The Antitrust Review of the Americas 2017

Published by Global Competition Review in association with

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United States: Energy

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Competitor collaborations can be risky

The oil industry was one of the early targets of the 1890 Sherman Antitrust Act and has remained in the crosshairs of both regulators and private plaintiffs since that time.[1] The close industry scrutiny has been attributed to a number of general perceptions: the impact of oil and gas prices on consumers' pocketbooks; profits labelled as excessive; the industry's ostensibly close relationship with regulators; and now, public anti-fossil fuel sentiment.

Competitor collaborations are becoming increasingly attractive. Current low oil and gas prices have led to an increased focus on cost-cutting measures, which can often be achieved by collaborating with competitors. Many agreements between competitors are considered per se illegal under the antitrust laws. And even if not per se illegal, competitor collaborations generally are not per se legal.

A recent decision by a federal court in Kentucky denying a motion to dismiss antitrust claims against Marathon Petroleum again demonstrates that competitor collaboration is seen as incompatible with a competitive marketplace.

In that case, the Commonwealth of Kentucky brought claims for conspiracy and monopolization under Sections 1 and 2 of the Sherman Act and for exclusive dealing under Section 3 of the Clayton Act, which prohibits agreements not to use or deal in the goods of a competitor.[2] Because the court ruled on a motion to dismiss, it was required to accept as true the well-pled allegations in the Commonwealth's complaint.

In a nutshell, Kentucky alleged that Marathon owns the only oil refinery in Kentucky and is its largest gasoline and reformulated gasoline (RFG) market supplier.[3] Kentucky claimed Marathon illegally manipulated the RFG market in Louisville and northern Kentucky, causing the wholesale and retail prices of gasoline in the area to be substantially higher than those found in comparable competitive markets.

The court agreed with Kentucky, finding it had sufficiently alleged plausible facts that Marathon violated the antitrust laws by combining its monopoly power with three types of agreements:

- exchange agreements with other major oil companies for delivery of RFG in Louisville and Northern Kentucky;
- supply agreements with unbranded grocery retailers requiring them to purchase all of their gasoline from Marathon or pay a penalty; and
- deed restrictions when Marathon sold service stations that permitted gasoline sales on the property only if the gasoline came from Marathon.

The court's findings on individual claims are discussed below.

Section 1 claim for agreements in restraint of trade

Before it could analyse Kentucky's section 1 claim, the court first needed to determine whether the agreements should be analysed under the per se rule (under which anticompetitive effects are presumed) or the rule of reason (under which the plaintiff must prove anticompetitive effects).

Kentucky argued for the application of the per se rule, at least with respect to the exchange agreements, on the ground that they were entered into among competitors and unlawfully allocated to Marathon the Louisville and Northern Kentucky RFG supply markets. Marathon countered that the rule of reason applied because Kentucky's amended complaint eliminated a previous reference to the per se rule.

The court noted that '[r]estraints that are per se illegal include horizontal agreements among competitors to fix prices or divide markets.'[4] But the court also noted that 'to justify a per se prohibition a restraint must have manifestly anticompetitive effects and lack any redeeming value.'[5] The court explained that the supply agreements and deed restrictions were vertical, which are not per se illegal. And although the exchange agreements were horizontal, meaning they could be per se illegal, they did not contain clauses in which the competitors agreed not to compete and they had potential procompetitive benefits. The court therefore determined that the rule of reason applied to each of the agreements.

Under the rule of reason, the court listed the following elements necessary to state a prima face case: '(1) a conspiracy; (2) that produced anticompetitive effects; (3) that the scheme affected relevant product and geographic markets; (4) that the conspiracy's goal and related conduct was illegal; (5) and that the restraint was the proximate cause of the plaintiff's antitrust injury.'[6]

The court quickly found those elements were met. First, it was undisputed that the complaint alleged a conspiracy (ie, the existence of the various agreements). Second, the court found (1) allegations of Marathon's high market share and the region's higher prices than comparable markets adequate to show anticompetitive effects, (2) the agreements allegedly affected RFG sales in the location where RFG is required to be sold, (3) the alleged conspiracy's goal of maintaining higher prices and a monopoly, and the related conduct of entering into the agreements, were unlawful, and (4) Kentucky alleged the conduct resulted in higher prices.[7]

Marathon, however, correctly claimed that the rule of reason additionally requires proof of harm to overall competition, which Marathon contended was not plausible. Although the court did not appear to believe harm to competition was a required element of the claim, it nevertheless analysed that element under each of the three agreements at issue.

