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 Judge Stanley Sporkin

MEMORANDUM OF THE UNITED STATES IN SUPPORT OF PETITION FOR AN ORDER TO SHOW CAUSE WHY RESPONDENTS SMITH INTERNATIONAL, INC. AND SCHLUMBERGER LTD. SHOULD NOT BE FOUND IN CRIMINAL CONTEMPT

I. Introduction

The United States has petitioned this Court for an Order to Show Cause Why Respondents Smith International, Inc. ("Smith") and Schlumberger Ltd. ("Schlumberger") should not be found in criminal contempt of the Final Judgment entered by this Court on April 12, 1994, in United States v. Baroid Corporation, et al., as modified by this Court on September 19, 1996. [Exhibits 1 and 7] Paragraph IV.F. of the Final Judgment, as modified, prohibits Smith, as the purchaser of the "drilling fluid business" divested pursuant to the Final Judgment, from "sell[ing] the drilling fluid business to, or combin[ing] that business, with the drilling fluid operations of . . . Schlumberger." On July 14, 1999, Smith sold to Schlumberger a 40 percent interest in a joint venture that included the divested "drilling fluid business," and the companies

combined that business with Schlumberger's drilling fluid operations, despite a warning from the Antitrust Division that the transaction would clearly violate the Final Judgment.

Smith and Schlumberger have knowingly and willfully violated this Court's Order. The United States asks this Court for an Order requiring Smith and Schlumberger to show cause why they should not be held in criminal contempt. The United States further asks this Court to fine the Respondents for their contemptuous conduct, and to issue such other Orders as are appropriate to punish the Respondents' willful violation of this Court's Order.[1]

II. Statement of the Facts

A. Description of the Final Judgment

On December 23, 1993, the United States filed a civil antitrust Complaint under Section 7 of the Clayton Act to block the merger of Dresser Industries, Inc. ("Dresser") and Baroid Corporation ("Baroid"), alleging that the transaction would substantially lessen competition in the diamond drill bit and drilling fluid markets. [Exhibit 2] Dresser competed in the drilling fluid business through its 64 percent interest in M-I Drilling Fluids (now known as M-I L.L.C. and hereinafter referred to as M-I); Baroid competed through its subsidiary Baroid Drilling Fluids.[2] The Complaint alleged that the U.S. drilling fluid market was dominated by three firms -- M-I, Baroid, and Baker Hughes, Inc. ("Baker Hughes"), which together accounted for at least two-thirds of domestic drilling fluid revenues. Simultaneously with the Complaint, the United

[1] The United States has contemporaneously filed a Civil Contempt Petition against Smith and Schlumberger.

[2] Drilling fluids are a mixture of natural and synthetic compounds used at oil and gas drilling sites to cool and lubricate the drill bit, clean the hole bottom, carry cuttings to the surface, seal porous well formations, control downhole pressure, and improve the function of the drill string and tools in the hole.

States filed a proposed Final Judgment. To preserve competition in drilling fluids, Paragraph IV.A. of the Final Judgment ordered Dresser to divest the "drilling fluid business," which was defined as either its 64 percent interest in M-I or all assets of Baroid Drilling Fluids, plus any other assets of Baroid Corporation used for its domestic or international drilling fluid business.

Paragraph IV.F. of the Final Judgment listed specific companies to which Dresser could not divest the drilling fluid business and further imposed restrictions on the purchaser of the drilling fluid business:

> The purchaser of the divested drilling fluid business shall not sell the drilling fluid business to, or combine that business with the drilling fluid operations of Dresser Industries, Inc., Baker Hughes, Inc., Schlumberger Ltd., or Anchor Drilling Fluids, or any of their affiliates or subsidiaries during the life of this decree.[3]

The Court entered the Final Judgment on April 12, 1994. Dresser chose to divest its interest in M-I and sold the interest to Smith. As required by Paragraph III.B. of the Final Judgment, Smith, as a condition of the divestiture, agreed to be bound by the provisions of the Final Judgment.[4] [Exhibit 4 at page 3] Thus, under the Final Judgment, Smith, as the purchaser of the drilling fluid business, was barred until April 2004 from selling that business to Baker

