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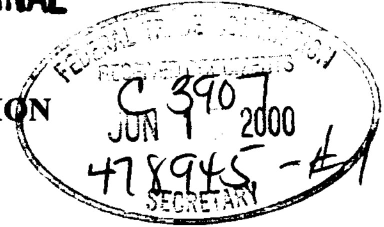


UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

In the Matter of	)	
	)	
Exxon Corporation,	)	
a corporation,	)	File No. ~~991-0077~~
	)	Docket No. C-3907
and	)	
	)	
Mobil Corporation,	)	
a corporation.	)	

OPPOSITION TO APPLICATION FOR APPROVAL OF PROPOSED BASE OIL SUPPLY CONTRACTS

The Independent Lubricant Manufacturers Association ("ILMA") urges the Federal Trade Commission ("FTC") to disapprove the proposed Base Oil Supply Agreements submitted by the ExxonMobil Corporation ("ExxonMobil") pursuant to Paragraph XIV.B of the Commission's Decision and Order in the above-referenced matter. ExxonMobil's proposed contracts with Castrol North America, Inc. ("Castrol") and Pennzoil-Quaker State ("PQS") do not achieve the remedial purposes of the Decision and Order to maintain a competitive base oil market, and, if approved, will result in harm to competition, especially for independent compounders and blenders, and ultimately the American consumer..

I. Introduction To ILMA

ILMA, established in 1948, is a national trade association of 150 regular member companies, consisting largely of small businesses, ranging in size from fewer than 10 to more than 200 employees. As a group, ILMA member companies blend, compound and sell over 25 percent of the United States' lubricant needs and over 75 percent of the metal removal fluids utilized in the country.

A lubricant is a liquid or solid substance used to reduce the friction, heat and wear between solid surfaces. ILMA members manufacture automotive, truck, marine, aircraft and industrial engine oils; transmission fluids; hydraulic fluids; greases; general industrial oils; power equipment oils; process oils; metal removal, treatment, protecting and forming lubricants; and rolling oils.

In order to manufacture a lubricant, ILMA member companies purchase oil and synthetic lubricant base stocks and a wide range of additives. ILMA member companies then compound and blend the base stocks with the correct additives in the proper proportions to produce a lubricant with the desired characteristics for a particular job.

ILMA members are diverse. A large proportion manufacture automotive lubricants for original equipment manufacturers and for the retail market, either under their own labels or through contract packaging arrangements. Many produce lubricants for metalworking and heavy industrial machines, while others supply lubricants for mining, textiles, food processing, electronics, as well as many other industries.

Independent lubricant manufacturers by definition are neither owned nor controlled by companies that explore for or refine crude oil to produce lubricant base stocks. Base oils are purchased from refiners, such as ExxonMobil, who are also competitors in the sale of finished products. Independent lubricant manufacturers succeed by manufacturing and marketing high-quality, often specialized, lubricants. Their success in this competitive market also is directly attributable to their tradition of providing excellent, individualized service to their customers.

ILMA has been involved with the FTC's review of the merger between the Exxon Corporation ("Exxon") and Mobil Corporation ("Mobil"). Since its announcement, ILMA provided information on the base oil and finished lubricants markets to the Commission. Many members of

the Association were interviewed by FTC attorneys and staff about the competitive effects of the merger. While ILMA did not take a formal position *vis-a-vis* the merger, it did write to the Commission on October 15, 1999, conveying the concerns raised by the Association's members. Many ILMA members were reluctant at that time to voice their individual concerns to the FTC because they feared retaliation from Exxon and Mobil -- the two largest base oil suppliers to independent lubricant manufacturers.

The Association was appreciative that the FTC's Decision and Order sought to protect and ensure a competitive base oil market for all participants. Immediately after the Decision and Order was announced, ILMA moved quickly to determine whether ExxonMobil would consider selling some or all of the to-be-divested 12,000 barrels-per-day ("MBD") of paraffinic base oils to an ILMA-organized buying group or consortium. ExxonMobil said it would entertain a bid from the ILMA buying group as possibly one of the as many as three customers contemplated by the Decision and Order. The Association did organize a buying group, which submitted a proposal to ExxonMobil for up to the full 12 MBD of paraffinic base oils being divested under the terms of the Decision and Order. ILMA's buying consortium was not a successful bidder. As discussed more fully below, ILMA wrote to the Commission on February 14, 2000, concerning the process undertaken by ExxonMobil in divesting the 12 MBD of base oils.

II. <u>It Is Difficult To Comment On ExxonMobil's Application For Approval</u>

As an initial matter, it is difficult for ILMA to comment on ExxonMobil's Application for Approval of Proposed Base Oil Supply Contracts ("Application"), because virtually the entire petition and supporting documents have been redacted in the public record copies in the Commission's docket. For example, the public record copies do not indicate how the 12 MBD of

base oils are divided between Castrol and PQS. This allocation can be significant because PQS earlier this year sold its 4.4 MBD base oil plant in Rouseville, Pennsylvania to Calumet Lubricants, who has discontinued base oil refining there. In addition, PQS has announced its intent to sell its base oil refinery in Shreveport, Louisiana. Thus, PQS' volumes under the proposed supply agreement with ExxonMobil could replace these volumes of base oils being taken off of the market.

