claim was asserted by a former Gunnison officer. The U.S. Justice Department (the Antitrust Division with the Colorado U.S. Attorney) took over the action and brought a claim under Sherman Act § 1. DOJ challenged the SGI-Gunnison February 2005 MOU and their conduct at the auctions in February 2005 and May 2005. In 2012, the parties made a settlement agreement that resolved all U.S. claims (with certain exclusions) for a total of $550,000, which included $100,000 for the whistleblower (plus $50,000 attorneys' fees for his counsel).

Drawing the Line Under Section 1

Sherman Act § 1 prohibits agreements that unreasonably restrain trade. Section 1 covers a range of horizontal agreements between competitors, from price fixing and bid rigging (always unreasonable, per se illegal, sometimes prosecuted criminally) to joint ventures that fully integrate the resources of its members that once competed (rule of reason, lawful unless the anticompetitive effects of the venture formation or ancillary restraints exceeds procompetitive benefits).

Agreements between horizontal competitors to coordinate pricing or other business activity, but without integration of existing resources or the creation of new capacity, rarely will generate competitive benefits that could be achieved through less anticompetitive means. In contrast, cooperation to share intellectual property, to share each other's existing assets, or to create new manufacturing or distribution capabilities, certainly can create efficiencies and other procompetitive benefits.

The difference between conduct that is per se illegal or should be handled under rule of reason usually is clear. The line between reasonable and unreasonable often is not. Even in the context of a challenge that was settled, the *Gunnison* case helps illustrate where DOJ draws those lines.

DOJ Alleged that "Agreement Not to Compete in Bidding" Was Unlawful

DOJ claimed that Gunnison's agreement in the MOU that it would not bid on certain leases violated Section 1. From DOJ's perspective, this "agreement not to compete in bidding" was not "joint bidding," but naked bid rigging, with an element of price fixing (because the bid was capped). DOJ pointedly alleged that the later AMI agreement was not part of the February 2005 MOU. Without the procompetitive context of a larger collaboration, DOJ found there was no justification to call this "joint bidding," but labeled it ordinary bid rigging.

Given these facts, DOJ at least could allege a rule of reason violation. According to Complaint, each of the two parties on its own allegedly would have been interested in bidding for these leases. This implies they did not need each other, certainly not to buy the leases. The bidding MOU certainly had an effect. At the extreme, at the May 2005 auction, the MOU left the auction with only one bidder (that is, SGI), and that bidder was able to pay only $2 per acre.

DOJ has taken the position that the MOU was per se unlawful. Although only implied in its Complaint, later in its Response to Public Comments on the proposed consent decree, DOJ explicitly stated that it had

> concluded that the Defendants' MOU was a per se unlawful restraint of trade… As stated in the [Competitive Impact Statement], the MOU was not ancillary to a procompetitive or efficiency-enhancing collaboration between the Defendants.

Since the MOU was not at the time associated with a broader collaboration, DOJ could apply the per se label. DOJ's Response to Public Comments continued:

> Defendants had been discussing the possibility of a broad joint venture since October 2004; however, by early February 2005 those discussions had broken down. With the auction imminent, Defendants executed the MOU, which eliminated competitive bidding between the companies for the leases. Although Defendants continued to entertain the possibility of establishing a broader, efficiency-enhancing collaboration, significantly, at the time they executed the MOU and obtained the leases, any such collaboration remained just that—a vague possibility. The fact that Defendants ultimately established such a collaboration does not transform their prior agreement not to compete into a lawful ancillary restraint.

Was this per se illegal bid rigging that could have been prosecuted criminally? DOJ did not say. There was room to allege per se illegal bid rigging, despite the ongoing discussions that later lead to the AMI agreement. But deciding whether to charge that this agreement was a criminal antitrust violation would have been more complicated. A trial on a "per se illegal" charge would have exposed the parties' ongoing but unconsummated effort to cooperate in bidding plus joint exploration and production (rather than just agree one would refrain from bidding), which would have undercut a straightforward criminal claim. The defendants would have argued that the early joint acquisition of leases could have contributed to their later joint development efforts. And of course these allegations were made in the context of a case to be settled without admission of liability, not taken to trial.

In any event, one can infer that DOJ and the parties disputed these issues. The settlement released the defendants from all manner of civil claims—qui tam, false claims, fraud, breach of contract, and antitrust—but not "any criminal liability." Gunnison and SGI risked criminal charges with an agreement that only one would bid.

DOJ Did Not Challenge Joint Bidding After Collaboration Agreement Was Formed

In Summer 2005, the parties made an "agreement to engage in a broad collaboration to jointly acquire and develop leases and pipelines in the Ragged Mountain area." They then continued the same pattern of "joint bidding"—one refraining from bidding—as before. Nevertheless, although the whistleblower included it in his claims, DOJ did not challenge this later conduct. DOJ did not challenge one party refraining from bidding after the Summer 2005 agreement was formed.

