Energy rivals plotted to suppress land prices

BY BRIAN GROW, JOSHUA SCHNEYER AND JANET ROBERTS
GAYLORD, MICHIGAN, JUNE 25, 2012

Emails show Chesapeake and Encana hatched plans to tame an oil-acreage rush in Michigan, Reuters found.

From: Aubrey McClendon [mailto:aubrey.mccclendon@chk.com]
Sent: Sunday, October 17, 2010 5:36 AM
To: Wojahn, Jeff
Subject: RE: Natural Gas Forum For Landowners - EnCana putting leasing on hold

Understand our teams are working on cooperative approach to state leasing, that's good I think. Anything else out their encouraging to talk about? thanks

From: Wojahn, Jeff [mailto:Jeff.Wojahn@encane.com]
Sent: Wednesday, October 20, 2010 10:19 AM
To: Aubrey McClendon
Subject: RE: Natural Gas Forum For Landowners - EnCana putting leasing on hold

We just finished our board meeting and we have our conference call today. I will be on the western slope touring Randy around our operations tonight and tomorrow...

From what I understand John Schoop has been leading the charge on working with your team on arranging a bidding strategy. I have a meeting with John planned on Friday and a review with Randy Monday.
Under the direction of CEO Aubrey McClendon, Chesapeake Energy Corp. plotted with its top competitor to suppress land prices in one of America’s most promising oil and gas plays, a Reuters investigation has found.

In emails between Chesapeake and Encana Corp, Canada’s largest natural gas company, the rivals repeatedly discussed how to avoid bidding against each other in a public land auction in Michigan two years ago and in at least nine prospective deals with private land owners here.

In one email, dated June 16, 2010, McClendon told a Chesapeake deputy that it was time “to smoke a peace pipe” with Encana “if we are bidding each other up.” The Chesapeake vice president responded that he had contacted Encana “to discuss how they want to handle the entities we are both working to avoid us bidding each other up in the interim.” McClendon replied: “Thanks.”

That exchange – and at least a dozen other emails reviewed by Reuters – could provide evidence that the two companies violated federal and state laws by seeking to keep land prices down, antitrust lawyers said.

“The famous phrase is a ‘smoking gun.’ That’s a smoking H-bomb,” said Harry First, a former antitrust lawyer for the Department of Justice. “When the talk is explicitly about getting together to avoid bidding each other up, it’s a red flag for collusion, bid-rigging, market allocation.”

The revelation of the discussions between Encana and Chesapeake, the second-largest natural gas producer in the United States, comes at a time when McClendon already is under fire.

The company’s board stripped him of his chairmanship after Reuters reported that he took out more than $1.3 billion in personal loans from a firm that also finances Chesapeake. The IRS and the Securities and Exchange Commission have launched inquiries.

The talks to suppress land prices could prove even more damaging – for McClendon, Chesapeake, Encana and other top executives with both companies.

Private industry cartels are forbidden in the United States, where price-fixing between competitors is illegal under the Sherman Antitrust Act. Violations carry stiff penalties. Companies can be fined up to $100 million and individuals up to $1 million for each offense. Jail sentences – which are rare – can be as long as 10 years, and collusion among competitors can lead to prosecution or fines for mail and wire fraud. Victims of bid-rigging can also seek triple the amount of damages.

Chesapeake and Encana say they discussed forming a joint venture in Michigan but opted against it. Typically, such partnerships can defray the steep costs of shale development, which include amassing thousands of acres of land and drilling dozens of wells.

In response to detailed questions from Reuters, Encana said it was undertaking an internal investigation, saying it “is committed to conducting its business in an ethical and legal way.” It acknowledged that its U.S. branch “discussed, but did not go forward with, a joint venture with Chesapeake Energy,” but added that it “cannot specifically address the questions posed at this time.”

Chesapeake spokesman Jim Gipson also said there had been discussions with Encana about “forming an ‘area of mutual interest’ joint venture” in Michigan. But he said “no such agreement was reached between the parties…. Nor did Encana and Chesapeake make any joint bids.”

