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CLIENT ALERT

FTC Imposes Record $5.6M Gun Jumping Fine on Oil Companies for Problematic Interim Operating Covenants and Prohibited Pre-closing Conduct

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I. Introduction

On January 7, 2024, the Federal Trade Commission ("FTC") imposed a record $5.6 million gun-jumping fine as part of a settlement of an enforcement action against crude oil producers Verdun Oil Co. ("Verdun"), XCL Resources Holdings LLC ("XCL") and EP Energy LLC ("EP"). In its complaint filed in the U.S. District Court for the District of Columbia, the FTC accused the oil companies of illegal pre-merger coordination and buyer's premature assumption of control of the target in violation of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act").[1]

Under the HSR Act, companies must notify the FTC and the Department of Justice Antitrust Division (the "DOJ" and together, the "Agencies") of certain mergers or acquisitions that meet certain minimum HSR thresholds. In the case

[1] *See United States v. XCL Resources Holdings, LLC, et al*., No. 1:25-cv-00041 (D.D.C. Jan. 7, 2025).

that a transaction must be reported to the Agencies, deal parties must observe a 30-calendar day waiting period before they can close the transaction.[2] By the end of the waiting period, the Agencies can decide to conduct an in-depth investigation of the transaction—a Second Request—which extends the waiting period until parties substantially comply with the Second Request. During the waiting period, parties must operate separately and independently and the buyer cannot exert control of the target business. Failure to adhere to these requirements is considered gun jumping.

Post-signing or interim operating covenants in transaction agreements are common and designed to protect a buyer's purchase and to maintain the value of the target's business until closing. However, the covenants in this case went beyond the interim operating covenants typically found in transaction agreements, giving the buyers control over EP's ordinary course conduct and competitive decision-making. Because the parties were horizontal competitors, the conduct alleged by the FTC made for an easy case of gun jumping in violation of the HSR Act. The complaint alleged that "[t]his was no mere technical violation; the Defendants' conduct effectively allowed one competitor to acquire beneficial ownership, including control over key competitive decisions of the other, before the transaction closed, which is precisely what the HSR Act prohibits."[3]

II. Background

Verdun agreed to acquire EP for $1.4 billion pursuant to a purchase agreement executed on July 26, 2021 (the "Purchase Agreement"). On the same day, the parties notified the FTC of the proposed transaction, triggering the HSR waiting period. The FTC issued a Second Request to investigate the proposed transaction, and on March 25, 2022 ultimately allowed the transaction to proceed, but subject to a consent decree requiring the divestiture of EP's Utah operations to avoid anticompetitive overlap in that region. The FTC alleges that the parties engaged in illegal conduct lasting from the date that the Purchase Agreement was signed (July 26, 2021) through the date that the Purchase Agreement was amended (October 27, 2021), a 94-day period well before the end of the HSR waiting period (March 25, 2022).[4]

a. Challenged Interim Operating Covenants

The FTC alleged that the Purchase Agreement contained several interim operating agreements that gave rise to the gun jumping violations:

- EP agreed "not to propose, agree to, or commence any individual operation on the Assets anticipated to cost in excess of Two Hundred Fifty Thousand ($250,000)," unless XCL or Verdun first expressly approved the activity, with no ordinary-course exceptions.[5]

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[2] 15 U.S.C. § 18A.

[3] Complaint, *United States v. XCL Resources Holdings, LLC, et al.*, No. 1:25-cv-00041, at 2 (D.D.C. Jan. 7, 2025).

[4] *Id*. at 6.

[5] *Id*. at 9.

- EP agreed to "not conduct any operation in connection with" the numerous crude oil wells EP was developing "unless such operations are expressly permitted" under the Purchase Agreement "or are otherwise approved by Purchaser."[6]

- The parties also agreed to shift financial risk to XCL and Verdun for certain EP business activities, including risk associated with meeting EP's customer commitments as they anticipated that the Purchase Agreement's restrictions would cause potential crude oil supply shortages.[7]

b. Alleged Gun Jumping Conduct

According to the FTC, the problematic interim operating covenants resulted in conduct that constituted clear gun jumping violations under the HSR Act, including the following:

- EP immediately transferred control over key aspects of its business to XCL and Verdun, resulting in XCL halting EP's new well-drilling operations.[8]

- During this hold period, XCL and EP who, as the FTC noted, were "direct competitors in the marketplace" coordinated to manage EP's customer contracts, including communicating supply shortages and arranging deliveries, in order to fulfill commitments to customers in the Eagle Ford region.[9]

- EP was required to submit all expenditures (including expenditures related to ordinary-course activities) above $250,000 for Verdun's or XCL's approval, though, according to the FTC, XCL and Verdun often received and approved expenditure requests that fell well below the $250,000 threshold.[10]

- XCL required changes to certain ordinary-course business operations, including EP's well-drilling designs and its leasing and renewal activities.[11]

- EP gave XCL virtually unfettered access to EP's competitively sensitive business information on a granular basis, such as EP's site design plans, customer contract and pricing information, and daily supply and production reports.[12]

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6 *Id*.
7 *Id*. at 10.
8 *Id*. at 4.
9 *Id*. at 4-5.
10 *Id*. at 5.
11 *Id*.
12 *Id*.

- Verdun coordinated with EP on EP's contract negotiations with certain customers in the Eagle Ford production area, specifically observing that certain customer contracts included below-market prices, and directed EP to raise prices in the next contracting period.[13]

III. Key Takeaways

The FTC's record $5.6 million gun jumping fine marks a rare gun jumping action by the Agencies and should be a cautionary tale that overbroad interim operating covenants and potential gun jumping conduct puts both sides of the transaction at risk, not just the purchaser.

Generally, parties to a transaction should confer with antitrust counsel prior to discussing integration, exchanging information/data, or discussing a potential transaction with customers, suppliers or the public. Parties should be vigilant about not prematurely transferring control over, or beneficial ownership of, the target before the expiration of the HSR waiting period. This includes engaging with customers and coordinating to negotiate customer contracts and fulfilling any existing customer contract commitments.

Additionally, parties should be careful to limit information exchanges before closing, particularly where parties are actual or potential competitors. Due diligence and pre-closing integration planning should always be conducted with the appropriate safeguards. For example, especially in the instance where parties are horizontal competitors, parties should refrain from sharing competitively sensitive information except through a clean team agreement. Further, information should be supplied on an aggregated and/or anonymized basis.

Finally, parties to a potential transaction must be mindful of potential gun jumping risk in the negotiation—and implementation—of interim operating covenants. Interim operating covenants should provide for reasonable ordinary-course exceptions and should be limited and tailored to cover actions necessary to maintain the value of the target's business until closing. Parties should involve antitrust counsel in drafting or reviewing the covenants during the negotiation process to ensure that the covenants do not give rise to improper information exchanges or buyer's premature control over the target and its pre-closing operations during the period between signing and closing.

Willkie antitrust attorneys will continue to monitor, analyze, and report on the developments in this area. If you have any questions about potential gun jumping risks or any other antitrust risks generally, please contact a Willkie attorney.

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[13] *Id*.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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