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Area of Mutual Interest Agreements – Potential Issues

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The AMI provision

- In an Area of Mutual Interest (AMI) agreement, the parties agree to offer each other a proportionate share of any newly acquired leases and other interests within a defined contract area, or "area of mutual interest."
- The term "AMI" is commonly used to refer to both (a) the geographic area that is subject to the agreement, and (b) the AMI agreement (or section of a larger agreement) itself.
- An AMI is usually found as an ancillary component of a broader agreement, such as:
  - Operating agreements
  - Farmout agreements
  - Exploration agreements, participation agreements, and other joint development agreements.

The AMI provision

- Example:
  - *Area of Mutual Interest*. The Parties agree that, (a) the Prospect Area, plus (b) all lands within one-half (1/2) mile of the perimeter of the Prospect Area, shall constitute an Area of Mutual Interest ("AMI") which shall remain in effect for a period of three (3) years from the date on which total measured depth is reached in the Initial Earning Well, unless extended; provided, however, if this Agreement is terminated by mutual agreement of the Parties or pursuant to the provisions of [other termination provisions], then the AMI shall also terminate at the same time.

The AMI provision

- Purpose: Since, typically the Parties will not have leased all of the area being explored and developed:
  - Assures each Party has the right to maintain its relative position in the project vis-à-vis the other Parties.
  - An AMI will reduce the Parties' competition for future acquisitions, since any acquisition of interests in the Prospect Area must be offered proportionately to the other Parties.
  - As a consequence of the foregoing, an AMI can reduce the acquisition costs since the Parties are no longer rushed to purchase leases in an attempt to gain competitive edge.
  - The Parties will be more willing to expend funds on a seismic survey and/or drilling exploratory wells if they know they will have the option of sharing in any acquisitions of interests in the AMI area.

The AMI provision

- During negotiations with counterparties and potential partners, it is important to consider all material aspects of an AMI arrangement.
- Based on the outcome of such negotiations, it is key to draft the AMI provisions carefully.
  - Courts have recognized that AMI provisions are governed by the law of contracts.
  - A court's reading of an AMI is thus restricted to the language of the AMI provision and can only be supplemented by extrinsic evidence when the agreement is ambiguous. *See Kincaid v. Western Operating Co., 890 P.2d 249, 252* (Colo. App. Ct. 1994).

Negotiation Considerations: How is the AMI defined?

- Carefully define the Prospect Area and Prospect Depths.
- Prospect Area examples:
  - All lands within the geographical boundaries of the pooled units more particularly described on Exhibit "A", insofar and only insofar as they cover the Prospect Interval.

  Or

  - Those lands outlined on the plat attached hereto as Exhibit "B", insofar and only insofar as they cover the Prospect Interval
- (Caution: Be aware of statute of frauds issues)

Statute of Frauds

- These agreements generally involve the transfer of leases or mineral interests, and are therefore governed by the Statute of Frauds.
- Land descriptions by reference to another agreement, map or plat is ok, provided that the description is sufficiently certain.
- *Westland Oil Dev. Corp. v. Gulf Oil Corp.,* 637 S.W.2d 903 (Tex. 1982).
  - Letter agreement attempted to create an area of mutual interest, and described the lands by reference to an ancillary farmout agreement: "If any of the parties hereto… acquire **any additional leasehold interests affecting any of the lands covered by said farmout agreement, or any additional interest from Mobil Oil Corporation under lands in the area of the farmout acreage**, such shall be subject to the terms and provisions of this agreement."
  - Texas Supreme Court allowed the first description because the referenced farmout agreement contained an adequate legal description of the lands and was attached to the letter agreement.
  - However, the Court held that the second description (as to "lands in the area") was not legally sufficient.