Exchange agreements

Kentucky alleged that Marathon entered into exchange agreements with major competitors to limit supply options to gasoline retailers and deprive them of competitively priced alternatives. The court agreed with Marathon 'that exchange agreements have procompetitive benefits, such as allowing petroleum companies access to markets without substantial investments in refineries,' but found 'that does not mean all exchange agreements are procompetition.'[8]

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Indeed, the court stated that 'many joint arrangements and operations in which members of the industry engage already may provide the opportunity for collusion on price and output.'[9] The court found the alleged facts were sufficient to draw the reasonable inference that the 'exchange agreements are meant to further Marathon's alleged stranglehold of RFG in Louisville and Northern Kentucky.'[10] It held that discovery was needed to determine whether 'Marathon meant to discourage other suppliers from creating supply to the market with these agreements.'[11]

Supply agreements

Marathon argued that the supply-agreement claim should be dismissed because the complaint failed to allege that the agreements foreclosed competitors from a substantial share (generally 30 to 40 per cent) of the market. The court held it would be improper to dismiss for failure to allege a specific percentage of market foreclosure without allowing discovery on that issue.

Deed restrictions

With respect to the deed restrictions imposed on the sale of its service station properties, Marathon asked the court 'to use common sense' to assess the overall effect because 'there must be plenty of suitable sites for retail gas stations remaining, and Marathon has not encumbered enough properties to harm overall competition.'[12] The court refused to engage in what it called 'pure speculation', and found 'it to be plausible that deed restrictions on a significant number of retail locations would harm overall competition.'[13]

Section 2 claims for monopolisation

The court stated there are two elements to a monopolisation claim under section 2. The first is the possession of monopoly power and the second is anticompetitive conduct. Kentucky alleged that Marathon had an RFG wholesale market share of 90 to 95 per cent in Louisville and Northern Kentucky, which the court found sufficient to satisfy the first element.

The court described the second element – anticompetitive conduct – as 'the use of monopoly power to foreclose competition, to gain a competitive advantage, or to destroy a competitor.'[14] The court noted that '[a] monopolist is not free to take certain actions that a company in a competitive market may take, because there is no market constraint on a monopolist's behavior.'[15] In rejecting Marathon's argument that 'if there is any business justification for the agreements, then they do not violate section 2', the court explained that 'the pleadings alone are insufficient to establish that a rational business purpose existed'.

The court concluded a reasonable inference exists that Marathon has engaged in anticompetitive conduct because (1) it is plausible Marathon intends to foreclose the market with exchange agreements, (2) the supply agreements could help Marathon control output and increase prices of RFG in the market, and (3) the deed restrictions explicitly keep competitors out of the market.

Clayton Act section 3 claim for exclusive dealing

Section 3 of the Clayton Act is aimed at tying and exclusive dealing arrangements; in this case, Marathon's supply agreements that require retailers to by 100 per cent of their listed RFG amounts from Marathon or pay a penalty. The court described section 3 as requiring two elements: (1) exclusive dealing and (2) foreclosure of or 'substantially lessened' competition.[16]

Marathon argued that a stated volume commitment, as contained in the supply agreements, is not necessarily the same thing as exclusivity. The court disagreed, noting that 'even though a contract does not contain specific agreements not to use the goods of a competitor, if the practical effect is to prevent such use, it comes within the condition of the section as to exclusivity.'[17] The court then found that 'the practical effect of requiring a retailer to buy 100 per cent of its listed RFG amounts from Marathon or pay a penalty is to prevent the purchase of a competitor's products.'

With respect to the second element, market foreclosure, the court again found it would be improper to dismiss the claim at the pleading stage for a failure to show substantial foreclosure and that discovery was needed on that issue. The court instead held that the 'alleged facts showing that Marathon has a dominant market share of RFG in Louisville and Northern Kentucky' sufficiently supported 'the inference that competition had or would be substantially lessened by the contracts involved.'[18]

Lesson to be learned: Be cognisant of the risks of competitor collaborations

Though it appears likely that the issues in the *Kentucky* case should be narrowed (if not eliminated) through summary judgment before trial, the court's ruling means that extensive and correspondingly expensive discovery and briefing will be required to get to that point. The decision should therefore serve as a timely reminder to industry participants – operators and service providers alike – that all competitor collaborations carry some level of antitrust risk.

