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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

FEDERAL TRADE COMMISSION, 600 Pennsylvania Ave., N.W. Washington, D.C. 20580	
Plaintiff,	[Public Version]
vs.	
BP AMOCO, PLC, Brittanic House, 1 Finsbury Circus London EC2M 7BA, England	Civil No. ______
and	Date: February 4, 2000
ATLANTIC RICHFIELD COMPANY, 333 S. Hope Street Los Angeles, California 90071	
Defendants.	

POINTS AND AUTHORITIES IN SUPPORT OF FEDERAL TRADE COMMISSION MOTION FOR A PRELIMINARY INJUNCTION PURSUANT TO SECTION 13(b) OF THE FEDERAL TRADE COMMISSION ACT

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Preliminary Statement

BP Amoco plc ("BP"), the largest producer and seller of Alaska North Slope crude oil ("ANS crude"), today exercises demonstrable market power – "the power to control prices or exclude competition"[1] – in the sale of crude oil to refineries in California, Hawaii and Washington. BP proposes to acquire Atlantic Richfield Co. ("ARCO"), the firm most likely to constrain BP's exercise of market power. BP and ARCO were the pioneers in developing the North Slope, and today are the two most important oil companies operating there. They account for more than half of the ANS crude discovered over the last decade, and currently produce more than 70% of all ANS crude; they are the only two operators of ANS oil fields; they each own more proven ANS reserves than any other oil company; they have the largest leaseholds of exploration and production acres, and have drilled the largest number of exploration wells on the North Slope; and, individually, each has won more exploration tracts than any other company in the last decade.

The impact of this merger will be felt in Alaska, where competition to find and develop new sources of ANS crude will be lost; on the West Coast, where the merger will shore up BP's efforts to maintain higher crude oil prices; and in crude oil futures trading on the New York Mercantile Exchange ("NYMEX"). BP's acquisition of ARCO is likely "substantially to lessen competition [and] tend to create a monopoly," Clayton Act § 7, 15 U.S.C. § 18, and must be enjoined. Plaintiff, the Federal Trade Commission ("FTC" or "Commission"), seeks a preliminary injunction, under FTC Act § 13(b), 15 U.S.C. § 53(b), enjoining this merger pending adjudication by the Commission.

The relevant inquiry under the Clayton Act is whether the transaction will give the merged firm market power, alone or in conjunction with competitors.[2] Courts usually have to predict

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[1] *U.S. v. Grinnell Corp.*, 384 U.S. 563, 571 (1966) (*quoting U.S. v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956)). *See also Forsyth v. Humana, Inc.*, 114 F.3d 1467, 1475 (9th Cir. 1997).

[2] *See e.g.,* 1992 U.S. Dept. of Justice and Federal Trade Commission Horizontal Merger

(continued...)

1 whether the merger will create market power by drawing inferences from the market shares of the
2 merging firms and their competitors.[3] This court need not rely upon a prediction because BP
3 *already* exercises significant market power. This merger will eliminate the greatest threat to the
4 perpetuation of that power.[4]
5 BP today exercises significant market power over the sale of crude oil to West Coast
6 refiners that it has identified as vulnerable to noncompetitive pricing. A 1999 BP presentation to
7 its own managers aptly summarizes BP's strategy toward the West Coast refineries:[5]
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9 [
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17 [2](...continued)
18 Guidelines § 0.1 (hereinafter, "Merger Guidelines"), *reprinted in* 4 Trade Reg. Rep. (CCH)
¶ 13,104 (April 2, 1992; as amended, April 8, 1997)("unifying theme of the Guidelines is that
19 mergers should not be permitted to create or enhance market power or to facilitate its exercise.")