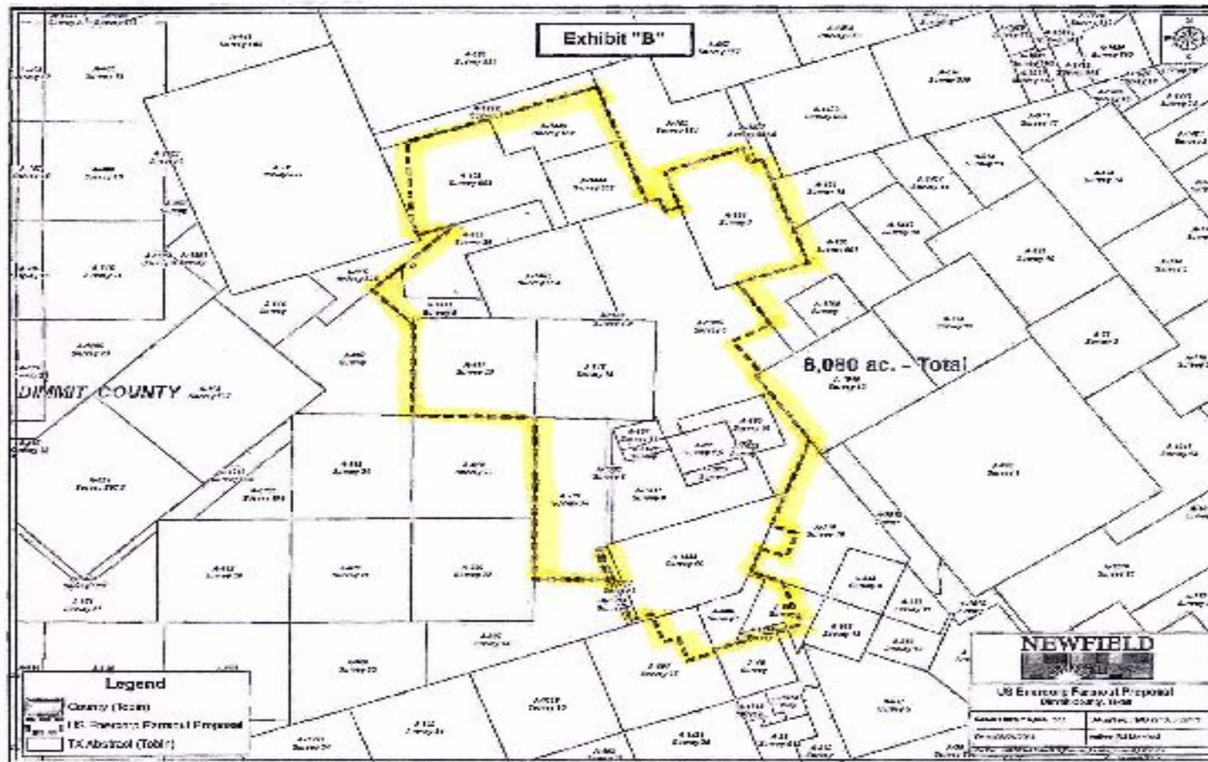
Negotiation Considerations: How is the AMI defined?

- Commonly, parties define the geographic boundaries governing the AMI by drawing or coloring an outline of the proposed AMI on a plat.

- Often, these maps do not contain field notes, or metes and bounds descriptions or even legible names of leagues, labors, or surveys which would enable one to locate these areas on the ground by survey.

- Ambiguities may arise if the plat is not clear or the boundaries of the Prospect Area do not lie along survey or tract lines.

Example of a plat outlining the AMI



Negotiation Considerations: How is the AMI defined?

- If the boundaries of the AMI do not lie along survey or tract lines, it may be useful to negotiate the inclusion of specific provisions addressing how this issue will be resolved:

  - *Example 1*: To the extent the boundaries of the lands outlined on **Exhibit "B"** do not lie on or along survey, section, or other governmental tract lines, the Parties intend to include partial surveys, sections, or governmental tracts in the AMI.

  - *Example 2*: It is the intent of the parties hereto that the heavy dark lines highlighted in yellow lie on survey, section, or other governmental tract lines, and that no partial surveys, sections or governmental tracts be included in the AMI. If any portion of the survey is within the dark line, then all of that survey is within the Area of Interest.

Negotiation Considerations: How is the AMI defined?

- If with the documents at hand, it is still unclear whether the AMI description is sufficiently certain, Parties may want to include a "catch-all" or "savings" clause to attempt to cure any description issues and prevent the parties from challenging the AMI under the Statute of Frauds.

  - *Example*: If for any reason it is or becomes unclear as to whether any tract of land lies within the area covered by the AMI, the Parties intend the AMI to be effective with respect to any and all lands clearly within the outlined area.

Negotiation Considerations: How is the AMI defined?