Antitrust lawyers said the fact that the companies discussed a formal joint venture wouldn’t dispel legal concerns.

“It’s a red flag for collusion, bid-rigging, market-allocation.”

Harry First
Former Justice Department lawyer

BID RIGGING? Former Department of Justice attorney Darren Bush said the emails between Chesapeake and Encana seem little more than an effort to suppress land prices in Michigan.

REUTERS/RICHARD CARSON
A May 2010 auction of public land in Michigan featured fierce competition between Chesapeake Energy Corp and Encana Corp. In another such auction five months later – after emails show the rivals discussed how to avoid bidding each other up – almost every bid by both companies went uncontested, Reuters found. Bids were so low in October that the state sold more than twice the amount of acreage but received about 5 percent of the revenue it had raised in the May auction.
LAND RUSH

The discussions about how to team up in Michigan apparently began in early June 2010, when Chesapeake and Encana were competing fiercely to acquire land in the Collingwood Shale formation in Northern Michigan.

The shale formation is a layer of oil- and gas-rich rock lying thousands of feet below the rolling hills, cherry groves and family farms of northern Michigan. It extends from beneath the dunes on Lake Michigan and Lake Huron’s shorelines to the center of the mitten-shaped state.

In 2010, the region was at the forefront of America’s shale boom – a buying frenzy made possible by the innovative drilling technology known as hydraulic fracturing, or “fracking.” The technique has fueled the largest U.S. land grab since the Gold Rush of the 1850s – and Chesapeake and Encana are among the biggest players nationwide.

Chesapeake’s McClendon has been the single most acquisitive buyer. In the last 10 years, his company has amassed more than 15 million acres of land in the United States – an area about the size of West Virginia. Encana has leased 2.5 million acres. In Michigan alone, the two companies combined hold more than 975,000 acres of land – an area about the size of Rhode Island.

At a May 2010 auction of public land run by Michigan’s Department of Natural Resources, Chesapeake and Encana had been the dominant buyers. Through intermediary bidders, the two giants spent almost $165 million combined – 93 percent of the record $178 million taken in by the state – to acquire more than 84,000 acres of land. Chesapeake alone spent $138 million, according to a Reuters review of state data. Firms bid an average of $1,413 per acre for

Inside the Chesapeake-Encana talks

May 6, 2010: At a record-breaking Michigan state auction, Chesapeake and Encana bid against each other; state raises record $178 million.

June 6: A Chesapeake official reaches out to Encana to discuss teaming up. The email is copied to Chesapeake CEO McClendon and Jeff Wojahn, president of Encana U.S.A.

June 15: McClendon asks top Encana and Chesapeake officials which company should handle bidding with one land owner who “wants us to bid against each other...”

June 16: McClendon tells a top deputy it’s time “to smoke a peace pipe” with Encana “if we are bidding each other up” in one land deal.

June 18: Chesapeake’s internal logs say one Chesapeake vice president is “working with ECA to try and avoid bidding each other up.” ECA is Encana.

June 25: A Chesapeake internal log says one top official continues to work on a deal with Encana “so we don’t continue to push the price up.”

July 2: A map of Michigan prepared by Chesapeake divides the state into proposed areas that Chesapeake would operate and areas Encana would control.

July 16: A land broker for Chesapeake asks company officials if it’s just “coincidence” that both Chesapeake and Encana have cut back their bids significantly.

Oct. 14: An Encana U.S. official emails a Chesapeake colleague that he “wanted to identify Encana’s suggested contract lands and bidding responsibilities so you can take a look” before an upcoming Michigan state auction.

Oct. 19: A map prepared by Chesapeake shows projected acreage to be bid on at state sale. The map shows a breakdown that would give the two companies virtually identical positions of coveted oil acres.

Oct. 20: Wojahn, president of Encana’s U.S. operation, sends McClendon an update: One Encana official has been “leading the charge on working with your team on arranging a bidding strategy.”