As a result, ILMA and other commenters will have to speculate on major portions of the Application. The FTC, therefore, should review the Application to ensure that all of the information redacted by ExxonMobil in the public record copies, in fact, satisifies the Commission's rules as to "confidential business information."

The FTC should not be surprised if there are few comments submitted on ExxonMobil's Application. Because ExxonMobil controls 75 percent of the "merchant" base oils worldwide and is a formidable competitor in the finished lubricants market, most independent lubricant manufacturers are fearful of submitting comments to the Commission opposing the Application because of fear of retaliation. This is not an insignificant issue, especially if ExxonMobil attempts to argue that the few number of comments filed with the FTC on the Application supports the company's assertion of no harm to competition.

III. The Base Oil Market Has Shifted Dramatically Since The Decision And Order Was Issued

It is imperative that the FTC include as part of its review of ExxonMobil's Application an assessment of the changes that have taken place in the base oil market since last December, especially because one of the remedial purposes of the Decision and Order is to maintain a competitive base oils market for independent lubricant manufacturers. The attached article (Attachment 1) from the May 2000 issue of *Lubes-N-Greases* discusses some of the factors that have

caused the change in base oil supplies, including steep increases in crude oil prices, the closures of several base oil refineries, and scheduled refinery turnarounds for maintenance.

Another factor to bear in mind is that BP Amoco has announced its intent to acquire Castrol. While BP Amoco currently does not refine base oils in the United States, worldwide exchange and other arrangements (*e.g.*, blending and packaging) between ExxonMobil and BP Amoco (potentially through Castrol) could have adverse competitive effects on compounders and blenders around the world.

In reviewing ExxonMobil's Application, the Commission also should review ExxonMobil's base oil pricing since the Decision and Order was issued. Notwithstanding that Exxon acquired its largest base oil competitor, ExxonMobil's base oil price increases (approximately 60 cents per gallon) have exceeded the per-gallon price increases attributable to benchmark crudes (*i.e.*, West Texas Intermediate) -- that is, ExxonMobil has used the situation to increase its spread or margins on base oils.

One of a number of concerns to ILMA with ExxonMobil's price increases goes to the process the company used to divest the 12 MBD of paraffinic base oils. In its meeting last December with ExxonMobil's representative, ILMA was told that the FTC would limit ExxonMobil to a "refiner's and not a refiner's/marketer's" margin for the to-be-divested base oils. ILMA's buying group developed its bid based upon that representation. The Association subsequently has learned that ExxonMobil told certain other, interested bidders for the base oils that their proposed price to ExxonMobil had to be a minimum of at least 50 cents per gallon over the commodity benchmark (*i.e.*, more than a refiner's margin) in order to make the "first cut" in ExxonMobil's process. At a minimum, it does not appear to ILMA that ExxonMobil treated each of the potential bidders the

same, causing the Association to conclude that ExxonMobil had decided before the Decision and Order was issued to whom it would award the base oil contracts and that the bidding process earlier this year was *post hoc* "cover."

In determining whether a competitive base oil market will exist for independent compounders and blenders if ExxonMobil's Application is approved, the FTC should take into account availability of Group II base oils to the independent sector, as well as regulatory changes, such as the Environmental Protection Agency's pending diesel desulfurization proposal. Refiners' access to capital is finite, and they must make decisions about how and where to deploy such capital. Marginal base oil plants in today's economic environment probably will not survive, and it is necessary for the FTC to take this changed situation since last year into account in evaluating whether ExxonMobil's Application satisfies the remedial purposes of the Decision and Order.

IV. The Proposed Base Oil Agreements Fail To Satisfy The Remedial Purposes Of The Decision and Order

The purpose of the Decision and Order's base oil provision is to ensure adequate supplies of paraffinic base oils for integrated refiners *and* independent compounders and blenders. ExxonMobil's proposed agreements with Castrol and PQS would thwart that goal for independents by channeling the mandatory sales of 12 MBD of base oils into the hands of two companies that already control (or will soon control) base oil supplies. This will allow those companies to reduce their output of base oils or prevent them from introducing new supplies into the U.S. market. Indeed, those reductions have already begun. The net effect will be the same as if ExxonMobil had simply taken Mobil's base oils directly off the market. ILMA previously had raised this concern in its letters to the Commission.

A. ExxonMobil Is Wrong That The Proposed Base Oil Agreements Will Stimulate Competition

PQS is a fully-integrated lubricant manufacturer. As noted above, PQS formerly manufactured paraffinic base oils at Rouseville, Pennsylvania, and it is looking to sell its Shreveport, Louisiana base oil plant. Along with its output from the Excel Paralubes joint venture, PQS processes these base oils into finished lubricant products. Shortly after the FTC required ExxonMobil to sell the 12 MBD of base oils, and presumably while ExxonMobil was in the midst of negotiations with PQS for the sale of those oils, PQS announced that it was closing its Rouseville plant and looking to sell its Shreveport facility. PQS's CEO, James J. Postl, was quoted as saying:

> The write-down of the Shreveport and Rouseville refineries reflects the company's focus on its core automotive consumer products business and market conditions for refineries. Pennzoil-Quaker State Company is committed to exiting the refining business[.]