And the *Kentucky* case is not an outlier. Recent antitrust cases and investigations of energy companies include:

- A Department of Justice (DOJ) indictment of the CEO of an oil and gas company accusing him of orchestrating a conspiracy between his and a competing company to not bid against each other for the purchase of certain oil and natural gas leases. The conspirators would allegedly decide ahead of time who would win the leases and the winning bidder would then allocate an interest in the leases to the other company.
- Following that DOJ indictment, royalty owners brought class action suits against the two companies (and individual defendants) for the alleged bid-rigging conspiracy to depress amounts paid to them for the acquisition of oil and gas leases.
- A price-fixing class action suit brought by buyers of oil from major oil refiners in California alleges the refiners conspired to control the supply, and therefore the price, of gasoline on the West Coast. Specifically, the refiners are accused of working together to disrupt supply by running unscheduled maintenance on their sites and exporting large amounts of gasoline from California.
- In the immediate wake of confirmation of a DOJ investigation regarding pressure-pumping services, the main component in fracking, an alleged class of companies that bought fracking services filed suit against several oil and gas service companies. The plaintiffs alleged that the service companies colluded to restrict and manipulate supply to increase prices and market share for fracking pressure-pumping services.

Other dealings with competitors can also lead to antitrust claims. For example, a natural gas processing company sued its competitor for monopolisation after the competitor allegedly refused to extend a facilities-sharing arrangement between the two companies under which the competitor processed and transported the plaintiff company's product.

Regardless of whether investigations are ultimately closed without further action or lawsuits are dismissed before trial or settled, they impose enormous costs on the companies involved

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– both monetarily and in lost time of executives who are required to defend against the charges and other company personnel assisting in the matters.

Competitor collaborations an integral part of everyday business in all facets of the oil and gas business. Joint bidding, farm-ins and farm-outs, areas of mutual interest, and swaps and exchange agreements are commonplace and often essential, as are countless other forms of joint ventures and collaborations. Companies, however, must be aware of the potential risks. If a proposed collaboration appears likely to involve high market shares or potentially to limit competition in the marketplace or increase prices to consumers, then it should be reviewed by counsel before it proceeds.

Notes

1 Indeed, the concept of a 'trust' was the brainchild of a lawyer with the Standard Oil Company of Ohio, and led to the formation of the Standard Oil Trust in 1882. That trust was 'busted' in a 1911 Supreme Court decision, which resulted in the creation of a number of completely independent and vertically integrated oil companies.

2 *Commonwealth of Kentucky v Marathon Petroleum Co*, No. 3:15-cv-354, 2016 WL 3199534 (W.D. Ky. June 8, 2016).

3 RFG is gasoline blended to burn more cleanly than conventional gasoline and to reduce smog-forming and toxic pollutants in the air we breathe. RFG is required in certain areas of the US.

4 Id. at *4 (citing Leegin Creative Leather Prods. v PSKS, Inc, 551 U.S. 877, 886 (2007)).

5 Id. (citing Leegin, 551 U.S. at 886).

6 Id. at *5 (quoting In re Milk Antitrust Litig., 739 F.3d 262, 270 (6th Cir. 2014)).

7 Id.

8 Id. at *6.

9 Id. (quoting *Marathon Oil Co v Mobil Corp*, 669 F.2d 378, 383 (6th Cir. 1981)). The court in *Marathon v Mobil* affirmed a temporary injunction blocking Mobil's proposed takeover of Marathon on the ground that there was a 'strong possibility' the proposed acquisition would violate the antitrust laws. The court found that 'the oil industry is characterised by a complex set of close working relationships: joint ventures for crude oil exploration and production; joint operation of pipelines and transportation; exchange agreements under which the companies swap among themselves crude oil and refined products from one location or terminal to another.' 669 F.2d at 381. Its finding was based, in part on expert testimony that 'the industry at every level from crude exploration right down to terminals [has] interdependent relationships and agreements among large companies.' Id. at 382. Of course, since that time, many far larger mergers in the industry have been approved by the regulators.

10 *Kentucky v Marathon*, 2016 WL 3199534, at *6.

11 Id.

12 Id. at *5-6.

13 Id. at *5.

14 Id. at *6.

15 Id. at *7.

16 *Kentucky v Marathon*, 2016 WL 3199534, at *7.

17 Id. (quoting Tampa Elec. Co v Nashville Coal Co, 365 U.S. 320, 326 (1961)).

18 Id. at *8 (quoting Tampa Elec., 365 U.S. at 326).

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Anne has a successful and sophisticated antitrust practice. She defends and prosecutes high-stakes antitrust cases, represents clients faced with antitrust and competition-related government investigations, and provides a wide range of associated services, including antitrust training and audits. Anne's practice is national and international in scope, and covers a diverse range of industries. She takes a real-world approach to facilitating business solutions to problems, and provides counselling to help clients avoid problems in the first place.

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ISSN 1468-7054

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