20 [3]*See, e.g., California v. American Stores Co.,* 872 F.2d 837, 841 (9th Cir. 1989), *rev'd on*
21 *other grounds,* 495 U.S. 271 (1990); *FTC v. Warner Communications, Inc.,* 742 F.2d 1156,
1162-63 (9th Cir. 1984).
22
23 [4]*See, e.g., United States v. El Paso Natural Gas Co.,* 376 U.S. 651, 661-62 (1964); *FTC*
v. Staples, Inc, 970 F. Supp. 1066, 1082-83 (D.D.C. 1997) ("direct evidence shows that
24 eliminating Staples' most significant, and in many markets only, rival, this merger would allow
Staples to increase prices or otherwise maintain prices at an anti-competitive level").
25
26 [5]Spot price is the amount paid for an individual sale of crude oil, while term contract sales
are pre-arranged sales of a specified quantity to be delivered over time. PX 54 at 14-15. [
27] PX 54 at 245-50; PX 206 at 1-2; PX 288 at 1.
In BP's terminology, [ ] translate into higher ANS prices. [ ] translate
28 into lower ANS prices. PX 206 at 1; PX 54 at 93-94.

]

Unless enjoined, this proposed merger would fortify BP's already dominant position by eliminating the firm most likely to challenge or constrain BP. ARCO is a substantial competitive force in Alaska and on the West Coast in the exploration, production, transportation, and sale of ANS crude oil.[6] ARCO was responsible for the discovery of the North Slope's vast reserves in the late 1960s. Today ARCO produces over 30% of ANS crude oil, controls 22% of the Trans-Alaska Pipeline System ("TAPS"), and is second only to BP in the marine tonnage used to ship ANS crude to the West Coast.

ARCO's presence at all levels of ANS crude exploration, production and transportation operates as a restraint on BP's prices to refiners on the West Coast.[7] ARCO's expansion (but for this merger) could lead to lower ANS crude oil prices in the near future. ARCO's production of ANS crude oil available to West Coast refiners will increase this year, when ARCO commences production at its new Alpine field, which is expected to give ARCO an additional 62 thousand barrels a day ("MBD") by 2001.

This merger would also eliminate competition between the two most important rivals for oil and gas exploration leases on the North Slope. Diminished competition will slow the pace of exploration and development of new oil fields, and reduce revenues to the owners of those properties, Alaska and the Federal Government. No longer will ARCO's vigorous competition hold the promise of increased crude supply.

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[6]ANS crude oil moves from producing fields on the North Slope to "Pump Station 1" at the northern end of the TAPS pipeline. From there, TAPS transports the ANS crude oil south to Valdez, Alaska, an ice-free port, for tanker shipment.

[7]Although ARCO currently consumes most of its ANS crude production at its refineries, it plays a small but significant role in merchant sales. PX 272 at 1; PX 285 at 1-2; PX 401 at 1 [

]. Even at its relatively small current position, [
] PX 274 at 1. For example, [
] PX 270 at 1; PX 287 at 2.

Other firms cannot replace ARCO as a competitor because BP and ARCO have substantial and unique advantages. They own the [ ] proprietary seismic and well data, are the only two operators of producing acreage, and together control the crude processing infrastructure and more than 70% of the transportation facilities on the North Slope. Those assets give BP and ARCO information and cost advantages that deter competitors from bidding aggressively.

The defendants' track records reflect these advantages. BP and ARCO, collectively, won more than [ ]% of the auctioned state tracts (measured in dollars) over the last decade and more than 70% of the tracts in the May 5, 1999, Federal lease sale in the National Petroleum Reserve – Alaska ("NPRA"). PX 110 at 10, 21. The failure of other major oil companies (*e.g.,* Shell, Amerada Hess, and Conoco), reflects the difficulty of competing against BP and ARCO. *See, e.g.*, PX 142, ¶ 13 [ ]; PX 157, ¶ 14. Their exit also serves as a cautionary tale for any firm that believes that it can compete against the merged firm.

BP also is a major oil trader. The merger would increase its ability to manipulate oil futures markets by enlarging its control of crude oil pipeline and storage facilities into and in Cushing, Oklahoma. NYMEX, the largest futures market in crude oil, trades futures contracts for crude oil delivered at Cushing. BP's substantial control over the Cushing crude oil infrastructure would increase its ability to monitor and control the supply of crude oil that can be delivered to satisfy NYMEX contracts, and thus manipulate NYMEX futures trading in crude oil.

