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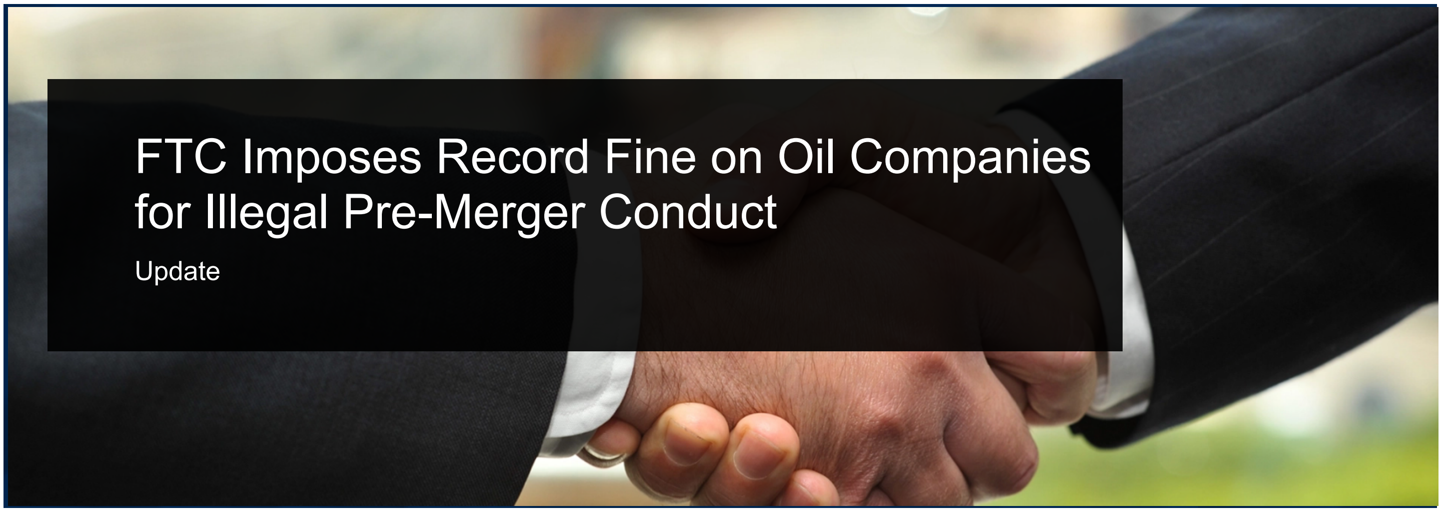

FTC Imposes Record Fine on Oil Companies for Illegal Pre-Merger Conduct

Update

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On January 7, 2025, the Federal Trade Commission (FTC) announced that crude oil producers XCL Resources Holdings, LLC (XCL), Verdun Oil Company II LLC (Verdun) and EP Energy LLC (EP) collectively will pay a $5.68 million civil penalty to resolve allegations they engaged in illegal pre-merger coordination, also known as "gun jumping," in violation of the Hart-Scott-Rodino Act (HSR Act). This is the largest fine ever imposed for a gun jumping violation in US history.

The HSR Act requires merging parties to report transactions over certain size thresholds to the FTC and Department of Justice so that those agencies can conduct an antitrust review before closing. The agencies typically have 30 days after a transaction has been reported, which is known as the HSR waiting period, to conduct their initial assessment. The investigating agency can extend that waiting period by issuing a "second request" demand for additional information should they deem the transaction needs more in-depth review. During the HSR waiting period, the acquiror is prohibited from taking ownership or control over the target business. Such gun jumping is punishable by a civil penalty of up to $51,744 per day (the maximum penalty is adjusted annually).

On July 26, 2021, Verdun and XCL entered into a $1.45 billion agreement to acquire EP that triggered the HSR Act's notification and waiting period requirements. During the initial 30-day HSR review period, the FTC's investigation identified significant competitive concerns about the transaction, including that it would have eliminated head-to-head competition between two of only four significant energy producers in Utah's Uinta Basin and would have harmed competition for the sale of Uinta Basin waxy crude oil to Salt Lake City refiners. To resolve those concerns, on March 25, 2022, the FTC entered into a consent agreement with XCL, Verdun and EP that required the divestiture of EP's entire business and assets in Utah.

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According to the FTC's complaint, instead of observing the waiting period requirement, XCL and Verdun "jumped the gun" and assumed operational and decision-making control over significant aspects of EP's day-to-day business operations immediately upon signing the purchase agreement. Per the complaint, the parties' unlawful gun jumping activities during the interim period that were memorialized in the purchase agreement included:

- Granting XCL and Verdun approval rights over EP's ongoing and planned crude oil development and production activities. XCL immediately took advantage of these rights and ordered a stop to EP's new well-drilling activities, resulting in a crude oil supply shortage for EP when the US market was facing significant supply shortages and multiyear highs in oil prices.
- Providing that XCL and Verdun would bear all financial risk and liabilities associated with EP's anticipated supply shortages, which resulted in XCL and EP working in concert to satisfy EP's customers supply commitments, and EP employees reporting to their XCL counterparts with details on supply volumes and pricing terms. XCL engaged directly with EP's customers and held itself out as coordinating EP's supply and deliveries in the Uinta Basin.
- Requiring EP to submit all expenditures above $250,000 to XCL or Verdun for approval. As a result, buyer approval was required before EP could perform a range of ordinary-course activities needed to conduct its business, such as purchasing supplies for its drilling operations and entering or extending contracts for drilling rigs.
- Permitting XCL and Verdun to order EP to change certain ordinary-course business operations, including its well-drilling designs and leasing and renewal activities.
- Allowing Verdun to review and coordinate with EP regarding prices for EP's customers in the Eagle Ford region of Texas, with Verdun directing EP to raise prices in the next contracting period.
- Providing XCL and Verdun with almost-unfettered access to EP's competitively sensitive business information, including EP's site design plans, customer contract and pricing information, and daily production and supply reports.

As stated in the FTC's complaint, the waiting period obligation for this transaction began on July 26, 2021, the date the parties executed their purchase agreement. On October 27, 2021, during the course of the FTC's investigation, XCL, Verdun and EP executed an amendment to the purchase agreement that allowed EP to resume operating independently and in the ordinary course of business, without XCL's or Verdun's control over its day-to-day operations, thereby ending the illegal gun jumping conduct. Thus, XCL, Verdun and EP were in violation of the HSR Act for 94 days.

This case is noteworthy not only for the magnitude of the penalty imposed on the transaction parties, but also because the violation arose both from provisions in the purchase agreement itself, as well as the parties' conduct after they executed the purchase agreement. It serves as an important reminder that merging businesses in HSR-reportable transactions must maintain independent operations at least until expiration of the HSR waiting period and in some cases until closing (similar obligations can also apply to M&A transactions involving competitors even in non HSR-reportable deals). This independence must be reflected in both the transaction documents and the actions of the parties. Antitrust counsel can assist with drafting appropriate conduct of business covenants in the purchase agreement and properly navigating integration planning and preclosing coordination during the interim period between sign and close.