Pennzoil-Quaker State Press Release dated January 6, 2000. It would appear that PQS could close Rouseville because it had strong reason to believe that it could secure base oils from ExxonMobil. The end result is that Rouseville's 4.4 MBD of base oils are no longer on the market.

Similarly, Castrol will soon be part of an essentially fully-integrated lubricant manufacturer and its purchase of base oils from ExxonMobil will alleviate its need to either manufacture base oils or bring them in from outside the U.S. BP Amoco is in the midst of acquiring Castrol. While BP Amoco does not currently manufacture paraffinic base oils in the U.S., it has significant base-oil capacity overseas. Castrol's acquisition of base oils from ExxonMobil frees BP Amoco from the need to either refine them in the U.S. or import them. Instead, BP Amoco/Castrol acquires the oils from ExxonMobil and then settles the account through complex global swapping arrangements that exchange U.S. base oil stocks for overseas stocks. An indication of how cozy those overseas

relationships are is the fact that, until the European Union required them to desist, BP Amoco and Mobil manufactured base oils jointly in Europe. *See Reuters*, "EC Authorizes Break up of Fuel and Lubricants JV Between BP Amoco and Mobil," March 2, 2000.

Moreover, BP Amoco/Castrol is uniquely positioned to enter the U.S. base oil market and the proposed sale by ExxonMobil helps to prevent them from doing that. Although BP Amoco does not currently manufacture base oils in the U.S. and it would be costly for them to build that capacity, few companies are better positioned to enter that market. BP Amoco has substantial refinery operations in the U.S. Independent lubricant manufacturers do not. It would be far easier and less costly for BP Amoco to begin refining paraffinic base oils than it would be for an independent lubricant manufacturer to integrate vertically into that market from scratch.

It is also worth noting that ExxonMobil actually blends and packages under contract for Castrol. Under these circumstances, it is doubtful that Castrol can actually act independently of ExxonMobil. Because of Castrol's near dependence on ExxonMobil in the U.S., Castrol is unlikely to discipline ExxonMobil's pricing of base oils or finished lubricants.

B. ExxonMobil Has Mischaracterized Refining Capacities And Market Concentrations

ILMA disputes ExxonMobil's assertion on page 10 of the Application that the Castrol and PQS base oil supply contracts will have a *de minimis* increase in market concentration. ExxonMobil's references in Table 1 reflect total base oil refining capacities, not paraffinic base oils. The relevant market for the FTC's analysis should be paraffinic base oils. It should not be lost on the Commission that ExxonMobil has 17 base oil refineries around the world and controls 75 percent of the "merchant" base oils in the market.

ExxonMobil misses the point on page nine of its Application when it asserts that "the result of the merger and these supply contracts will be to keep constant the number of competitors in the market for paraffinic Base Oil......" The issue is not the number of players in the market, but rather the effect of the proposed sale on competition. The sale of the 12 MBD of base oils to Castrol and PQS will lessen competition. ExxonMobil has not met its burden in its Application to prove to the FTC and the public how these proposed base oil supply contracts will maintain a competitive base oil market. On this basis alone, the Application should be rejected.

The Application also should be rejected because ExxonMobil has not evidenced how the proposed base oil supply agreements with Castrol and PQS will have a positive effect on competition. ExxonMobil is selling the 12 MBD of paraffinic base oils to its two largest, historical customers. As noted above, ExxonMobil has effective control over much of Castrol's blending and packaging in the U.S. There is no evidence that either Castrol or PQS will resell any of the base oils purchased from ExxonMobil, especially given current and foreseeable market conditions. Given Castrol's pending acquisition by BP Amoco, there is no reason that Castrol could not export some of its base oils purchased from ExxonMobil.

While discussing refinery capacities for paraffinic base oils and market concentration, it is interesting to note one dynamic which has occurred in the marketplace. Mobil had been a key supplier to independent compounders and blenders, offering pricing discipline to Exxon, the market leader. These Mobil customers, who were not given long-term written, supply contracts by Mobil, typically bought at a discount off of Exxon's posting. Since the merger, these customers have had their prices "harmonized" by ExxonMobil, generally in two steps beginning in March 2000. Some of these customers have approached other base oil suppliers, who have offered to sell them base oils

over a period of years. However, these refiners want to contract for volumes that exceed what most independent lubricant manufacturers normally can take in a given year.

C. ExxonMobil Has Not Effectively Divested Control Of The Base Oils

Because of the redactions made by ExxonMobil in the public record copies of the Application, it is difficult to assess just where the 12 MBD of base oils will be flowing. As noted above, Castrol and PQS are ExxonMobil's two largest, historical base oil customers. The FTC must assess whether Castrol and PQS are indeed purchasing 12 MBD of incremental base oils. Given PQS' closing of the Rouseville refinery and stated intent to leave the Shreveport facility, it is possible that PQS is taking the lion's share of the base oils. This information, however, is not in the public record. It is possible that either or both Castrol and PQS simply have rewritten their existing supply agreements with ExxonMobil into 10-year "take-or-pay" contracts and have not effectively increased their annual volume of base oil purchases. In this case, ExxonMobil effectively has retained control over the 12 MBD of base oils subject to the Decision and Order.