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[3] The Competitive Impact Statement, filed by the United States in conjunction with the Final Judgment, described the effect of Paragraph IV.F:

> The proposed Final Judgment prohibits the sale by the defendants of the drilling fluid business to their major competitors in the drilling fluid market: Baker Hughes, Inc., Schlumberger Ltd., and Anchor Drilling Fluids. This prohibition lasts for the life of the decree. The purchaser of the drilling fluid business is also prohibited from combining that business with the drilling operations of any of those three companies or Dresser.

[Exhibit 3 at page 11]

[4] Last year, Smith acquired the remaining 36 percent interest in M-I from Halliburton Company, giving Smith complete ownership of M-I.

Hughes, Schlumberger, Anchor Drilling Fluids ("Anchor"), or Dresser, or from combining that business with the drilling fluid operations of any of those firms.

Smith has conceded its knowledge of the Final Judgment's restriction to this Court. In 1996, Smith proposed acquiring Anchor, a Norwegian company that produced and sold drilling fluids worldwide. Smith sought the consent of the United States to a modification of the Final Judgment to permit the transaction to proceed. The United States joined Smith in a motion to modify the Final Judgment to allow the acquisition, provided Smith divest the United States drilling fluid operations of Anchor, referred to as Anchor USA. [Exhibits 5 and 6] Smith described the Final Judgment's restriction on page 3 of its Memorandum to Modify the Final Judgment:

> The Final Judgment enjoins Smith from combining its drilling fluid business (*i.e.* M-I Drilling Fluids) with the operations of Dresser Industries, Inc., Baker Hughes, Inc., Schlumberger Ltd. or Anchor Drilling Fluids." [Exhibit 4]

This Court entered an Order on September 19, 1996, approving the modification. [Exhibit 7] While the modification changed the restriction in Paragraph IV.F. to permit the acquisition of Anchor, it continued the bar on selling the divested drilling fluid business to, or combining that business with, Schlumberger's drilling fluid operations:

> The purchaser of the divested drilling fluid business shall not sell the drilling fluid business to, or combine that business, with the drilling fluid operations of Dresser Industries, Inc., Baker Hughes, Inc., or Schlumberger Ltd., or any of their affiliates or subsidiaries during the life of this decree. The purchaser of the divested drilling fluid business shall not sell the drilling fluid business to, or combine that business, with the drilling fluid operations of Anchor Drilling Fluids, except in accordance with the terms of the Joint Motion to Modify Final Judgment and Stipulated Divestiture Agreement filed by the United States and Smith International, Inc. on June 4, 1996, which is hereby incorporated and made a part of the Final Judgment.

That Order also extended the period during which Smith would be prohibited from selling to or combining with Schlumberger: "With respect to Smith International, Inc., the terms of this Final Judgment shall expire on the tenth anniversary of the date this Order is filed and entered." Thus, as to Smith, the Final Judgment, including the restrictions on Smith's drilling fluid transactions, does not expire until September 19, 2006.

B. Description of Smith's and Schlumberger's Contemptuous Actions

Smith and Schlumberger started discussing the formation of a joint venture of M-I and Schlumberger's drilling fluid operations in 1998 and informed the Antitrust Division at the end of September of the discussions. The companies signed a Memorandum of Understanding on October 21, 1998 and executed a formal joint venture agreement on February 5, 1999. Under the joint venture agreement, Schlumberger would pay Smith $280 million for a 40 percent interest in a joint venture that included M-I, and the parties would combine the operations of M-I and Schlumberger's worldwide drilling fluid business. The joint venture agreement recognized that the transaction could not proceed without modification of the Final Judgment:

> 8.5 Modification Should the parties fail to receive modification of the consent decree entered in *United States v. Baroid Corp*., 1994-1 Trade Cas. (CCH) ¶ 70,572 (April 12, 1994) and therefore fail to meet the condition precedent to closing set forth in Section 7.1(b), the parties agree to negotiate in good faith to try to find a mutually agreeable and legally permissible alternative whereby the substantive ends of this Agreement will be achieved.