Oct. 23: An internal Chesapeake document says Chesapeake no longer is “interested in MI state sale joint-bid strategy.”

Oct. 26-27: At the Michigan state land auction, Chesapeake and Encana buy no land in the same counties. Competition is virtually non-existent.
the right to extract oil and gas from the state-owned land.

Meanwhile, private landowners – aware that major energy companies were paying top dollar to lease property – sought competing bids from rival drillers. Some landowners were being offered more than $3,000 per acre in June 2010, documents reviewed by Reuters show.

Top executives from Chesapeake and Encana were growing weary of the rapidly escalating prices. In early June, Chesapeake vice president Doug Jacobson reached out to Encana to discuss what the emails characterized as an “area of mutual interest” in Michigan – regions where the two companies would have the option to share mineral leases equally after they were purchased.

A COMMON PRACTICE

Area-of-mutual interest agreements are common in the oil industry. They allow drillers to share in the risks and rewards of developing an energy play. But they aren’t meant to allow the discussion of strategies to divide territory or avoid competitive bidding, say oil and gas industry attorneys.

In subsequent months, the emails show, top officials discussed ways to prevent land prices from escalating. The solution they proposed: dividing up Michigan counties and private landowners between them.

From June 6 to June 15, 2010, the two companies swapped proposals. In many of the emails, officials refer to the companies by their three-letter stock abbreviations: CHK for Chesapeake and ECA for Encana.

On June 6, Chesapeake vice president Jacobson sent an email with the subject line “CHK/ECA – MI” to Encana vice president John Schopp. It was copied to McClendon and to Jeff Wojahn, Encana’s U.S. president. “Our proposal is pretty simple, say oil and gas industry attorneys.

In an email to Schopp, the Encana vice president, Jacobson suggested they discuss plans to split up where, and from whom, each company would lease land in Michigan. The reason, the email shows, was to ensure each company could acquire more land without bidding against the other.

“Also, when you are back in the saddle, I’d like to visit with you about the implications of the impact of our competition on acreage prices and whether or not the sooner we do this the better shot we have of keeping acreage prices from continuing to push up,” Jacobson wrote to Schopp.

Two minutes later, Jacobson forwarded that email to Chesapeake CEO McClendon and three other Chesapeake executives, documents show. The next day, McClendon sent his “peace pipe” email to Jacobson – an email that former Justice Department lawyer First said could be “government exhibit No. 1” in an antitrust case.

“It’s what the prosecutor puts up in a PowerPoint presentation for the grand jury,” said First, now a professor at New York University. “It would take a Hail Mary pass to defend that.”

To be sure, the documents reviewed by Reuters don’t provide a complete picture of what went on between the two companies. One unanswered question is whether Chesapeake and Encana consummated any collusive agreements – a condition that might be necessary to convince a jury that the companies broke the law.

One internal Chesapeake document indicates McClendon may have backed away from what a company memo characterized as a “joint-bid strategy” relating to a Michigan state land auction in October. The emails also don’t make clear what became of efforts between the companies to decide which of them would handle the bidding for land held by private owners.

But in the weeks after the discussions began, Chesapeake and Encana sharply cut the prices they were offering for land in Michigan, and average lease prices plunged in areas that had previously been hotly contested. At the time, the two companies were by far the largest lease buyers in the state.

Chesapeake did some of its buying through contractor David McGuire, who secured Michigan leases on the company’s behalf. In a July 16 email to Chesapeake executives, McGuire reported that both companies had cut the maximum per acre amount they were bidding by 50 percent. In the email, McGuire asked the executives whether this was a “coincidence?” In response, Chesapeake’s Jacobson didn’t address the question directly. Instead, he told McGuire to pare back further lease buying.

Other documents show that in July, Chesapeake put on hold more than a doz-
“PEACE PIPE” ENERGY RIVALS PLOTTED TO SUPPRESS LAND PRICES

en deals it had been negotiating with large private land owners. The documents show that both Encana and Chesapeake simultaneously stopped negotiating with one land owner, Walter Zaremba, and both withdrew offers for his land.

