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McClendon Indictment Calls for Caution, Not Confusion

The DOJ oilfield indictment should encourage compliance rather than overreaction

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On March 1, 2016, a federal grand jury indicted Aubrey McClendon, the high-profile former CEO of a major oil and gas company, for alleged bid rigging in the acquisition of natural gas leases. This news and the events that followed leave no one in the oil patch feeling comfortable, in an industry already having its share of troubles. Nevertheless, this enforcement action by the U.S. Department of Justice Antitrust Division does not break new ground or signal widespread investigation of energy companies, but it does highlight why oil companies should tread carefully in all competitor interactions. The development also provides a useful reminder that, outside of the extraordinary allegations alleged in the indictment, most joint bidding arrangements can continue to operate without significant antitrust risk.

Background

McClendon was a pioneer of the U.S. shale boom and was active in acquiring leases in areas promising for fracking recovery of oil and gas. The U.S. indictment alleged McClendon orchestrated a campaign to keep lease bid prices low during a land leasing boom from 2007 to 2012. Then CEO of Chesapeake Energy, McClendon allegedly formed agreements with other bidders about which parcels each would bid on and how to share ownership of leases the bidder had acquired at below-competitive rates. This conduct would violate the Sherman Act 1, which prohibits agreements that unreasonably limit competition.

The indictment was against McClendon individually, and it is "the first case resulting from an ongoing federal antitrust investigation into price fixing, bid rigging and other anticompetitive conduct in the oil and natural gas industry," according to DOJ's press release.

Chesapeake Energy announced it did not expect criminal prosecution, as it has been cooperating with DOJ. Under DOJ's antitrust leniency policy, companies and persons involved in anticompetitive conduct who report the conduct early and cooperate in the government's investigation may be able to avoid prosecution. But even if Chesapeake Energy is able to avoid criminal prosecution, DOJ's indictment of McClendon triggered a civil class action representing landowners in the Anadarko Basin, seeking damages for having signed lease rates lower than they would have been without the bid rigging between Chesapeake and rivals, which allegedly affected all rates in the region.

Collaboration among competing companies can also be legitimate and procompetitive.

Not All Joint Bidding Is Unlawful

An important distinction has been lost in much of the reporting on Chesapeake's alleged coordinating with rivals on lease bidding: Not all joint bidding is illegal, and not all potentially anticompetitive conduct is criminally prosecuted. Joint bidding in the appropriate context can be lawful and procompetitive.

Under the Sherman Act 1, only competitor agreements that "unreasonably" restrain trade are unlawful. Price fixing and bid rigging agreements of course may be illegal, especially when not part of a larger, legitimate business arrangement. And because such a stand-alone price fixing or bid rigging agreement is inherently and unambiguously anticompetitive, it is always deemed unreasonable and automatically illegal and can be criminally prosecuted.

On the other hand, antitrust is more generous when such agreements are part of companies' cooperating in a legitimate collaboration that may have procompetitive benefits. Companies working together in a joint venture may set the price of the joint venture's product (a principle confirmed by the Supreme Court in a case involving Texaco[1]) so long as the procompetitive benefits outweigh any anticompetitive harm. The oil and gas industry is familiar with such arrangements. A good example is an area of mutual interest (AMI) agreement, which typically defines a geographic area in which the

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parties will share rights to exploit oil or gas, combining their resources or sharing risk, and sometimes includes joint bidding.

The DOJ considers joint bidding in the context of such procompetitive collaborations to be potentially procompetitive and usually lawful. But DOJ will consider a stand-alone ("naked") joint bidding agreement to be simple bid rigging, as made clear in DOJ's 2012 settlement requiring Gunnison and SG Interests[2] to pay fines over allegations of an unlawful agreement not to compete in bidding for natural gas leases sold at auction by the U.S. Department of Interior's Bureau of Land Management.

The conduct alleged in the McClendon indictment easily was labeled bid rigging, as DOJ had determined the companies involved agreed on which would place bids for certain leases but did not otherwise cooperate or combine resources. Given that the agreement was explicit and McClendon was directly involved, DOJ would have believed criminal prosecution appropriate. Given McClendon's death and DOJ's withdrawing the indictment, there will be no immediate opportunity for DOJ to test these claims against McClendon.

The McClendon Indictment Is Not an Indictment of All Energy Industry Cooperation

DOJ's challenge to the lease bidding agreement allegedly orchestrated by McClendon does not indicate that DOJ believes all energy industry joint bidding, AMI agreements or collaborative efforts are suspect. Contrary to recent speculation, the McClendon case does not suggest there is a DOJ dragnet over the whole oil patch.

First, DOJ recognizes that many forms of collaboration among companies that otherwise compete are legitimate and procompetitive. DOJ enforcement decisions in this industry (Gunnison) and others help predict where it draws the line. Second, the allegations directed against McClendon were exceptional. While DOJ may pursue others who conspired with McClendon, announcement of challenges to numerous conspiracies should not be expected. Third, most oil companies are very cautious in antitrust-law compliance, knowing this industry is an attractive target for state and federal government enforcement, as well as private civil actions.

The energy company conduct that should signal trouble is coordination on pricing, bidding or other competitive factors, when not part of a larger, procompetitive collaboration or combining of resources.

The antitrust risk of such a collaboration is less, to the extent that the parties are integrating resources to bring to the market some new capability neither has on its own, whether assets, knowledge or financing. Collaboration is riskier if the combination leaves few or no other independent competitors. In addition, where the collaboration faces a customer or supplier, it is advisable to disclose the collaboration.

DOJ Antitrust Policy Already Emphasized Enforcement Against Individuals

DOJ's Antitrust Division has for years criminally prosecuted individuals involved in company antitrust crimes, which it sees as appropriate punishment and an effective deterrent. Individual indictments are not new, but recently DOJ announced it is increasing efforts to identify and punish individual officers and employees whose conduct led to company antitrust violations. This is in response to a department-wide initiative to emphasize individual accountability for corporate wrongdoing. To some extent, this means DOJ will make more intensive investigations of company antitrust violations to determine whether persons not directly involved in the conduct should be considered culpable and punished, as discussed in our alert on the DOJ Yates Memo.[3]

This new policy of increased individual accountability would not have implicated the McClendon indictment. Given the specific allegations against McClendon, DOJ obviously had determined that he was at the center of a conspiracy, directly responsible and a prime target for prosecution.

Rather, the new DOJ policy creates greater risk for management or supervisory employees who were not directly involved in the anticompetitive conduct but who arguably were on notice or sufficiently aware of the circumstances. The DOJ now is more likely to scrutinize whether such individuals' failure to investigate or take action to stop activity arguably makes them also culpable for the company's crime. DOJ's vigorous prosecution of anticompetitive conduct generally, and increased focus on enforcement against individuals specifically, highlights the need for companies to be diligent in their antitrust compliance and internal monitoring efforts. Having a robust antitrust compliance program can prevent wrongdoing and detection.

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