The companies having moved into the context of a larger collaboration, DOJ left it alone. DOJ certainly could not have alleged per se illegal conduct here, when the "joint bidding" was part of a larger, typical joint development agreement. The parties' later collaboration moved them to the other side of the line, from unreasonable to reasonable (or at least to not challenged).

After the AMI agreement was formed, the MOU was part of a broader collaboration, involving some integration of the parties' resources, and not a sham. Under the Competitor Collaboration Guidelines, one would expect this to be treated under rule of reason:

> Agreements not challenged as per se illegal are analyzed under the rule of reason to determine their overall competitive effect. These include agreements of a type that otherwise might be considered per se illegal, provided they are reasonably related to, and reasonably necessary to achieve procompetitive benefits from, an efficiency-enhancing integration of economic activity.

DOJ's analysis of the SGI-Gunnison AMI was similar. As DOJ said in its Response to Public Comments:

> Defendants' [later] joint acquisition of eighteen leases … was reasonably related to, and reasonably necessary to achieve, the potential benefits of their broad collaboration … or joint exploration and development…. It … included provisions for the joint acquisition and ownership of leases in the area, for conducting joint operations, and for building and operating a pipeline system to transport gas to end-users which required substantial capital investment. Defendants' agreement to share ownership of future leases acquired by either party aligned their incentives to cooperate … and discouraged any one Defendant from appropriating an undue share of the collaboration's benefits. Defendants' collaboration, thus, allowed them 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.

The later conduct of SGI and Gunnison certainly is fair to call "joint bidding" and was appropriate to be reviewed under the rule of reason.

In an ongoing dispute, not a settlement, DOJ would not immediately have let these parties off the hook for their conduct analyzed under the rule of reason. In a litigated case, DOJ would demand a more complete review. This would require balancing the procompetitive benefits against the anticompetitive effects of the venture and any ancillary restraints, plus consideration of whether a less anticompetitive way to achieve these benefits was available. Although in *Gunnison* DOJ did not engage in anything like a full analysis of the competitive effect of the AMI agreement and its joint bidding provision, certainly it was right to acknowledge the existence of the later AMI agreement as moving the parties out of per se territory and onto the safer ground of the rule of reason.

The "Reasonable" Collaboration

DOJ's challenge to the *Gunnison* MOU, and refraining from action against the later AMI agreement, outlines the advice counsel may give to businesses forming collaborations or joint ventures. Counsel should ask: What resources are being integrated and why? How are the collaborating companies restricted outside the venture? Who else is competing?

First, the collaboration should integrate resources to bring some new capability to the market. Each party contributes something (money, knowledge, assets) that makes it possible for the joint venture to engage in procompetitive activities that the parties individually could not undertake. A typical AMI agreement might be justified because neither party could bid on own, but together the parties could amass enough acreage so they efficiently could exploit it. Perhaps one could bid and develop, but other brings resources (capital, know-how, infrastructure) that make it possible to take more leases or exploit them more quickly. They share risk, reducing the total risk of each, where neither would enter alone but both would enter with a partner. In contrast, if the arrangement involves no integration of resources and no creation of new capacity, it likely will not generate efficiencies that could not be achieved through less anticompetitive means.

Second, collaboration should restrict the collaborators only as reasonably necessary for collaboration to work. For example, limiting their competition against joint venture may be justified by the need to prevent free riding or expropriation of the collaboration's information or opportunities, which may reduce incentives to make collaboration work. Such restrictions should cover a limited area and be of limited duration, only as much as needed to protect the collaboration. The parties also should take steps to limit spillover into any of their independent, competing lines of business through information exchanges or the like.

Third, there should remain competition outside collaboration. No matter how positive the integration, a collaboration or joint venture should not eliminate competition by simply reducing number of competitors. For example, SGI and Gunnison were the only potential bidders at the May 2005 auction. Even if neither could afford to purchase or develop more than half the leases, it is hard to justify a joint bid that left no competitors in the auction.

In addition, where the collaboration faces a customer or supplier, it is advisable to disclose the collaboration. Recall BLM required that its successful bidders certify that that the bid was "arrived at independently."

Conclusion

Although it may be tempting to attribute these parties' troubles to a failure in timing, their problems were greater than having just failed to ink the AMI agreement before implementing the single-bid MOU. The substantive issue was that, absent actual formation of the broader collaboration, the bidding agreement was naked, subject to per se challenge and the greater risks that can bring. DOJ's *Gunnison* action and inaction presents a useful case study in how to counsel cooperating competitors and where the government will draw the line.

The case is *United States v. SG Interests I, Ltd., SG Interests VII, Ltd., and Gunnison Energy Corporation*, No. 12-cv-00395-RPM-MEH (D. Colo. filed Feb. 15, 2012).

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