“We suspected collusion when Encana called and said the deal was off, and Chesapeake lost interest at the same time,” Zaremba said after Reuters showed him several of the emails, none of which he had previously seen. He was already in litigation with Encana, claiming that it reneged on a deal for about 20,000 acres he owns. “Sure as hell something happened because things don’t just break down like that overnight.”

Oil and gas industry lawyers said the cooperation plan outlined in the emails under the auspices of an “area of mutual interest” isn’t how joint ventures are meant to be handled.

We suspected collusion when Encana called and said the deal was off, and Chesapeake lost interest at the same time. Sure as hell something happened because things don’t just break down like that overnight.

Walter Zaremba
Michigan land owner

“These agreements are not a way in which companies divide up territory together or avoid sellers playing them off each other,” said Bruce Kramer, an expert on oil and gas law.

Chesapeake and Encana have never publicly disclosed any joint venture, and oil and gas industry analysts consider them fierce rivals. Each holds major land positions in several of the same shale-rich states. Their competitive streaks make the behind-the-scenes communications all the more striking.

At least a dozen emails between top-level executives of the two firms address themes that competitors are warned not to discuss with each other, according to antitrust guidelines set by the American Petroleum Institute, the leading U.S. oil industry trade group.

To avoid potentially illegal behavior when competitors meet at an industry conference, for instance, the trade group warns against discussing any number of topics, most of which Chesapeake and Encana covered in the emails reviewed by Reuters.

Among the subjects the institute says competitors should avoid: sharing confidential or proprietary information; discuss-
ing agreements, either explicit or implicit, on pricing; company purchasing, merger or divestment plans; market allocation and development plans; inventories or costs. “Any discussion regarding potential energy or economic scenarios that may arise must be limited to generalities,” the guidelines say.

Attempts at price-fixing by rival corporations are typically difficult to prove in court. That’s because competitors rarely commit collusive agreements to writing.

Top Chesapeake and Encana executives, however, spelled out their ideas in great detail, the emails show, from the beginning of June 2010 through that October.

“This looks like a great start,” Encana’s Schopp replied June 7 to Chesapeake’s Jacobson’s proposal to divide bidding responsibilities. “A few suggestions that would maximize our effectiveness.”

Among his recommendations was that the companies split owners into two groups; Chesapeake would handle negotiations with one and Encana with the other. That way, the two wouldn’t bid against one another. Also copied on the June 7 email from Schopp: Encana CEO Randy Eresman.

About one week later, June 15 at 6:51 a.m., McClendon himself weighed in. He copied Encana’s U.S. president Wojahn and Eresman. Referring to one company that owned mineral leases on more than 30,000 Michigan acres, McClendon wrote that it “looks like NorthStar wants us to bid against each other next week, let’s discuss that it “looks like Northstar wants us to bid against each other”

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NorthStar is an energy company based in Traverse City, Mich. The company declined to comment.

Another note about NorthStar appeared in a June 16 Chesapeake summary of Michigan land deals. It said that McClendon “does not want to complete (sic) with Encana on this deal if CHK is interested.”

“We call that bid rotation,” a violation of antitrust law in which participants in a transaction select who will be the winner in advance of bidding, said Herbert Hovenkamp, a law professor and antitrust expert at the University of Iowa.

Later on June 16, Jacobson asked Schopp how soon he thought Encana could craft a formal deal to work together. Chesapeake, he added, was largely amenable to the “county split.”

That’s when Jacobson urged quick action to keep “acreage prices from continuing to push up.”

DIVIDING MICHIGAN

Perhaps the most sophisticated plan the two companies forged was developing a bidding strategy for the auction of state land in Michigan on October 26, 2010.

Bidding at the state’s May 2010 auction had been vigorous and contested. That helped the state raise a record $178 million from the sale of more than 118,000 acres, according to a review of state auction data by Reuters. At that auction, 83 percent of the more than 1,200 winning bids had competitive offers.