Another factor not available in the public record is the status of the base oils from Valero's Paulsboro, New Jersey refinery. The Decision and Order required Mobil's contract for base oils from this plant to be amended. It is the understanding of ILMA members that, if these base oils were to be made available in the open market, ExxonMobil still controls the loading racks through which the base oils must pass, effectively enabling ExxonMobil to control availability and pricing.

Accordingly, the FTC needs to satisfy itself that ExxonMobil effectively has divested itself of both the "wet" barrels themselves, as well as the ability to control the pricing of these base oils.

D. The Sales To Castrol And PQS Effectively Establish The "Floor" For Base Oil Prices

ILMA believes that a healthy and competitive base oil market will be stifled by the proposed sale of the base oils to Castrol and PQS. The net effect is that ExxonMobil, Castrol and PQS are the largest players in the finished lubricants markets and the contracted base oil prices will establish the "floor" for the rest of the market. ExxonMobil sets the market prices for base oils, and the proposed contracts with Castrol and PQS will increase those prices. ILMA's buying group had effectively offered a "spot" buying price, which traditionally is above a contract price, and the buying group was told by ExxonMobil that its offer on a net-present value basis was probably off of Castrol and PQS' offers by as much as $1 billion. Thus, the floor for base oil pricing has to rise. Then, under Exxon's historical pricing model, one would assume that Castrol and PQS' final buying price would then be adjusted below that market posting. This is not pro-competitive.

E. ExxonMobil Is Sqeezing Competitors In The Finished Lubricants Market

At the same time ExxonMobil is seeking the Commission's approval of its Castrol and PQS deals, it is flexing its newly acquired market power by squeezing the independent lubricant manufacturers between high base-oil prices and steady finished-lubricant prices. Since the Mobil deal, ExxonMobil has significantly raised base-oil prices to independent lubricant manufacturers (approximately 60 cents per gallon). ExxonMobil, however, has passed along substantially lower increases to its distributors or company-controlled outlets (approximately 20 cents per gallon). (Attachment 2). By exercising its control over price, ExxonMobil is able to ensure that its distributors and company-owned outlets are able to sell lubricants at well below the price of independently manufactured lubricants. The attached communications from ILMA members bear witness to ExxonMobil's price squeeze. (Attachment 3). Indeed, many ILMA members are

witnessing ExxonMobil distributors or sales people who, in some instances, are selling finished lubricants for less than ExxonMobil sells base oils to independents.

This is not fair and unfettered competition, and it would not be possible were Mobil still a viable base-oil supplier. If independent lubricant manufacturers could still turn to Mobil for base-oil supplies, Exxon would have had to think twice before dramatically raising base-oil prices. In the event of such a price hike, independents previously could have turned to Mobil for base-oil supplies. ILMA fears that without an independent Mobil, ExxonMobil is free to squeeze many of independent lubricant manufacturers out of business. ILMA also suspects that as soon as ExxonMobil succeeds in eliminating competition from the independents, the price of finished products will be "harmonized" with the price of base oils.

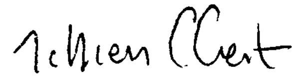
At a minimum, the Commission should consider the fairness of allowing ExxonMobil to make internal base-oil transfers at prices well below market price. ILMA believes that the Decision and Order should be modified to prevent such discriminatory below-market internal transfers.

V. The FTC Should Disapprove The Proposed Base Oil Agreements

Based upon the foregoing, ILMA urges the FTC to disapprove ExxonMobil's Application. It does not satisfy the remedial objectives of the Decision and Order. Moreover, ExxonMobil has not met its burden to demonstrate that a competitive base oil market will be maintained for independent compounders and blenders. If approved, the base oil supply contracts will adversely affect a competitive base oil market for independent lubricant manufacturers.

ILMA is prepared to assist the FTC with additional information necessary to evaluate ExxonMobil's Application.

Respectfully submitted,



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ATTACHMENT 1

This Is Why You

Like a big man wearing a shirt that's one size too small, the lubricants industry is feeling mighty uncomfortable. "It's snug," agree major and independent blenders alike. All are concerned about tightness in base oil supply, and wondering how to secure the barrels they need to make finished lubricants.

They're right to be worried. By all accounts, 2000 has marked a tipping point for base oils. After nearly three years of oversupply, base oil—life's blood for the industry—is in tight supply overall, and particularly short in certain grades such as bright stock. Every barrel in the U.S. seems to be buttoned down tight. Prices, which traditionally shift in tiny increments, rose sharply in the first quarter of the year, and are sticking hard.

Nine months ago, the picture was quite different. Base oil supplies were flush, and excess capacity held prices down. Refiners scraped by on paper-thin margins (or even lost money) and expected more of the same. Then, several things happened.