- If with the documents at hand, it is still unclear whether the AMI description is sufficiently certain, Parties may want to include a “catch-all” or “savings” clause to attempt to cure any description issues and prevent the parties from challenging the AMI under the Statute of Frauds.
  - *Example*: If for any reason it is or becomes unclear as to whether any tract of land lies within the area covered by the AMI, the Parties intend the AMI to be effective with respect to any and all lands clearly within the outlined area. In addition, each Party agrees never to assert that the description of the AMI is insufficient under the Statute of Frauds, or that this Agreement is wholly or partially unenforceable under the Statute of Frauds.

Prospect Interval Example

- Where possible, be specific and include upper and lower depths by reference to a well-described log from a well-described marker well:
  - Those subsurface depths located between the stratigraphic equivalents of the top of the Eagle Ford Shale formation, being a subsurface depth of 7,934 feet, and the base of the Buda formation, being a subsurface depth of 8,150 feet, each as seen in the dual induction compensation neutron density log dated March 7, 1982, for the Energy Resources Company Walter White #8 well, API # 4248333503, located in the Jesse Pinkman Survey, Abstract 546, LaSalle County, Texas.
  - Specifically define any reserved formations that will not be subject to the AMI.

Negotiation Considerations: The AMI trigger

- Consider the event(s) that would trigger the AMI obligations: This event would be typically defined as: (1) an Acquisition (2) by a Party (3) of an Acquired Interest (4) within the AMI term.
  - *(1) <u>An Acquisition</u>*: Typically, this would include the
    - Direct or indirect acquisition of an "Acquired Interest" in the AMI;
    - Proposed acquisition of such Acquired Interest; and/or
    - Direct or indirect acquisition of an option or right to acquire such Acquired Interest.
  - *(2) <u>By a Party</u>:* This term will certainly include the Parties to the Agreement but generally should be expanded to include related parties of same.
    - *<u>Example of definition of "Related Parties</u>"*
      - *If the Party is an individual:* a Related Party would be any person related by blood in the third degree or by marriage in the second degree or any other person acting as a representative or agent of that individual or otherwise for the benefit or on behalf of that individual.

Negotiation Considerations: The AMI trigger

- *(2) By a Party: (cont.)*
  - *Example of definition of "Related Parties" (cont.)*
    - May also include a Party's "Affiliate": typically defined as, with respect to any Person:
      - (i) any Person directly or indirectly controlling, controlled by or under common control with such Person, or
      - (ii) any Person who is an officer, director, general partner, manager, or trustee of such Person or any Person described in clause (i) above.
        - How to define "Control"? the terms controlling, controlled and common control, shall mean (x) the ownership of ten percent (10%) or more of the stock ownership or equivalent beneficial ownership interest of the owned Person; (y) the ability, directly or indirectly, to exercise ten percent (10%) or more of the voting rights of the controlled Person; or (z) the ability, directly or indirectly, to direct the management or policies of such controlled Person, whether through the ownership of voting rights, pursuant to a contract, or otherwise.

Negotiation Considerations: The AMI trigger

- *(3) Of an Acquired Interest*: Parties may choose two different approaches, which will produce very different results:
  - *A restrictive approach*: any lease, mineral interest, royalty interest, overriding royalty interest, or renewal or extension thereof covering lands within the AMI.
  - *An expansive approach:* any oil and gas leasehold interest (including any renewal, modification, amendment, or extension of same); or any other interest in the oil, gas and mineral estate, including any working interests, operating or non-operating rights, fee mineral interests, production payments, net revenue or net profits interests, carried interests, royalty interests, overriding royalty interests, and any other interest in oil and gas rights, or right to earn or acquire any such interest under a farmout/farmin contract, farmout option contract, or any other right to explore for, drill for, develop, produce, exploit, store, dispose of, process, compress, separate, transport, market, or distribute oil or gas or other associated hydrocarbons; *or any other right or interest in any treatment and processing plant, equipment, machinery, fixtures, facilities, flow lines, pipelines, gathering lines, easement, permits, licenses, servitudes, rights of way, surface leases, salt water disposal well, injection well, water well, and other surface rights, and other tangible personal property or improvements*, located in or on the AMI, or used or held for use in connection with the operations of any of the rights or interests described above; or any other option or right to acquire any of the foregoing.

