McDermott Will & Emery

DOJ Finds Antitrust Violation in Joint Bid for Oil & Gas Leases

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The U.S. Department of Justice's recent action challenging a joint bidding arrangement for natural gas leases highlights the antitrust risks of joint bids. This newsletter describes considerations parties considering joint bids can take to evaluate and potentially manage their antitrust risks.

The U.S. Department of Justice (DOJ) recently announced a settlement requiring two companies that allegedly coordinated bids for oil and gas leases to pay a total of $550,000 in fines related to an agreement not to compete. The agreement in question allegedly related to joint bids for four natural gas leases sold at auction by the federal government. The DOJ noted this was the first time it had challenged an anticompetitive bidding agreement for the sale of governmental mineral rights.

This settlement highlights the fine line between pro-competitive and anti-competitive joint bids and sheds light on some of the landmines companies must avoid, especially in bidding situations not previously addressed by antitrust regulators.

Background: Summary of DOJ Complaint

The facts described below summarize the DOJ's complaint. Gunneson Energy Corporation (GEC), SG Interests I Ltd. and SGI Interests VII Ltd. (collectively, SGI) were separately engaged in the exploration and development of natural gas resources in the Ragged Mountain area of western Colorado. Prior to 2003, the companies focused their activities on different parts of the Ragged Mountain area: SGI tended to acquire leases on the eastern side of the mountain and GEC acquired leases along the southern boundary. Beginning in 2003 and 2004, however, both began to seek overlapping pipelines and leases.

Friction between the parties from the new overlap resulted in litigation in 2004, leading to settlement discussions in 2004 and 2005. During settlement negotiations, the parties discussed a joint acquisition of the overlapping leases, improvements to the existing overlapping pipelines and joint development of new pipelines to serve the area. These discussions were ultimately abandoned. In December 2004, the U.S. Department of Interior's Bureau of Land Management (BLM) announced a Notice of Competitive Lease Sale that included three new Ragged Mountain area tracts, with auction set to occur in February 2005. It also announced a similar Notice of Competitive Lease Sale, with auction set to occur in May 2005. The minimum opening bid set by BLM at these auctions was $2 per acre.

Between February and May 2005, the DOJ alleged that SGI and GEC executed a Memorandum of Understanding (MOU) to jointly bid on four separate parcels of land being auctioned off by the BLM at the two separate auctions. Pursuant to this MOU, only SGI would bid at auction for the leases, though prior to the bid, the parties would set a maximum bid price. Assuming SGI acquired the leases, it would assign a 50-percent interest in the leases to GEC at cost.

At both auctions, GEC attended but did not bid, while SGI bid for and successfully obtained the four parcels. In its complaint, the DOJ alleged that neither company informed BLM of the agreement to bid jointly. The DOJ also alleged that during the first auction, the parties obtained three leases for $72 per acre, $30 per acre and $22 per acre. Prior to the second auction, the parties agreed to bid as high as $300 per acre for a parcel. However, they obtained the fourth lease at auction for only $2 per acre, which was BLM's opening minimum bid.

Although SGI and GEC did eventually execute an additional agreement to engage in a broad collaboration to jointly acquire and develop leases and pipelines in the Ragged Mountain area, this did not occur until several months after the successful bids.

The DOJ investigated this agreement after a whistleblower lawsuit was filed under the False Claims Act. As a result of its investigation, the DOJ filed a complaint alleging GEC and SGI entered into an unlawful agreement to bid on the four BLM leases. The DOJ further alleged, as a result of this agreement, SGI and GEC avoided bidding against one another for the four leases and BLM received less revenue from the sale of the leases than it would have received had SGI and GEC competed against one another for the leases.

Considerations in Joint Bidding

It is not uncommon for energy firms to submit bids for property or a lease together. Joint bids can occur in other industries as well. For example, joint bidding can occur when two firms pool their resources and submit a single bid jointly for an asset that they would otherwise be unable to afford individually. Not all joint bids are anti-competitive and violate antitrust laws. Instead, many joint bids are typical of and benefit competition.