The most critical event was crude oil prices. They bounded upward, cracking the $30 mark in February before easing off to about $26 per barrel as this issue goes to press. As feedstocks like vacuum gas oil rose in cost, naturally so did base oil prices.

"Since April 1999, we've had base oil increases of nearly 50 cents a gallon," reports a Midwestern lubricant manufacturer. "Additive prices are being affected too, since so much of them are petroleum-based," points out another.

The biggest single increase came in mid-March, with ExxonMobil leading the way with base oil price hikes ranging from 9 to 13 cents per gallon. Other suppliers quickly followed suit.

Second, base oil manufacturing capacity has been shrinking. In September, Equilon closed its 5,000-barrel-per-day base oil plant at Wood River Ill.; it sold the fuels refinery there last month to Tosco. Soon after the year began, Pennzoil sold its 4,400 b/d Rouseville, Pa., base oil plant to Calumet Lubricants, which promptly ended base oil refining there and swung production to white oils and other specialties.

Several other base oil plants, meanwhile, were off-line temporarily: Equilon's Deer Park, Texas, plant underwent a scheduled "turnaround" which took almost six weeks to complete; it came back on stream in early April. Sun Company's 9,200 b/d Yabucoa, P.R., facility also completed a turnaround. And Pennzoil's Shreveport, La., facility was out of service during part of February because of a fire.

The above events, suggests one major base oil seller, unexpectedly coincided with an uptick in lube demand, as the U.S. economy hummed along and Asia-Pacific began to recover. Together, these facts piled up and weighted the scales. It's now a seller's market, and signs are that it will remain so through the end of the year.

That Uncertain Feeling

According to more than one buyer, the uncertainty in the market is more worrisome than the price increases. Base oil sellers used to lay a bid on the table and be willing to hold that price for a few weeks or even months. Today, a price that isn't accepted immediately can expire quickly—by the end of the day sometimes. "Prices are 'subject to change without notice,' and we're not seeing the creative things like price escalators, de-escalators, and protections in the contract that used to be there for both sides," says the president of one old-line independent.

Still, this lube blender isn't surprised. "It's a last effort to make back money

Your

By Lisa Tocci

the refiners have lost over the past 10 years," he feels. The crude oil price spike let the refiners move prices up, and they won't go back down very easily, he surmises.

Several base oil refiners agreed, insisting that after three particularly rough years, they must make reasonable profits. Says one Houston-based seller, "Every commodity goes through a cycle; you might have two, three or four up years, and then it changes again. In 1987, for example, Chevron brought RLOP [its Richmond Lube Oil Plant] on stream, and things turned down as that capacity took a while to absorb. Then, Excel Paralubes came on stream in 1996-97, and we've seen three down years again. 1999 saw the worst refining margins in base oils and fuels in 20 years." It's time now, he and others argued, for investments to be recouped and refinery margins to become healthy.

Several refiners say their production slates have been stymied by the delay of GF-3, the next generation of passenger car motor oils. It was to have been balloted and approved already, but has slipped far behind schedule. "With quality requirements today, motor oil sellers can't just take any base oil and plug it in. There are additive and base oil restrictions," notes a major motor oil brander. He believes some brief easing of base oil supply and pricing may be felt next season, but it won't last long, once demand for GF-3 quality oils hits.

Until then, refiners who retooled to meet GF-3 base oil requirements, and buyers who want to finalize their formulations and lock in base oil contracts, are on freeze-frame. ExxonMobil's new Raffinate HydroConversion project at Baytown, Texas, for example, is poised to begin pumping out GF-3 quality base oil — but sits idle now. The RHC unit was up and running in November, but taken back down to wait — and wait — for GF-3 oils to be needed. It probably will be back on stream later this year, a source says, when its customers need to make GF-3 quality products.

Take It or Leave It Some experienced blender/compounders take a more pragmatic view of the current snugness. Barrels of base oil are not in

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Motiva's Deer Park Facility

Turnaround

Every base oil plant regularly undergoes a "turnaround," a scheduled maintenance and inspection. The plant comes offstream for a period that can last weeks or even months while the refinery makes process changes, upgrades and repairs equipment, installs fresh catalyst or "debottlenecks."

As the year began, U.S. base oil capacity stood at 224,000 barrels per day, but not every plant is on stream every day. Two major plants, Equilon's Deer Park, Texas, and Sun's Yabucoa, P.R., had turnarounds earlier this year. Soon, even more are expected. "They could take a bad situation and make it worse," warns one lube maker in the Midwest.

Chevron's 14,000 b/d Richmond, Calif., Lube Oil Plant (known as "RLOP") is expected to be offstream for at least 28 days during October.

Excel Paralubes, the 21,500 b/d Conoco-Pennzoil joint venture, has a 28-30 day turnaround scheduled for all of October, in conjunction with its fuel refinery turnaround.

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short supply, they told *Lubes'n'Greases*, they're merely expensive. It's attitude adjustment time, says one, for buyers who are used to bargain hunting.