[Exhibit 8]

The Antitrust Division opened an investigation to determine if the Division should consent to modification of the Final Judgment to permit Smith to form the joint venture with Schlumberger. As part of its investigation, the Antitrust Division issued Civil Investigative

Demands to both companies for information and documents, reviewed the 60 boxes of documents submitted in response, and conducted interviews and a deposition.

In July 1999, before the Division reached a final decision on whether to consent to modification, Smith and Schlumberger decided to proceed with the joint venture. On July 1, Schlumberger wrote the Division that it had decided to discontinue its U.S. drilling fluid operations, and that "it seems clear that the *U.S. v. Baroid* decree should not prohibit Schlumberger and Smith from consummating their proposed joint venture whereby Schlumberger would contribute its remaining (non-U.S.) drilling fluid business to M-I in exchange for a 40 percent interest in M-I." [Exhibit 9] Then, on July 8, 1999, Smith's counsel wrote the Division claiming that, with the decision to shut down Schlumberger's U.S. drilling fluid operations, "the Baroid decree does not apply to this transaction and neither the Court nor the Division has jurisdiction over the joint venture," because there would be "no competitive effect" on the U.S. drilling fluid industry. [Exhibit 10] The letter also stated that the targeted closing date of the transaction was July 14, 1999, but that Smith would provide the United States with 48 hours notice in any event. A letter sent by Smith's counsel on July 12, 1999, advised that the parties intended to close the transaction on July 14. [Exhibit 11]

On July 13, 1999, the Division warned Smith and Schlumberger in writing that proceeding with the proposed joint venture would violate the Final Judgment. The letter, sent by facsimile, stated, "In our view, such action by Smith would clearly violate the Final Judgment entered by Judge Sporkin in United States v. Baroid Corporation, et al., Civil Action 93-2621." [Exhibit 12] Counsel for both companies received the letter on July 13; nonetheless, the companies consummated the transaction on July 14. [Exhibit 13]

III. Argument

A. This Court Has Jurisdiction

This Court has statutory power to enforce compliance with its orders. 18 U.S.C. § 401(3) (1998); Federal Rules of Criminal Procedure 42(b); see also McComb v. Jacksonville Paper Co., 336 U.S. 187, 193 (1949). A court whose order has been disobeyed has jurisdiction and venue to hear the contempt proceeding. Leman v. Krentler-Arnold Hinge Last Co., 284 U.S. 448, 454-55 (1932). Moreover, Paragraph XIV of the Final Judgment in this case 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.

B. Smith and Schlumberger's Actions Meet the Legal Standard for Criminal Contempt

1. Legal Standards for Criminal Contempt

Failure to comply with a court order or decree may be deemed contempt of court. In order for Respondents to be found in criminal contempt under 18 U.S.C. § 401(3), the petitioner must prove three elements beyond a reasonable doubt: "(1) there must be a violation (2) of a clear and reasonably specific order of the court, and (3) the violation must have been willful." United States v. NYNEX Corp., 8 F.3d 52, 54 (D.C. Cir. 1993); see also United States v. Twentieth Century Fox Film Corp., 882 F.2d 656, 659 (2d Cir. 1989), cert. denied, 493 U.S. 1021 (1990); Chapman v. Pacific Tel. & Tel. Co., 613 F.2d 193, 195 (9th Cir. 1979); In re Economou, 645 F. Supp. 1055, 1057 (S.D.N.Y. 1986), aff'd sub nom. SEC v. American Bd. of Trade, Inc., 830 F.2d 431, 439-40 (2d Cir. 1987), cert. denied, 485 U.S. 938 (1988).