Firms should consider several issues before submitting a joint bid to be sure the activity falls on the pro-competitive side of the spectrum.

Disclosure Reduces Risk. Firms bidding jointly can significantly reduce their antitrust risk by disclosing to the seller that they are joint bidders. A joint bid eliminates competition between two firms, as they can no longer bid against each other. Without disclosure, a joint bid is more likely to be characterized as a bid from a single firm and an agreement not to bid at all from the second firm. If it is disclosed in advance, the seller has the potential to structure its sale process in a way to maximize competition, including potentially forbidding joint bids. Therefore, as a general matter, joint bidders should state when bidding that they are submitting the bid jointly.

In the case of GEC and SGI, it does not appear as though the parties disclosed to the BLM that they were bidding jointly for the leases on the four parcels of land. In fact, GEC attended the bid auctions, but did not actually bid. Had the parties disclosed their intention to bid jointly to BLM before submitting their joint bid, perhaps BLM could have taken steps to ensure a more competitive outcome.

Purpose and Effect of Joint Bidding. Joint bidders increase their risk profile if the arrangement prevents them from bidding for assets that, absent the joint bid arrangement, they would have bid for separately. Joint bidding is typically pro-competitive when two companies that would otherwise be unable to bid individually work together to submit a bid. For example, if two energy companies would not individually bid on a lease because of their size or risk profile, they may choose to pool their resources and bid jointly. Joint bidding of this type should make the market more competitive, creating a bid the seller would not otherwise have received. On the other hand, parties incur risk if their intent in entering into the agreement is to purchase property at artificially depressed prices and to divide the savings among those competitors who refrained from bidding. From a practical perspective, if there are many firms likely to bid on an asset, a joint bid is less likely to lead to an anti-competitive outcome.

The DOJ alleged GEC and SGI would have bid for the BLM leases individually were it not for their agreement, presumably because they would have an incentive to acquire assets near their natural gas pipelines in the Ragged Mountain area. In fact, it appears they were the two bidders mostly likely to pursue the leases aggressively, given their $300-per-acre valuation of the leases.

The DOJ also alleged in its complaint that had SGI and GEC both bid on the leases at auction, the BLM would have received more revenue from the sale of the natural gas leases. Here, the fact that one of the leases sold for BLM's minimum opening bid indicates that no one other than SGI bid at BLM's second auction. As a result, even though the parties valued this property at up to $300 per acre, the seller received only $2 per acre. The agreement was problematic, therefore, because both parties were apparently highly motivated to bid on the leases on their own, but instead agreed to bid jointly, and the price paid was artificially reduced because the arrangement eliminated competition.

Joint Productive Activity Reduces Risk. A pro-competitive joint bid typically contemplates subsequent joint productive activity, where a measure of risk sharing or joint provisioning of some goods or services is considered. Parties may support a pro-competitive joint bid if they create an arrangement to share resources or allocate risks in developing a property. For example, a competitive joint bid for a natural gas lease likely would anticipate some sort of joint funding for exploration and development of the natural gas resources in the land.

In the case of GEC and SGI, however, no agreement to jointly develop leases and pipelines in the Ragged Mountain area was executed until *after* the parties had entered into the MOU to jointly purchase the leases. The DOJ cites to this fact as evidence of the anti-competitive intent in executing the joint bid. Firms intending to bid jointly for natural gas or oil leases or other properties can reduce their antitrust risks by stating their intention to engage in joint development of the property, and making the joint bid ancillary to, and necessary for, that joint productive activity. This reduces risks, as compared with having the joint bid appear more like a naked agreement not to compete.

Conclusion

Joint bidding is often pro-competitive, but can at times be anti-competitive. Understanding the issues noted above, and the suggested safeguards, will help ensure a firm's joint bid with a competitor is seen as a competitive joint bid agreement, not an unlawful bid-rigging agreement.