Base oils buyers, like any others, can be divided into two camps. In one camp are those who need specific base stocks and value the security of term contracts.

In the other you'll find the risk-takers, those who like to haggle and play the field. "When the market is in balance and there's no surplus to sell onto the spot market, then it's tough for this guy," says one source. "If the market is significantly oversupplied, his philosophy looks good. But now he may be scratching his head and rethinking that philosophy, because he may not find the barrels he needs when the market is in tight supply."

Said one West Coast base oil sales executive: "I just had one customer who got really mad and said he absolutely wouldn't pay our price and would buy elsewhere. He checked and found he couldn't do any better, though. Ten minutes later, he called me back and said very sweetly he'd take the offer at that price. I don't rub anyone's nose in it, but after what the past years have been like it's sure nice for a change not to be getting beat up on price all the time, to be able to say, 'That's what it costs — take it or leave it.'"

That scene is playing elsewhere, as one Houston supplier found: "I quoted a price to one customer, who flat out turned it down. When they called back two weeks later, to say they'd accept it, I had to tell them 'no,' that offer wasn't good anymore. They'd turned it down and so I'd placed those barrels elsewhere. I was sorry to disappoint them, but I couldn't help it.

"You have to manage these relationships through good times and bad, so I don't gloat over it," this base oil manager added sympathetically. "Most people are good to deal with, but 10 to 20 percent of the independent blender-compounders will wreak havoc to get a penny out of you. Now they've got to realize that things have changed, and their expectations have to change dramatically, too." ∎

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(A catalyst changeout may also take place at this showplace Group II/III plant.)

Motiva's Port Arthur, Texas, base oil plant is going down on Nov. 7, and will not come back on stream until March 1, 2001, as it completes its transformation into a Group II base oil refiner. When it comes back, it will be with enlarged capacity and two separate lube trains, giving it enormous flexibility.

And in nearby Ontario, Canada, giant Petro-Canada will be in turnaround from late May to mid-June, a spokesman says. Its finished base oil capacity is 15,000 b/d of Group II and III quality.

In all, estimates one base oil seller, the market will be short some 3 million barrels of base oil by year end.

In the run-up before the turnarounds, each base oil producer can be expected to fill its reserve tanks and hoard up surplus barrels. "We're putting product in the tank now," reports one base oil supplier. "We can't wait too long, because all our supply is under contract." Customers who have contracts for supply can thus be assured of getting what they need while the plant is offstream. But non-contract barrels will be tight both before and during the actual turnaround, as each supplier hedges to ensure his contract obligations are met.

Refiners not in turnaround also will try to build inventories — if they can. The choice is whether to sell barrels now, or gamble that margins will be even more rewarding in the fall, should shortages pinch even harder.

One bright spot: a source at ExxonMobil says it has decided to delay its planned turnaround at Beaumont, Texas, until after the end of the year, if possible. This means the 12,000 b/d plant will be taken down early next year — instead of coinciding with the other turnarounds.

Said the ExxonMobil source, "There was a period there for the past few years where overall refining margins were not very attractive. So now we're running our plants as hard as we can run them." ExxonMobil base oil barrels are only sold on term contracts, not as spot barrels, and the company is adamant about meeting those contract obligations.

In addition to watching the total number of barrels that are being taken out of service, base oil buyers also are scrutinizing the types of base oils being affected. When Motiva brings back its Port Arthur plant next year, for example, its days of making Group I quality base oil will be over. It will be devoted to making high-value Group II base oils, as demanded by the newest generation of passenger car motor oils. The plant will no longer make bright stock, either, and that particular heavyweight base stock — which has been very tight since Equilon's Wood River, Ill., plant closed — will be in shorter supply than ever.

Finally, three other base oil refineries bear watching:

Ergon Inc. is increasing lube oil capacity this year to 4,300 b/d at its Newell, W.Va., refinery.

Pennzoil's Shreveport, La., 8,600 b/d solvent-refined base oil plant is on the auction block, as the company backs out of refining.

Marathon-Ashland Petroleum's 8,500 b/d plant in Catlettsburg, Ky., expects to see its base oil capacity drop 8 percent later this year when it starts cranking out base stocks suitable for making GF-3 motor oils. —*Lisa Tocci*

ATTACHMENT 2

5

EXXON COMPANY, U.S.A.
POST OFFICE BOX 2180 • HOUSTON, TEXAS 77252-2180

December 6, 1999

As you may be aware, Exxon Corporation and Mobil Corporation recently announced the completion of their merger. The new Exxon Mobil Corporation is committed to being the world's premier petroleum and petrochemical company, combining the best attributes of two already successful companies.

One result of the merger was the creation of a dedicated Lubricants & Petroleum Specialties Company within Exxon Mobil Corporation to serve our worldwide business. We are the market leader in finished lubricants and basestocks and are totally focused on meeting the needs of our distributors. We have the products, services, technology and market coverage to serve you even better.

We will retain and grow the Exxon, Mobil and Esso brands. Distributors will play a key role in that growth.