Five months later, at the October auction, the bidding and the results proved remarkably different and far less lucrative. It raised just $9.7 million from the leasing of about 274,000 acres – more than twice the acreage sold in May but almost $170 million less in revenue.

The average winning bid in October was $46, the Reuters analysis shows. In May, it had been $1,413. Most of the winning bids in October were for the minimum price set by the state: $13 per acre.

One possible reason for the dreary auction results in October is that prices for natural gas had fallen significantly, about 20 percent.

Another possible reason, according to documents reviewed by Reuters: Two of the largest buyers in October – Chesapeake and Encana – had been discussing how to avoid bidding against the other.

On October 14 – a dozen days before the state auction – Kurt S. Froistad, a land executive with Encana, emailed Gary Dunlap, Chesapeake’s vice president of land. The subject line: “Michigan State Lease Sale.”

Froistad told Dunlap he was “working on a draft agreement for the sale, but wanted to identify Encana’s suggested contract lands and bidding responsibilities so you can take a look.”

The suggested split shows Encana as the “bidder” at the auction for state land in Charlevoix, Cheboygan, Kalkaska and Crawford counties. Chesapeake would be the “bidder” in Emmet, Presque Isle, Roscommon, Missaukee and Grand Traverse counties, according to the email.

CHIEFS IN THE LOOP

Over the next three days, Chesapeake executives designed maps outlining the proposed split of bidding at the state auction, according to emails.

McClendon and Wojahn, president of Encana’s U.S. unit, were aware of the proposed auction bidding strategy. “Understand our teams are working on a cooperative approach to state leasing, that’s good I think. Anything else out there encouraging to talk about?” McClendon wrote in an email to Wojahn on Oct. 17.

“We haven’t arrived at a strategy yet but as we approach the sale we will be happy to have a fulsome technical discussion,” Wojahn replied on Oct. 18.

A day later, Chesapeake drew up a particularly detailed map. It projected how the county split could allow each firm to end up with almost exactly 134,000 “oil acres” after the auction. Oil-rich shale is much more valuable, since crude trades at

$178m

The record amount raised by the state of Michigan in a May 2010 land auction
a massive premium to natural gas.

On Oct. 20, Wojahn sent McClendon an update: “From what I understand (Encana’s) John Schopp has been leading the charge on working with your team on arranging a bidding strategy. I have a meeting with John planned on Friday and a review with Randy Monday.” Randy is Randy Eresman, Encana’s CEO.

McClendon appears to have decided to back away from the auction plan proposed by Froistad. A summary of Chesapeake’s new ventures, sent in an email on Oct. 23, notes that, as a result of a meeting with McClendon, staff members should inform Encana that Chesapeake had lost interest in the “joint-bid strategy.”

In the end, Chesapeake and Encana did not acquire state land in the exact counties outlined in the proposals and in the maps Reuters reviewed. But an analysis of the auction results shows that neither company bought any land in the same county as the other. Earlier, at the May auction, bidders for Chesapeake and Encana had competed fiercely for tracts in several of the same counties.

BURDEN OF PROOF

Because the state does not keep a bid-by-bid record for parcels in which there was competition, it’s unclear whether Chesapeake and Encana ever bid against each other in October.

But records do show that other companies bid against Chesapeake in just 10 percent of the 320 leases it purchased at the fall auction. That’s in stark contrast to the Michigan state auction in May. Then, Chesapeake faced competing bids for every one of the more than 850 leases it secured.

Encana fared similarly in the fall auction. In October, only 27 percent of the 1,675 leases it purchased were contested. In the May auction, companies bid against Encana in each of its 70 successful offers.

Antitrust experts said that even though the plans discussed in the emails didn’t play out exactly as envisioned, they nonetheless may have had the desired effect.

“In a situation where there is some level of collusion going on, it’s hard to get agreement on everything. It’s not easy to form cartels,” said law professor First. “The fact that a cartel isn’t perfectly effective doesn’t mean it isn’t harmful.”

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