Acquired Interests *(continued)*

Potential loophole: equity interests

- …. any leasehold interest in any oil, gas and/or mineral lease in the AMI Area (an "Acquired Interest," ***whether acquired by lease, sublease, purchase, farmout, acquisition of shares or other equity interests in an entity directly or indirectly owning the Acquired Interest or otherwise …)***

Acquired Interests *(continued)*

Potential loophole: equity interests

- …. any leasehold interest in any oil, gas and/or mineral lease in the AMI Area (an "Acquired Interest," whether acquired by lease, sublease, purchase, farmout, acquisition of shares or other equity interests ***(other than public securities)*** in an entity directly or indirectly owning the Acquired Interest or otherwise …)

Negotiation Considerations: The AMI trigger & the AMI offer

- *(4) Within the AMI Term*. The parties should establish a term for the survival of the AMI. A term is necessary to prevent the AMI from arguably violating the Rule Against Perpetuities in certain jurisdictions and to limit its effect to within the anticipated period of time envisioned by the Parties for the particular venture.

- The Parties should also negotiate a procedure for offering and electing to participate in an Acquired interest. Generally, the Acquiring Party will provide an offer to the non-acquiring parties of a percentage of the Acquired Interest. The non-acquiring parties are allowed a certain period of time to make their election.

  - *Example*: the Acquiring Farmor shall notify Farmee in writing, within fifteen (15) days after such acquisition or proposed acquisition, and offer seventy percent (70%) of the Acquired Interest, except for the Reserved Formation, within the AMI, to the Farmee. Farmee shall then have a period of fifteen (15) days from receipt of such written notification to elect whether or not to participate in such acquisition, INSOFAR AS the Acquired Interest includes lands within the AMI and depths within the Prospect Interval.

Negotiation Considerations: The AMI offer

- What should be included in the AMI offer for it to be valid? It should contain information reasonably necessary for a buyer to make an informed decision.
  - *Example*: The written notification by the Acquiring Party to the other, shall contain:
    - the conveyance, agreement or other instrument vesting, or which will vest, the Acquiring Party with record or beneficial ownership to the Acquired Interest;
    - a description of all burdens and obligations related to or affecting the Acquired Interest, and, if the Acquired Interest is subject to other agreements, copies of those agreements shall be obtained and furnished by the Acquiring Party (whichever is applicable);
    - copies of all checks, drafts, and similar type instruments, given, or to be given, by the Acquiring Party as consideration for acquisition of the Acquired Interest together with copies of all invoices for actual out-of-pocket costs incurred by the Acquiring Party that are directly related to acquisition of the Acquired Interest; and
    - all other data and information available to the Acquiring Party in its evaluation of whether to acquire the Acquired Interest.

Negotiation Considerations: The AMI offer & AMI election

- Consider the mechanics of offer and election. Define deadlines for responding to an AMI offer and consequences for failing to respond.
  - *Example:* The Non-Acquiring Party shall, not later than thirty (30) days after receipt of such notice from the Acquiring Party, notify the Acquiring Party, in writing, whether it wishes to participate in such acquisition. Failure of a Non-Acquiring Party to respond within the time and in the manner provided herein to the Acquiring Party's notice shall be deemed to be an election not to participate in such acquisition.
- Identify sensitive matters that may require a shorter deadline (*e.g.,* drilling in the area being acquired).
  - *Example:* If there is a well drilling within a one-third (1/3) mile radius of any portion of the Acquired Interest, then the Acquiring Party's notice shall so specify and the Non-Acquiring Party shall advise the Acquiring Party of its election not later than seventy-two (72) hours following the Non-Acquiring Party's receipt of the Acquiring Party's notice.
- Will there be multiple related parties? Consider whether to name a representative for such related parties for notification and election purposes.

Negotiation Considerations: The AMI election

- Carefully state the percentage of the Acquired Interest each party would be entitled to acquire under the AMI provisions:
  - Will it be a fixed percentage?
  - Or will it change over time? *i.e.,* it may follow the actual working interests of the parties in the Prospect Area at the time the acquisition that triggered the AMI obligations occurred.
  - If there are multiple parties to the AMI, what happens if certain parties elect not to participate and others elect to participate? Are the participating parties entitled to take their proportionate share of the declined interests? Should the Acquiring Party re-offer such declined interest to the remaining parties?
    - In *Cyanostar Energy Inc. v. Chesapeake Exploration LLC*, 317 P.3d 217 (Okla. Civ. App. 2013), an Oklahoma court held that, unless the AMI expressly provides that the Acquiring Party has to re-offer declined interests to the remaining parties, the Acquiring Party would be entitled to keep such declined interests.