There will be no changes in the products we provide you or in the way you order and receive products, and you will continue to receive the same level of support from our sales and customer service personnel. We will continue to honor our commitments under existing contracts. Maintaining our high standards of service to you is a top priority. In the future, as we implement changes to serve you better, we will keep you informed.

We are very excited about the merger and the launch of our new Lubricants & Petroleum Specialties Company. You will be hearing more about ExxonMobil and our new Lubricants & Petroleum Specialties Company in the weeks and months ahead.

Sincerely,

6851 East Marginal Way South
Seattle, WA 98108
(206) 682-8427
fax: (206) 762-7203
email: shultz@shultzdist.com

March 22, 2000

Dear Valued Customer,

On behalf of Shultz Distributing, Inc., the ExxonMobil Company and our staff, we would like to thank you for your continued support and the business partnership you have included our company and our alliances in.

The petroleum industry continues to witness many changes. Prices of crude have risen more than 300% since last year at this time, and the effects we all see at the gas pump today. Base stock costs have risen sharply as well in the past year. Most major oil companies have already begun the implementation of a second or third price increase, as these market costs are directly affected.

ExxonMobil had announced a $.12 per gallon price increase nationwide last September. Together with ExxonMobil, we were able to defer this to the first quarter of the year. The last letter sent out referred to a price increase on some package goods, but none on the majorities of fast-moving products. We now must pass on the above increase, effective April 5, 2000. This is only reflective of the price increase we received last September. There have been two other increases implemented nationwide by ExxonMobil, but through extensive negotiations, and ExxonMobil's desire to continue building market share, we were able to avoid the current increases at this time.

We are all aware of the pressures pushing oil prices upward, and both ExxonMobil and Shultz Distributing, Inc. are committed to continuing to apply as much downward pressure as possible to keep prices current. But in this very volatile market, crude oil prices drive the cost of finished products and that market has no ceiling.

Your territory manager will contact you on the affected changes and will try to help you manage your purchases and inventory to further reduce the immediate effect of the price increase.

Again, on behalf of ExxonMobil and Shultz Distributing, Inc., we thank you for your continued support and loyalty. We appreciate your business and the opportunities you have afforded us.

Vince McBroom
President
Shultz Distributing, Inc.

Martin H. Smith
Vice President, Sales and Marketing
Shultz Distributing, Inc.

THE SWITCH IS ON . . . EXXON

ATTACHMENT 3

May 31, 2000

Mr. Richard Ekfelt
Independent Lubricant Manufacturers Association
651 South Washington St.
Alexandria, Virginia 22314

Dear Dick:

It is very difficult to understand why the FTC would approve the ExxonMobil proposal for base oil supply agreements with Castrol North America, Inc. and PQS for 12,000 barrels per day of paraffinic base oils.

This move by Castrol and PQS for the ten-year supply agreements, will in essence, enable PQS and Castrol to manipulate the pricing by taking it out of the hands of many independents and putting it in the hands of Castrol/PQS. Allowing these two and ExxonMobil to control base oil pricing will be counterproductive, and in my opinion, would not be a competitive situation.

Should the FTC really want to keep the competitive nature of the base oil price intact, they need to mandate that ExxonMobil sell this oil, or at least offer it, to a consortium such as ILMA or any other large group of independent marketers. This would get it out of the hands of the big players and keep some semblance of competition in our markets; thereby minimizing the chance for price fixing.

We have already seen instances in the Midwest where Mobil jobbers have voiced their concern over the fact that Mobil has raised finished lubricant pricing to the wholesaler/jobber, but not to certain direct Mobil national accounts. The reasoning behind this is fairly obvious, in that Mobil and the major oil companies control so much business, they can already manipulate pricing without consequence.

In closing, I think it is fairly obvious that by letting consolidations of the big oil companies continue, you are going to see escalating prices. I have yet to ever see the synergies of all these large mergers produce cheaper pricing for the independent or the consumer. Please let me know if you ever see this phenomenon occur.

Also, Dick, as we discussed on the phone, should this letter be revealed with our name on it, it would cause irreparable damage, as we would probably be targeted by one of the oil companies. I trust that you receive this letter in confidence.

Sincerely,

President

June 5, 2000

Mr Dick Ekfelt
Independent Lubricant Manufacturers Association
651 S. Washington St
Alexandria, VA 22314

Dear Mr Ekfelt:

Please relay my comments to the FTC regarding the ExxonMobil request to supply Pennzoil-Quaker State and Castrol 12,000 barrels per day of paraffinic base oil.

This agreement, if approved, will undoubtedly have lasting detrimental consequences for the American consumer.

Pennzoil has recently closed its Rouseville, PA, refinery and is trying to sell its Shreveport, LA, refinery. Castrol's parent company, BP-Amoco, has closed its Whiting, IN, refinery. These refinery closings have triggered a significant shortage of base oils and are keeping the supply chain tight and prices high in spite of recent crude oil price stabilization. In fact, many refineries are already telling their smaller, independent customers that they are "sold out."

As major oil companies merge, exit the refining business, and become each other's customers, competition will inevitably decease and prices will increase proportionately.

