IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Petitioner, v. SMITH INTERNATIONAL, INC., and SCHLUMBERGER LTD., Respondents.	Supplemental to Civil Action No. 93-2621 -- SS/AK Judge Stanley Sporkin

PRETRIAL STATEMENT OF THE UNITED STATES FOR THE HEARING ON CIVIL AND CRIMINAL CONTEMPT

Introduction

The United States submits this pretrial statement for the civil and criminal contempt proceedings against Respondents Smith International, Inc. ("Smith") and Schlumberger Ltd. ("Schlumberger"). Local Civil Rule 16.5 requires pretrial statements for civil matters. Because the Court will hear the civil and criminal contempt cases together, Plaintiff believes the provision of pretrial information for both will assist in defining the issues for the November 17 hearing.

Statement of the Case

Description of the Nature of the Case

On July 27, 1999, the United States filed petitions for orders to show cause why Smith and Schlumberger should not be held in civil and criminal contempt for proceeding, in the face of a warning from the United States, with a transaction that is barred by a Final Judgment entered by this Court in United States v. Baroid Corporation, et al. Respondents filed their response to the Petitions on August 27, and the United States submitted its reply on September 10. At a September 13 hearing, this Court scheduled a joint hearing for both the civil and criminal contempt petitions on November 17, with a pretrial conference on November 2. On September 21, this Court entered orders to show cause to Respondents requiring them to explain why they should not be held in civil and criminal contempt.

The Baroid Judgment was filed on December 23, 1993, simultaneously with a civil antitrust complaint under Section 7 of the Clayton Act to block the merger of Dresser Industries, Inc. and Baroid Corporation, alleging that the transaction would substantially lessen competition in the United States drilling fluid market. The United States drilling fluid market was and is highly concentrated, with three firms controlling about 80 percent of sales. Dresser competed in the drilling fluid business through its 64 percent interest in M-I L.L.C. ("M-I"),[1] and Baroid competed through its subsidiary Baroid Drilling Fluids. Both M-I and Baroid Drilling Fluids manufactured and sold drilling fluids *domestically and internationally*. The Final Judgment ordered Dresser to divest either its 64 percent interest in M-I or Baroid Drilling Fluids and any other assets of Baroid used domestically or internationally to compete in the drilling fluid

[1] Halliburton Company owned the other 36 percent.

business. Dresser chose to divest its interest in M-I. Smith acquired that interest and agreed to be bound by the terms of the Final Judgment.[2]

Paragraph IV.F. of the Final Judgment placed restrictions on the types of transactions Smith could enter with certain named companies, including Schlumberger. Specifically, the Judgment prohibits Smith from "sell[ing] the drilling fluid business to, or combin[ing] that business, with the drilling fluid operations of Schlumberger Ltd. . . . or any of its affiliates or subsidiaries." (The prohibition is not limited to assets located or used to compete in the United States.) The Final Judgment was subject to a public notice and comment period under the Tunney Act (15 U.S.C. § 16) and was entered by the Court on April 12, 1994, upon a finding that entry of the Judgment was in the public interest. Schlumberger received actual notice before the end of the comment period that it was named in Paragraph IV.F. of the Judgment.

On July 14, 1999, Respondents formed a joint venture pursuant to which Smith contributed M-I and Schlumberger contributed drilling fluid assets. Schlumberger paid Smith $280 million and received a 40 percent interest in the joint venture that included M-I. Included in the package of Schlumberger's drilling fluid assets that were combined with M-I in the joint venture were key Schlumberger U.S. drilling fluid employees and its only research and engineering facility dedicated to drilling fluids. That facility, which is in St. Austell, England, supported Schlumberger's drilling fluid business in the United States and elsewhere in the world and its intellectual property. The joint venture is now competing in the drilling fluid business

[2] In August 1998, Smith acquired the remaining 36 percent of M-I from Halliburton Company.

worldwide, including in the United States. Subject to minor exceptions, Schlumberger agreed not to compete with the joint venture.