Negotiation Considerations: The AMI election

- By electing to participate, a party to an AMI obligates itself to acquire its AMI percentage of the Acquired Interest and pay its proportionate share of the acquisition costs incurred by the Acquiring Party.
  - Typically, each non-acquiring party must elect whether to participate in all of the property being acquired and cannot pick and choose as to the portion of the property it will acquire.
  - What happens if the Acquired Interest covers lands both inside and outside the AMI boundary? If only the lands inside the AMI boundaries can be acquired, how will the acquisition costs be allocated between lands inside and outside the AMI boundary?
    - *Example:* If an Acquired Interest covers lands both inside and outside the AMI, then a Party must elect to participate as to lands only inside the AMI, and the acquisition costs will be allocated on a surface acreage basis between the lands inside and outside the AMI.

Negotiation Considerations: The AMI election

- Non-payment of acquisition costs. What happens if a party that elected to participate ultimately does not pay its share of the acquisition costs? Typically, such party would forfeit its election.
  - *Example*: Failure of an electing Party to pay such electing Party's proportionate share of the out-of-pocket cost incurred by the Acquiring Party shall be deemed an election not to participate in the Acquired Interest and a waiver of any right to do so, notwithstanding any written election to participate by that Party.
- How will the conveyance giving effect to the election be documented? Typically, the Acquiring Party first takes title to the Acquired Interest and later conveys the respective share to the electing Parties. Parties typically agree to a form assignment that will be used in connection with each such conveyance and is attached to the AMI Agreement.
- It should be clear that the Acquiring Party cannot create additional burdens on any Acquired Interest prior to the assignment of the Acquired Interest to the electing Party or Parties.

Negotiation Considerations: Special issues

- Existing AMI. Is there an existing AMI among a subset of the parties burdening the properties? Therefore, an acquisition in the AMI may trigger both; consider which AMI should prevail. If the new AMI should prevail, then the consent of the parties to the existing AMI will need to be obtained (to the extent such parties are not also parties to the new AMI).

- Existing Leases in the AMI. What if one Party already owns existing leases within the AMI? Consider whether such Party should offer to the other parties its proportionate share of those leases or whether to specifically exclude such leases from the AMI.
  - *Example*: The AMI shall not apply to any Lease(s) owned by a Party or its Affiliates prior to the Effective Time.

Negotiation Considerations: Special issues

- In some cases, Parties agree to certain "Pre-Approved Acquisitions" which are exempt from the standard offer and election mechanism in the AMI. Therefore, the non-acquiring Parties are obligated to participate in these acquisitions. These Pre-Approved Acquisitions should be carefully defined.
  - Example: If the Acquiring Party identifies and acquires or contracts to acquire an Acquired Interest, the Acquiring Party shall provide to the Other Party, an Acquisition Notice with respect to such Acquired Interest and the Other Party shall be obligated to participate with the Acquiring Party in the acquisition of such Acquired Interest if and to the extent that the Purchase Price paid or to be paid by the Acquiring Party does not exceed $1,250 per Net Mineral Acre and the total amount of any one Acquisition Notice is not greater than $2,500,000.

Negotiation Considerations: Special Issues

- If the AMI is within a Farmout or other similar agreement and the agreement is depth limited, will the Farmor retain any depths in the AMI leases? In those cases, Farmor would typically reserve certain formation(s).

  - In order to protect Farmor’s reservation:
    - such reserved formations should be carved out from the standard AMI obligations, and
    - Farmee should offer to the Farmor 100% of interests acquired in the reserved formation.

  - Since an acquisition of a single lease covering both the AMI and the reserved formation would trigger both the standard AMI obligations and the obligation to offer to the Farmor 100% of the reserved formation, it is advisable that Parties determine beforehand how the lease bonus and other acquisitions costs will be allocated between the AMI and the reserved formation.

Negotiation Considerations: Unearned interests

- If Farmee fails to completely earn the Contract Area, does it forfeit Acquired Interests within the unearned area?

    - *Example*: If Farmee fails to drill and complete the required number of Earning Wells and the Assignment is partially terminated pursuant to [*the applicable termination provision*] above, then, Farmor shall have the right, but not the obligation, to acquire one hundred percent (100%) of Farmee's right, title, and interest in all Acquired Interests within the Unearned Prospect Lands, INSOFAR and ONLY INSOFAR as they cover the Unearned Prospect Lands (the "Unearned AMI Interests"). In such case, Farmee shall promptly notify the Farmor, in writing, and the Farmor shall then have a period of fifteen (15) Business Days from receipt of such written notification to elect whether or not to acquire all or part of each Unearned AMI Interest.