FTC approval of this venture would allow ExxonMobil to neutralize its two biggest competitors, Pennzoil and Castrol, by entering into a predetermined price fixing vendor-customer relationship, while at the same time strangling competition from the smaller independents by cutting off the supply of base oil. All of this will be at the expense of the American consumer.

Is this what the FTC had in mind when it approved the Exxon-Mobil merger? Did the FTC foresee a series of refinery closings? Did the FTC envision a severe shortage of base oils? Could the FTC possibly have imagined an Exxon controlled cartel encompassing the likes of Mobil, Pennzoil, Quaker State, Amoco, British Petroleum and Castrol?

Please do not approve this base oil supply agreement. There is no way that this is in the best interest of the American people.

Please contact me if you would like to discuss this further.

Sincerely

JUNE 8, 2000

RE: EXXONMOBIL

TO WHOM IT MAY CONCERN:

I JUST WANTED TO EXPRESS MY CONCERN OVER THE PROPOSED BASE OIL SUPPLY CONTRACT EXXONMOBIL HAS SLATED FOR PQS AND CASTROL. I AM STILL BAFFLED OVER HOW EASY THE TWO LARGEST OIL COMPANIES IN THE WORLD WERE ALLOWED TO MERGE WITH SUCH EASE. SOMEONE FROM EXXON HAD TOLD ME THAT THE FTC WAS AFRAID TO CHALLENGE THE MIGHTY EXXON AND THEIR DEEP POCKETS.

THE PROPOSED 12 MBD AGREEMENT IS GREAT FOR THE TWO BID-WINNING COMPANIES AND POTENTIALLY DISATROUS FOR EVERYONE ELSE. HOW DO WE KNOW THAT THE SUPPLY OF BASE OILS WILL NOT DRASTICALLY SHRINK FOR ALL OF US, THUS LEADING TO HIGHER PRICES AND/OR NO OIL AVAILABLE FOR US? EXXON SATISFIED THE FTC CONDITION BY DOING WHAT WAS EASIEST FOR THEM INSTEAD OF WHAT WOULD BE THE MOST EQUITABLE, GIVING THE ILMA CONSORTIUM THE FIRST OPTION TO BUY THE OIL. NOW CASTROL IS BEING ACQUIRED BY BP/AMOCO/ARCO AND THE FTC IS THUS PROTECTING THE TWO BIGGEST OIL ENTITIES IN THE WORLD. THE SUPPLY CHAIN WILL BE TOTALLY WARPED WITH TWO MONSTER OIL COMPANIES THAT CAN PUT ANY OR ALL OF THE ILMA MEMBERS OUT OF BUSINESS WITH UNFAIR COMPETITIVE ADVANTAGES. IT SEEMS ONCE AGAIN THE SMALL OIL COMPANIES WILL BE LEFT UNPROTECTED AND THE BIG OIL COMPANIES CAN DO WHATEVER THEY WANT BECAUSE OF THE LACK OF CONVICTION BY THE FTC.

TWO OF OUR MOST FORMIDABLE COMPETITORS ARE CASTROL INDUSTRIAL AND THE LOCAL MOBIL DISTRIBUTOR. WE FEEL WE WOULD BE AT A HUGE COMPETITIVE DISADVANTAGE WITH BOTH COMPANIES. CASTROL WOULD HAVE A TREMENDOUS ADVANTAGE AGAINST US WITH SUBSTANTIALLY LOWER BASE OIL COSTS AND WHAT WOULD STOP EXXONMOBIL FROM PROTECTING THEIR EXPANSIVE DISTRIBUTOR NETWORK AND ONLY PASSING ALONG PRICE INCREASES TO THE SMALLER OIL COMPANIES LIKE OURSELVES?

THANK YOU FOR HEARING OUR INPUT.

YOURS TRULY,

Fax

To:	ILMA	From:	
Fax:	703-836-8503	Pages:	
Phone:	703-684-5574	Date:	
Re:	Exxon/Mobil FTC Approval	CC:	

● Comments:

ILMA HQ,

I am compelled to respond to your fax soliciting the membership's view of Exxon/Mobil requesting the FTC to approve base oil supply agreements with Castrol, N. A., and PQS.

It is really no big surprise that these two existing Exxon base oil customers are declared to be the customers of choice by Exxon/Mobil.

If the FTC approves Exxon's request that BP/Amoco/Castrol and Pennzoil/Quaker State be approved as customers of the 12,000 MBD it would appear counterproductive to the interest and spirit of the FTC mandate. The intention was to "maintain a competitive base oil market for independent compounder blenders." I do not personally view either company as an independent but rather a Major marketer and therefore believe this deal only rearranges/formalizes previously existing supply agreements and does not carry out the real objective of the FTC mandate.

This supply agreement, if approved, will keep the tight supply picture very sound and could lead to additional increases in base oil pricing that will directly drive independent compounder/blender costs even higher.

It is already apparent all base oil price increases have not been passed through by Exxon/Mobil on finished product prices by looking on the Wal-Mart shelves. Mobil Super has increased $.20/gallon in the last year when base oils have increased by over $.60/gallon.

Regards,