The joint venture formed by Respondents on July 14, 1999, violates Paragraph IV.F. of the Final Judgment in that (1) Smith sold to Schlumberger part of the divested drilling fluid business when it sold a 40 percent interest in a joint venture that included M-I to Schlumberger; and (2) Smith combined M-I with the drilling fluid operations of Schlumberger.

At the time Respondents proceeded with the joint venture, they were on notice that the United States would view consummation as a clear violation of the Final Judgment. Respondents had originally asked the Antitrust Division to review a proposed joint venture between Respondents that they conceded would have required modification to permit the transaction to proceed. Then, in late June, as the Antitrust Division was nearing the end of its investigation, Schlumberger informed the Division that it had decided to "discontinue" its U.S. drilling fluids operations, that the joint venture agreement had been restructured to omit Schlumberger's "U.S. assets" and that Schlumberger now believed the restructured transaction would not require modification of the Final Judgment. Schlumberger provided additional details about the restructured transaction and the reasons why it did not believe that transaction violated the Judgment in a letter dated July 1. On Thursday, July 8, Smith wrote the Division that the companies planned to close the restructured transaction involving M-I and the non-United States assets of Schlumberger "in the very near future," with July 14 targeted as the consummation date, but that the Division would be provided at least 48 hours' notice prior to the closing. On Monday, July 12, Smith provided notice of its intention to proceed with the transaction on July

14. In response, on Tuesday, July 13, the Antitrust Division sent Respondents a letter stating that the consummating the joint venture "would clearly violate the Final Judgment" and that if the parties went forward, the Department would "take appropriate action in the District Court."[3] Respondents received the letter prior to proceeding with the transaction.

At all times, Respondents were aware that they could seek modification or clarification of the Final Judgment from this Court on their own initiative.[4] They consciously and deliberately chose not to do so after carefully weighing the risks. Respondents feared that filing a motion would entail some delay and recognized that there was a chance that the Court would deny it. They also were aware of the possibility of contempt proceedings, both before and after receipt of the letter from the Antitrust Division on July 13. Yet, Respondents consummated their transaction on July 14 because they concluded that the business and financial advantages of proceeding immediately were more important. Consummation of the transaction placed Respondents in civil contempt, and the willful violation of the Final Judgment placed them in criminal contempt.

Identities of the Parties

[3] Contrary to Respondents' assertion in their Pretrial Statement, the Division has never "interpreted" Paragraph IV.F. of the Final Judgment to apply only to transactions involving United States assets or that adversely affected United States commerce.

[4] Contrary to Respondents' assertion in their Pretrial Statement, the Division never told or asked the parties not to go to the Court on their own to seek modification and obviously could not have prevented them from doing so.

Plaintiff is the United States of America. Smith is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Houston, Texas. Smith has competed in the drilling fluid business through M-I, which was in 1993 when the Final Judgment was filed, and is now, one of the three dominant competitors in the $1 billion United States drilling fluid business and the approximately $2.5 billion worldwide drilling fluid business. Schlumberger is a corporation organized and existing under the laws of the Netherlands Antilles, with headquarters in New York, New York and Paris, France. Schlumberger's United States oilfield service business is based in Sugarland, Texas. Schlumberger has competed in the drilling fluid business through its Dowell Division.

Both respondents provide services and products in the United States and throughout the world to companies that drill for oil and natural gas. Schlumberger is the second largest oilfield service company in the world with total revenues in 1998 of approximately $12 billion and United States revenues of about $2 billion. Smith's 1998 worldwide revenues were approximately $2 billion; its United States revenues were about $1 billion.

Basis of the Court's Jurisdiction

This Court has statutory power to enforce compliance with its Orders under 18 U.S.C. § 401(3) (1998) and Rule 42(b) of the Federal Rules of Criminal Procedure, as well as inherent power to enforce compliance with its Orders. In addition, Paragraph XIV of the Final Judgment provides:

> Jurisdiction is retained by this Court for the purpose of enabling any of the parties to this Final Judgment to apply to this Court at any time for such further orders and directions as may be necessary or appropriate for the construction or carrying

> out of this Final Judgment, for the modification of any provision hereof, for the enforcement of compliance herewith, and for the punishment of any violations hereof.