Negotiation Considerations: Unearned Interests

- If Farmor will have the right to acquire unearned interests, will the Farmor be able to pick and choose the Unearned AMI Interest it wishes to acquire?

  - The Farmor, shall notify Farmee in writing on or before the expiration of the fifteen (15) Business Day period as to whether or not Farmors elect to acquire each Unearned AMI Interest (whether in whole or in part), and the portions of each Unearned AMI Interest Farmor elect to acquire. If the Farmor, fails to so notify Farmee on or before the expiration of the fifteen (15) Business Day period, it shall be deemed that Farmor elected not to participate in the Unearned AMI Interests. Farmee shall immediately thereafter execute and deliver to each participating Farmor its designated interests in such Unearned AMI Interests in the form of the attached Exhibit B (including special warranty language), and such assigned interests shall bear only their proportionate shares of those burdens that existed at the time of acquisition by Farmee.

Negotiation Considerations: Termination; Exclusive Leasing Rights

- What will happen if the Agreement being complemented by the AMI terminates? Will the AMI also terminate?
- Consider whether any Party should have exclusive acquisition rights within the AMI.

Sample language: "During the term of the AMI, Party A shall have the exclusive right to acquire Oil and Gas Interests within the AMI…."

- Purposes of exclusive leasing right provisions:
  - One party has greater expertise or knowledge of the lease status in the area
  - One party is only a financial partner
  - One party is already far along in the leasing process
  - Avoids driving up acquisition costs by competing against each other
  - One party is more selective than the other
- Some situations may call for one Party to have exclusive leasing rights in one part of the AMI, while another party has the exclusive leasing rights in another part of the AMI.

Exclusive leasing rights *(continued)*

- "During the term of the AMI, Party A shall have the exclusive right to acquire Oil and Gas Interests within the AMI….
- "… The exclusive rights to acquire Oil and Gas Interests within the AMI set forth in this section shall not apply to Oil and Gas Interests acquired by Party B pursuant to a merger or an acquisition of a package of properties in which the properties within the AMI, as applicable, constitute less than half of the total value of the properties (as determined under the applicable purchase agreement); provided, however, that for avoidance of doubt, any such Oil and Gas Interests within the AMI shall nevertheless be subject to the AMI, notwithstanding anything herein to the contrary….
- "…During the term of the AMI, Party A shall deliver to Party B, no later than the fifth Business Day of each month, a written update of such leasing activity conducted within the AMI and all Acquired Interests acquired in the AMI in the prior month, including the estimated cost, location and net acres associated with each such acquisition."

Caution: Antitrust Implications of Exclusive Leasing Rights

- A and B are independent E&P companies who are acquiring leases in the same areas.
- The parties commence discussions regarding a potential formal collaboration agreement to acquire leases and develop new gathering lines. These discussions are abandoned.
- Nevertheless, A and B agree on a Memorandum of Understanding to jointly bid on four leases at upcoming BLM auctions.
  - Under the MOU: (a) only A will bid at the auctions; (b) the parties set a maximum price that A can bid; and (c) if A acquires the leases, B will receive a 50% interest at cost.
- Thereafter, A and B complete their negotiations and enter into a formal agreement to jointly acquire and develop leases and gathering lines within a Contract Area.
- Any problem here?

U.S. v. SG Interests and Gunnison Energy

- The Justice Department Antitrust Division filed a civil suit under the antitrust laws and the False Claims Act.
  - Antitrust: the Justice Department charged that A and B engaged in unlawful bid-rigging.
  - False Claims Act: the Justice Department charged that A and B falsely certified that the bids were "arrived at independently" and "tendered without collusion with any other bidder for the purpose of restricting competition."
  - The MOU was not ancillary to the later JV Agreement.
- A and B signed consent decrees requiring each company to pay $275,000 in penalties.
- The Justice Department brought a civil case, not a *criminal case*, despite the fact that the Justice Department very often pursues criminal charges over bid-rigging in auctions.
- Perhaps this case was civil because the parties were discussing a broad collaboration and apparently eventually entered into one.
- Does this mean that bid-rigging in lease auctions is unlikely to be pursued criminally?