2. The Final Judgment is a Clear and Reasonably Specific Order of This Court

Paragraph IV.F. of the Final Judgment describes restrictions imposed on the purchaser of the divested drilling fluid business: "The purchaser of the divested drilling fluid business shall not sell the drilling fluid business to, or combine that business, with the drilling fluid operations of . . . Schlumberger Ltd., or any of its affiliates or subsidiaries during the life of this decree." In construing this language, the Court should read it essentially as a contract, United States v. ITT Continental Baking Co., 420 U.S. 223, 236-37 (1975); United States v. Western Elec. Co., 894 F.2d 1387, 1390 (D.C. Cir. 1990), looking first to the "plain meaning of the Decree's language." Western Elec., 894 F.2d at 1394; see United States v. Armour & Co., 402 U.S. 673, 678 (1971).

The Final Judgment's restriction on transactions that Smith may enter is simple and straightforward: Smith is barred from selling its 64 percent interest in M-I to Schlumberger and from combining that business with Schlumberger's drilling fluid operations. The Final Judgment is clear and specific.

3. Smith and Schlumberger Violated this Court's Order

Smith has violated both the "sell" and "combine" provisions of the Final Judgment -- prohibitions to which it agreed to be bound. Schlumberger, with full knowledge of the Final Judgment, has aided and abetted Smith in the violation.

Prior to formation of the joint venture, Smith owned 100 percent of M-I (the 64 percent interest it acquired from Dresser and the 36 percent interest it acquired from Halliburton). In consummating the joint venture, Smith sold to Schlumberger for $280 million a 40 percent interest in a joint venture that includes M-I, thereby selling a portion of the original 64 percent

Dresser interest -- the divested "drilling fluid business." Smith's action thus violated the decree's prohibition against selling the drilling fluid business to Schlumberger.

Also, in consummating the joint venture, Smith combined M-I (including the original 64 percent interest) and Schlumberger's worldwide drilling fluid operations. Smith's action thus violated the Final Judgment's prohibition on combining the divested "drilling fluid business" with the drilling fluid operations of Schlumberger.

Schlumberger, as the essential other party to the joint venture transaction, aided and abetted Smith in violating the decree. Schlumberger had notice of the Order, as it admitted in its letter to the Division and as its agreement with Smith reflected. [Exhibits 8 and 9] Further, Schlumberger was also informed by the Division, along with Smith, that proceeding with the transaction would be a clear violation of the Final Judgment. [Exhibit 10]

In entering the transaction, Smith violated its obligation to comply with the Final Judgment, an obligation it has previously admitted to this Court. [Exhibit 4] Schlumberger has aided and abetted Smith in that violation. See, e.g., Max's Seafood Cafe v. Quinteros, 176 F.3d 669, 674 (3d Cir. 1999) ("One with knowledge of a court order who abets another in violating the order is surely in contempt."); Rockwell Graphic Systems, Inc. v. DEV Indus., Inc., 91 F.3d 914, 919 (7th Cir. 1996) (non-parties "may subject themselves to [the injunction's] proscriptions should they aid or abet the named parties in a concerted attempt to subvert those proscriptions"); Waffenschmidt v. MacKay, 763 F.2d 711, 714 (5th Cir. 1985) ("Nonparties who reside outside the territorial jurisdiction of a district court may be subject to that court's jurisdiction if, with actual notice of the court's order, they actively aid and abet a party in violating that order."), cert. denied, 474 U.S. 1056 (1986); Alemite Mfg. Corp. v. Staff, 42 F.2d 832, 832 (2d Cir. 1930)

("[A] person who knowingly assists a defendant in violating an injunction subjects himself to civil as well as criminal proceedings for contempt.").

4. Smith and Schlumberger Willfully Violated This Court's Final Judgment

Willfulness can be shown if a defendant knows or should reasonably be aware that his conduct is wrongful. See, e.g., United States v. Greyhound Corp., 508 F.2d 529, 531-32 (7th Cir.1974).[5] In this case, Smith and Schlumberger knew or reasonably should have known that their joint venture would violate the Final Judgment's prohibition against Smith selling M-I to, or combining M-I with, the drilling fluid operations of Schlumberger.