The FTC seeks a preliminary injunction to prevent BP from acquiring ARCO pending FTC plenary adjudication of the transaction. The public interest requires that the Court act now, before the transaction closes and unwinding it is not practical. If the merger is not preliminarily enjoined, and the FTC or a reviewing court should subsequently determine that the merger is unlawful, appropriate relief will be difficult or impossible and competition will have been harmed for a substantial period.

Recognizing the considerable competitive concerns raised by this merger, BP and ARCO have attempted to fashion a separate peace with the Governor of Alaska through a "Charter for

Development" (the "Charter"). The Charter itself acknowledges Alaska's belief that the merger will reduce competition. Alaska chose the Charter as its compromise. The FTC and the West Coast states have not, and those states have commenced their own lawsuits challenging the merger.[8] The Charter has serious substantive and procedural disabilities. It utterly fails to provide a remedy for the West Coast refiners targeted by BP's exercise of market power, and does not purport to do so. As Alaska's Commissioner of Natural Resources acknowledged: "[T]o be frank, we aren't totally aligned with California on this issue. They'd like lower oil prices, we like higher oil prices."[9] Even if the divestitures contemplated by the Charter were fully implemented, BP would significantly increase its dominant position in each of the markets addressed by this motion.

ARGUMENT

I. BP's ACQUISITION OF ARCO VIOLATES § 7 OF THE CLAYTON ACT BECAUSE IT MAY SUBSTANTIALLY LESSEN COMPETITION IN SEVERAL MARKETS

The FTC is entitled to a preliminary injunction "upon a proper showing that, weighing the equities and considering the FTC's likelihood of ultimate success, such action would be in the public interest." 15 U.S.C. § 53. Under this "public interest" standard, this Court "must 1) determine the likelihood that the Commission will ultimately succeed on the merits and 2) balance the equities." *FTC v. Warner Communications,* 742 F.2d 1156, 1160 (9th Cir. 1984). The FTC satisfies its burden if it "'raise[s] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.'" *Id.* at 1162 (quoting *FTC v. National Tea Co.*, 603 F.2d 694, 698 (8th Cir. 1979)).

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[8]The FTC submits that these actions should be consolidated.

[9]Reuters, "Alaska won't push BP for more oil divestitures," Dec. 1, 1999, <http:\\www.biz.yahoo.com/rf/991201/6f7.html>. The State of Alaska benefits from high West Coast ANS prices, which is the basis for the calculation of severance taxes and royalties paid to the State. PX 427 at 8; PX 113 at 2, 4. The higher the ANS price to West Coast refiners, the better it is for Alaska.

A court's role in evaluating the Commission's likelihood of success on the merits "is not to make a final determination on whether the proposed merger violates Section 7, but rather to make a preliminary assessment of the merger's impact on competition." *Warner Communications,* 742 F.2d at 1162. Section 7 of the Clayton Act is intended to arrest anticompetitive mergers "in their incipiency" and, accordingly, requires a prediction of the merger's likely impact on future competition. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 362 (1963). Because the statute requires a forward-looking assessment, certainty is not required.

The central question under Section 7 is whether a merger is likely to create or enhance market power. BP *already* exercises market power here. Where a firm exercises market power, the acquisition of a significant rival may enhance that power and reduce the chances that it would be undermined. Thus, the courts have held that where a firm with market power acquires its most significant present and future competitor, "the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great." *Philadelphia Nat'l Bank*, 374 U.S. at 365 n. 42. *Accord Staples,* 970 F. Supp. at 1082-83. In such markets, competition depends on firms like ARCO with the potential and incentive to constrain the dominance of market leaders like BP.

A. The Merger is Likely to Lessen Competition Substantially in the Production and sale of Crude Oil to Targeted Refineries on the West Coast.