Criminal Case Example - *Michigan v. Encana*

- In March 2014, the Michigan Attorney General filed **criminal bid-rigging charges** against Encana Oil and Gas USA and Chesapeake Energy Corporation.
- The AG alleged that Encana and Chesapeake conspired in 2010 not to bid against each other at public oil and gas lease auctions and in private negotiations for oil and gas leases. The AG alleged that the agreement stopped a "bidding war" and caused lease prices to "plummet."
- Multiple incriminating e-mails were discovered among top executives of the 2 companies, including:
  - "Should we throw in 50/50 together here rather than trying to bash each other's brains out on lease buying?"
  - A note projecting that the two companies could "save billions of dollars in lease competition."
  - An internal e-mail from the CEO to a VP stating that it was "time to smoke a peace pipe" with Encana "if we are bidding each other up."

CEO SUMMIT
DO YOU COLLUDE?
SOME-TIMES.
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DilbertCartoonist@gmail.com
ARE YOU COLLUDING WITH ANYONE NOW, BECAUSE I'D SURE LIKE TO COLLUDE WITH YOU.
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WHAT ARE YOU INTO? MAYBE A LITTLE PRICE-FIXING?
THIS IS ALL HAPPENING SO FAST.

Criminal Case Example - *Michigan v. Encana (continued)*

- On May 5, 2014, Encana settled, agreeing to pay the State of Michigan a fine of $5 million and to plead no contest to one criminal antitrust violation.
- Chesapeake has not settled and is continuing to fight the criminal antitrust charges.
- On June 5, the Michigan AG filed additional criminal racketeering and fraud charges against Chesapeake, alleging that Chesapeake lied to Northern Michigan landowners to obtain gas leases on their land.
- Northstar Energy has sued Encana and Chesapeake in the Western District of Michigan, alleging violations of both the Sherman Act and state antitrust laws, collusion, civil conspiracy, and various other tort claims.
  - Northstar owned 9,838 acres in Utica/Collingwood shale in Northern Michigan, and had received lease offers from both.
  - Suit claims Encana withdrew its lease offer, and CHK then drastically reduced its offer.
  - On March 10, 2014, the Court denied Encana's and CHK's Motion to Dismiss on the all antitrust counts.

CEO SUMMIT
OBVIOUSLY IT'S ILLEGAL FOR COMPANIES TO RIG BIDS.
BUT INTERESTINGLY, THE CRIME IS NEARLY IMPOSSIBLE TO PROVE WHEN NOTHING IS WRITTEN DOWN.
I'D LIKE YOU TO MEET EDDIE. PAY CLOSE ATTENTION TO HOW MANY TIMES HE STOMPS HIS HOOF.
Dilbert.com DilbertCartoonist@gmail.com
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Pending Class Action in Kansas: *Richard Catron, individually and on behalf of those similarly situated, v. Colt Energy, Inc., et al.*

- The defendants have an AMI Agreement covering a large AMI in SE Kansas.
- The complaint alleges that the agreement is an illegal market allocation agreement.
- Deposition of one defendant's former president:
  - Q: Why did Layne (Energy) decide to buy some of Colt's wells and not all of them in Kansas?
  - A: Because we decided that we would draw an AMI because we had land that was overlapping one end to the other, so we bought some of the wells and we had wells transferred to them on each side of the border that we had drawn into the maps that we had laid out, and it was just **a negotiation at the time for them to stay out of an area and us to work in an area** just from a land standpoint….
  - Q: And so you had everything to the west and they had everything to the east?
  - A: Well, I don't think we had everything, but the fact is that we had – **the AMI that was defined at the time was for us to stay out of that – this area and not to take leases out here.**

Ways to Mitigate Antitrust Risk

- 1) Avoid AMI agreements that involve *only* joint leasing
  - Collaboration agreements solely related to leasing – especially leases that the parties might independently have bid for – present significant antitrust risks and may easily be characterized by the government as *per se* illegal price fixing.
    - Note that for the last several years, the Justice Department Antitrust Division has been conducting training seminars for public contracting officials all across the country regarding how to spot collusion and other illegal conduct in the public bidding process.
  - In contrast, agreements whose purpose is to pool resources of two companies to accomplish tasks they could not perform on their own (such as oil and gas exploration and product and infrastructure development) are more likely to pass antitrust muster – *assuming* that the joint leasing component of the collaboration is "reasonably necessary" to achievement of the collaboration's overall cost-reduction and efficiency-enhancing effects.