The Court had subject matter jurisdiction over the original action under the federal antitrust laws, and it had jurisdiction to enter the Final Judgment, including Paragraph IV.F., which set forth prophylactic relief that furthered the objective of preserving or promoting competition in the United States drilling fluid market. A court's jurisdiction to enter a final judgment and to enforce compliance with a final judgment may encompass transactions that might not independently violate the antitrust laws. United States v. Loew's, Inc., 371 U.S. 38, 53 (1962); United States v. United States Gypsum Co., 340 U.S. 76, 88-89 (1950); United States v. Grinnell Corp., 384 U.S. 563, 580 (1966); FTC v. National Lead Co., 352 U.S. 419, 429 (1957); United States v. Thomson Corp., 949 F. Supp. 907, 914 (D.D.C. 1996); United States v. AT&T, 552 F. Supp. 131, 150 n.80 (D.D.C. 1982) (citation omitted)), aff'd, 460 U.S. 1001 (1983).

Statement of Claims Made by the United States

In its Petitions the United States makes the following claims:

(1) The restrictions upon Smith that are set forth in Paragraph IV.F. of the Final Judgment are clear and unambiguous.

(2) The joint venture formed by Respondents on July 14, 1999 violates Paragraph IV.F. of the Final Judgment.

(3) With respect to the criminal contempt petition, the violation of the Final Judgment by Respondents was willful.

Statement of Defenses Raised by Respondents

Not applicable.

Schedule of Witnesses to be Called by the United States

Because this Court has entered the Orders to Show Cause, the United States assumes that Respondents will present their case first at the November 17 hearing to explain why they should not be held in civil and criminal contempt. To the extent that the direct and cross examination of witnesses called by Respondents do not cover all of the areas that the United States believes are relevant, the United States plans to introduce in its responsive case the excerpts from depositions that are listed in Attachment 2 to this Pretrial Statement. The United States may use portions of the depositions in videotape form during the hearing. The United States also reserves the right to call any live witnesses necessary and appropriate to respond to Respondents' case.

List of Exhibits to be Offered in Evidence by the United States

Attachment 1 is a list of exhibits the United States currently plans to offer at the November 17 hearing. The first sixteen exhibits were attachments to the Memorandum in Support of the United States' Civil and Criminal Petitions and the Reply of the United States to the Response of Smith and Schlumberger, filed on July 17 and September 10 respectively. The remaining exhibits were submitted by either Smith or Schlumberger in response to post-filing discovery. The United States reserves the right to offer additional exhibits in response to Respondents' case.

Designation of Depositions to be Offered into Evidence by the United States

Attachment 2 is a list of the deposition designations the United States currently plans to offer at the November 17 hearing. As stated in the previous section relating to witnesses, the

United States plans to introduce the deposition excerpts in its responsive case to the extent that the direct and cross examination of witnesses called by Respondents do not cover all of the areas that the United States believes are relevant. The United States may use portions of the depositions in videotape form during the hearing. The United States reserves the right to use additional portions of the stenographic and videotape records of the depositions for impeachment purposes during the hearing. The United States also reserves the right to designate additional portions of the depositions in response to Respondents' counterdesignations or in response to Respondents' case.

Description of the Relief Sought by the United States

With respect to the civil contempt petition, the United States asks this Court to find Respondents in civil contempt; order rescission of the joint venture agreement they consummated on July 14, 1999; order restoration of the assets, including personnel, each Respondent contributed to the joint venture to their pre-transaction condition; order disgorgement of the profits Respondents have made from the joint venture; give Respondents five days to complete the rescission and an appropriate period of time for restoration; impose on each of them a daily fine in the amount of $100,000 until they do so; and order Respondents to pay the United States' attorneys' fees and costs.

With respect to the criminal contempt petition, the United States asks this Court to find Respondents guilty of criminal contempt and fine each of them $1 million.

Dated: October 28, 1999 Respectfully submitted,

"/s/"
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