First, as shown above, the plain language of the Final Judgment clearly prohibits the joint venture. Second, on July 13, 1999, the day before Smith and Schlumberger consummated the joint venture agreement, the Division warned them in writing that proceeding with the proposed joint venture would violate the Final Judgment.

Smith's letter of July 8 [Exhibit 10] asserts that the shutting down of Schlumberger's U.S. drilling fluid operations and the exclusion of Schlumberger's U.S. assets from the joint venture allowed Smith to avoid the Final Judgment's restriction.[6] But Paragraph IV.F. of the Final Judgment contains no language limiting the Final Judgment's restriction to Schlumberger's U.S. drilling fluid assets or operations. Rather, the bar on Smith applies to a sale to, or combination with, the drilling fluid operations of Schlumberger "or any of its subsidiaries or

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[5] Willfulness can also be inferred from conduct that evidences a reckless disregard of a court order. In re Holloway, 995 F.2d 1080, 1082 (D.C. Cir. 1993), cert. denied, 511 U.S. 1030 (1994); Sykes v. United States, 444 F.2d 928, 930 (D.C. Cir. 1971).

[6] Similarly, in their press release announcing consummation of the joint venture, Smith and Schlumberger stated that the Final Judgment did not apply to the transaction because Schlumberger's U.S. drilling fluid assets were excluded.

affiliates." Smith and Schlumberger seek to read into the Final Judgment's plain language a limitation that they -- and they alone -- have devised.

> [T]he law is clear that a party who makes his own determination as to the meaning of a decree, acts at his peril. If [the defendant] had doubts as to its obligations under the order, it could have petitioned this court for a clarification or construction of that order. McComb, 336 U.S. at 192 [full citation omitted]. The law is equally clear that even where there is "no open and direct defiance," a company which acts under a "twisted interpretation" that would render a decree ineffective may be found guilty of civil and criminal contempt. United States v. Gamewell Co., 95 F. Supp. 9, 13 (D. Mass. 1951).

United States v. Greyhound Corp., 363 F. Supp. 525, 534 (N.D. Ill. 1973), aff'd, 508 F.2d 529 (7th Cir. 1974); see also, United States v. United Mine Workers, 330 U.S. 258, 293 (1947).[7]

Smith and Schlumberger proceeded with their transaction in contravention of the clear and specific language in the Final Judgment despite clear warning by the United States that the conduct would violate the Final Judgment. In consummating the joint venture, Smith willfully violated the Final Judgment and is in criminal contempt. Schlumberger willfully aided and abetted Smith in violating the Final Judgment and thus is also in criminal contempt.

D. Punishment

"Sentences for criminal contempt are punitive in their nature and are imposed for the purpose of vindicating the authority of the court. [Citations omitted.] The interests of orderly government demand that respect and compliance be given to orders issued by courts possessed of jurisdiction of persons and subject matter. One who defies the public authority and willfully

[7] Smith's and Schlumberger's attempt to insert a "U.S. assets" limitation into the Final Judgment not only contravenes its plain language, but constitutes a "twisted interpretation" that would render the Final Judgment's language meaningless. Schlumberger did not have U.S. drilling fluid operations when the proposed Final Judgment was filed on December 23, 1993.

refuses his obedience, does so at his peril." United Mine Workers, 330 U.S. at 302-03. The United States requests that the Court:

(1) find Smith and Schlumberger in criminal contempt;

(2) impose upon Smith and Schlumberger an appropriate fine;

(3) award the United States its costs and attorneys' fees incurred in filing this petition to show cause; and

(4) impose any other punishment that the Court may deem justified by Smith's and Schlumberger's actions.

IV. Conclusion

By consummating the joint venture, Smith and Schlumberger knowingly and willfully violated a clear and specific order entered by this Court in United States v. Baroid Corporation, et al. The United States respectfully asks this Court to issue an order to show cause why Smith and Schlumberger should not be held in criminal contempt and impose appropriate punishment.

Dated: July 27, 1999

Respectfully submitted,

_____/s/_____

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