Ways to Mitigate Antitrust Risk

- 2) Enter into a formal agreement
  - Ad hoc, informal collaboration is much more likely to attract antitrust interest than a more formal, carefully documented collaboration, which recites the procompetitive purposes of the collaboration and confines the joint activities to those reasonably necessary to fulfilling the procompetitive purposes.
- 3) The collaboration should include joint activity that will result in a collaboration that will have procompetitive and efficiency-enhancing purposes and effects, such as:
  - The collaboration will result in output expansion (*e.g.*, increased E&P).
  - The collaboration will facilitate entry and expansion by smaller E&P firms who might not have done so their own.
  - The collaboration will reduce costs for both firms.
  - Each party is contributing resources to the collaboration and sharing in the risk.

Ways to Mitigate Antitrust Risk *(continued)*

- 4) Identify why it is necessary to bid jointly (if that is part of the collaboration)
  - The antitrust agencies will weigh any potential anticompetitive harms (such as decrease in competition through joint bidding) against any procompetitive benefits and may look at whether joint bidding was “reasonably necessary” to the collaboration and whether there were less restrictive means “reasonably available” to achieving the goals of the collaboration.

- 5) Share risk
  - Sharing risk of loss shows that the parties are willing to pool risks as well as resources and demonstrates that the collaboration is not simply a cover for collusive activities. This is often an important factor in the Justice Departments’ analysis.

Ways to Mitigate Antitrust Risk *(continued)*

- 6) Limit information sharing regarding matters outside the particular collaboration at issue
  - Entering into collaboration or participation agreements with a competitor may create opportunities to share competitively sensitive information.
  - Implement safeguards to limit information exchange, such as:
    - Only exchange information that is reasonably necessary to the collaboration.
    - Do not exchange information on leasing plans or other competitively sensitive matters outside the scope of the collaboration.

Ways to Mitigate Antitrust Risk *(continued)*

- 7) Rigorously adhere to government certification and procurement regulations related to bidding on leases.

- 8) Consult antitrust counsel with any questions.
  - Antitrust analysis is particularly necessary before entering into a collaboration where the parties to the collaboration may collectively have a dominant position in any local geographic areas.
    - Both the Colorado and Michigan antitrust cases appear to have involved situations where the collaborating parties were, in fact, dominant in local areas.

Successor and Assign Issues

- In order to put third parties on constructive notice of the AMI, either the AMI Agreement or a Notice thereof, containing a description of the lands and the essential elements of the AMI provision, should be filed in the public records.
- Distinct issues here:

1. Acquired Interests acquired by an original Party
2. Acquired Interests acquired by successors of an original Party

- If there is notice to third parties of the AMI, then:
  - If an original Party acquires an Acquired Interest, the AMI Parties will have superior rights to their participation shares of that interests, vis-à-vis third parties.
  - But, suppose Party A assigns all his interest in leases within the AMI to Third Party B. Third Party B then acquires new leases within the AMI. Must Third Party B offer its interest in the new leases to the original AMI Parties?
  - The answer depends on whether Third Party B assumed Party A's rights and obligations under the AMI Agreement itself. The result can vary based on the facts, and even on the state in which the assets are located.

Successor and Assign Issues *(continued)*

- Example: *Golden v. SM Energy Company*, 2013 ND 17. In this 2013 North Dakota Supreme Court case, SM Energy, the successor of an oil and gas lease from a party to an AMI Agreement claimed that it was not bound by the AMI Agreement, even though it had notice of the AMI Agreement. The Court found that the AMI Agreement was not a covenant running with the land, so SM had not assumed it as a matter of law. The case was remanded for a determination as to whether the parties to the assignment had intended that SM was to assume the AMI Agreement.
- Of course, if SM did not assume the AMI Agreement, it would also not be entitled to the benefits of the AMI.
- By contrast, legal scholars in Texas generally view AMI's – *in most cases* – as covenants running with the land under Texas law.
- Careful legal drafting of the Agreement can ensure the desired result.
  - *For example*, a hard consent provision requiring that, without prior consent of the other Parties, no assignment of a Party's interest in any leases within the AMI shall be valid unless the assignment provides that the assignee expressly assumes and is bound by the AMI Agreement. Any assignment which violates such provision shall be null and void.

Thank you!

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