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FTC SECURES RECORD-BREAKING GUN-JUMPING FINE, OPINES ON BUYER'S RIGHT TO APPROVE TRANSACTIONS AND LACK OF DILIGENCE CONTROLS

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SUMMARY

The Federal Trade Commission ("FTC") sent a firm message—unlawful coordination of merging businesses prior to the closing under the Hart-Scott-Rodino Antitrust Improvements ("HSR") Act will be aggressively enforced. On January 7, 2025, the federal agency secured a record-breaking $5.684 million fine from three oil companies for unlawful coordination—also known as "gun jumping"—in violation of the HSR Act's mandatory waiting period. The proposed final order, if entered, orders each of the buy side and the sell side to be fined $2.842 million, the largest total gun-jumping penalty in U.S. history.

The HSR Act requires parties to transactions meeting certain thresholds submit notification of and specified information about the transaction to the FTC and the Antitrust Division of the Department of Justice ("DOJ"). To give the enforcement agencies time to review the transaction, the HSR Act mandates a 30-day waiting period starting from the day that the FTC and DOJ receive the required notifications, accompanying documents, and filing fee.

The FTC complaint in this case alleges Verdun Oil Company II LLC ("Verdun") [which was "under common management" with XCL Resources Holdings, LLC ("XCL") at the time of the transaction] agreed to acquire EP Energy LLC ("EP"), an alleged competitor of both acquirers. While the parties complied with the HSR notification requirements, the complaint alleges that various aspects of the purchase agreement and the parties' actions violated the mandatory waiting period.

ALLEGED VIOLATION: BUYER TAKING OPERATIONAL CONTROL OF SELLER PRIOR TO CLOSING

First, FTC alleged that the purchase agreement immediately gave XCL and Verdun control over much of EP's business, including approval rights over "crude oil development and production activities and many of EP's ordinary-course expenditures." Using this authority, XCL allegedly halted

"EP's new oil-drilling activities for several weeks." The complaint states that this "contributed to EP having crude oil supply shortages in September and October 2021 at a time when the United States was experiencing significant supply shortages and spiking crude oil prices."

Additionally, the complaint alleges that the purchase agreement "specifically provided that XCL and Verdun . . . would bear all costs associated with EP's supply shortages," which the parties anticipated would occur when XCL directed EP to cease well-drilling activities prior to closing. The FTC asserts that this supply shortage was intentional, and the purchase price for the transaction was increased to cover EP's anticipated losses from the reduction in output. The complaint alleges that to carry out the cessation of certain production and continued supply to EP customers, EP employees effectively reported to their counterparts at XCL.

Further, the FTC asserts that XCL employees began actively supervising EP's well-design and planning activities, and "coordinated directly with EP's customers to discuss EP's supply shortage and to arrange for alternative delivery to the customer, which XCL made either from its own supplies or from purchases it made on the spot market." The complaint further details the extent of this alleged control as Verdun directed EP customer interactions, including setting prices and contract terms, and XCL required changes to EP's ordinary-course business operations, including approval rights for hiring field personnel.

ALLEGED VIOLATION: PURCHASE AGREEMENT REQUIRING BUYER APPROVAL OF LOW-THRESHOLD EXPENDITURES WITH NO ORDINARY COURSE EXCEPTION

Taking effective control of a target during the HSR mandatory waiting period constitutes a textbook violation of U.S. antitrust law, but the parties' purchase agreement drew its own scrutiny from the FTC.

The purchase agreement required EP to submit to XCL or Verdun for approval all expenditures above $250,000, which—according to the complaint—"is a relatively low threshold in the crude development and production business." This provision had no ordinary-course exception and, according to the complaint, "effectively transferred control over a significant portion of EP's day-to-day operations to XCL and Verdun." With that low threshold in place, EP allegedly had to seek approval for such ordinary course expenditures as "purchasing supplies for its drilling operations and entering or extending contracts for drilling rigs."

Material transaction approval provisions are typical in purchase agreements, aiming to protect the buyer's legitimate interest in preserving the value of the acquisition. However, merging parties and deal lawyers alike should consider these thresholds carefully. By setting them too low (based on factors such as size of the deal and the relevant industry) or failing to include an ordinary course exception, parties may risk a gun-jumping violation of the HSR Act if that threshold effectively transfers control of the seller's day-to-day business to the buyer.

ALLEGED VIOLATION: MISHANDLING AND MISUSE OF SENSITIVE DILIGENCE INFORMATION

The FTC further alleges that Verdun operations and sales employees used EP's confidential information from the data room to inform pricing and contract terms when Verdun and EP were still competitors in the marketplace before the transaction closed. The confidential diligence information was allegedly provided by EP through the data room without safeguards on buyers' use or access within Verdun and XCL. Moreover, after the parties signed the purchase agreement, the sensitive information continued to flow. According to the complaint, XCL and Verdun requested and received competitively sensitive information from EP, including details of customer contracts, pricing, production volumes, business plans, site design, and vendor agreements, sometimes on a daily basis. FTC viewed the seller as complicit: "[EP] took no meaningful steps to resist these requests from XCL and Verdun" and "made no effort – and XCL and Verdun offered no protections on its own – to limit the access to, or use of, EP's competitively sensitive information by XCL's and Verdun's employees."

This violation could have been avoided by use of appropriate clean team arrangements to safekeep the diligence materials and prevent their access by buy-side employees with competitive operational duties, as well as designating that the diligence materials could only be used for the limited purpose of evaluating the EP business, not operational direction or coordination. The complaint reflects the need for important antitrust safeguards for deals: careful control of information in the diligence process, the proper use of clean teams, and thoughtful management of information post-signing.

CONCLUSION: CASE EMPHASIZES THE NEED FOR THOUGHTFUL DILIGENCE PROCESS, AGREEMENT DRAFTING, AND INTEGRATION PLANNING

These fines serve as significant warning and reminder of the importance of complying with the HSR Act's waiting period requirements. Notably, the proposed final order will impose stiff penalties on both sides, holding both the buyers *and* the seller responsible. To avoid running afoul of the HSR Act, merging parties should ensure that buyer does not take operational control of the target too early, that integration planning does not become actual integration of the parties' operations, that the purchase agreement does not allow buyer to effectively make everyday business decisions for the target, and that diligence into confidential and competitive information is appropriately limited.

RELATED PRACTICE AREAS

- Antitrust
- Transactional

MEET THE TEAM

Rebecca A. D. Nelson

St. Louis / Washington

rebecca.nelson@bclplaw.com
+1 314 259 2412

Paul A. Barrs

St. Louis

paul.barrs@bclplaw.com
+1 314 259 2376

Emilee L. Hargis

St. Louis

emilee.hargis@bclplaw.com
+1 314 259 2028

Darren E. Ray

Washington

darren.ray@bclplaw.com
+1 202 508 6034

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