1. BP Exercises Market Power Today.

The ultimate objective of a merger inquiry is to determine whether, after the merger, the merged firm will be able to exercise market power, *i.e.*, raise prices or restrict output.[10] As this Circuit has held:

> a plaintiff may demonstrate market power either by direct evidence or by circumstantial evidence. *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1434 (9th Cir.), *cert. denied*, 116 S. Ct. 515 (1995). Direct proof of market power may be shown by evidence of restricted output and supracompetitive prices. *Id.* Such a showing is "direct proof of the injury to competition which a competitor with market power may inflict, and thus, of the actual exercise of market

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[10]*See U.S. v. Grinnell Corp.*, 384 U.S. 563, 571 (1966); *U.S. v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956); *Hospital Corp. of America v. FTC,* 807 F.2d 1381, 1387 (7th Cir. 1986); *Warner Communications,* 742 F.2d at 1162-63.

power." *Id.*

Forsyth, 114 F.3d at 1475. Direct proof of market power, not available in most cases, is readily evident here – in BP's price discrimination among buyers of ANS, and in its shipments to Asia intended to increase price on the West Coast. Given this direct evidence, "[t]he more common type of proof . . . circumstantial evidence," *i.e.*, defining markets and measuring shares is not strictly necessary.[11] *See Rebel Oil Co.,* 51 F.3d at 1434 (9th Cir. 1995) (a group of sales over which sellers have market power constitutes a market).

Most broadly defined, the market affected by BP's acquisition of ARCO is the production and sale of crude oil to targeted refineries on the West Coast.[12] Two facts constitute direct evidence of BP's market power in this market: (1) BP already engages in systematic and pervasive price discrimination among its targeted customers; and (2) BP elevates overall ANS crude oil prices on the West Coast through strategic exports to Asia.[13]

A refinery operates most efficiently with a particular "slate" of crude oil. Many West Coast refineries rely upon ANS crude oil for a substantial portion of their supply. PX 235 at 5-6. Other crude oils differ significantly from ANS in key characteristics, including gravity, sulfur content, metals content and pour point. PX 54 at 39-43. These characteristics affect the products that can be made from the crude oil, the equipment needed to refine it, and the costs of doing so. *Id.* Accordingly, refiners will not switch to other crude oil, even at the margin, until the price differential reaches [ ] "trigger point" – the point at which running the last

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[11] *See also* Baker, "Product Differentiation Through Space and Time: Some Antitrust Policy Issues," 42 ANTITRUST BULL. 177, 185 (1997).

[12] The relevant market could be defined narrowly as the production and sale of ANS crude oil. "Sale" includes internal transfers within vertically integrated producers and refiners. Each of the factors that compels the conclusion that crude oil sold to targeted refiners is a relevant market also supports the ANS crude oil market. Since the merger has demonstrable anticompetitive effects even in the broader market, it is not necessary to define a narrower "ANS crude oil" market.

[13] *E.g.*, PX 201 at 3, 11 [
]

1 barrel of ANS crude oil is no more profitable than running a different crude oil given that refiner's
2 equipment and product slate. Trigger points for ANS differ from refinery to refinery. PX 54 at
3 68-70, 199-202; PX 214 at 4; *see also* PX 236 at 1.
4 BP [
5], the highest ANS price it could seek before the refinery would turn to
6 another source of crude oil. PX 54 at 68-70. BP generally [
7
8] PX 201 at 3, 9-10. BP then [
9]
10 exactly how much ANS crude oil to ship to Asia in order to tighten supplies and increase spot
11 prices on the West Coast, and thereby to maximize its aggregate profits from ANS sales:
12 [
13
14
15].
16 To control the disposition of ANS crude oil, and to discriminate among refineries with
17 such precision, BP sells nearly all ANS crude on a "delivered" basis. PX 209 at 7 [
18]. BP
19 ships crude oil from Alaska to the West Coast in its tankers and delivers it to the refinery's
20 storage tanks.
21 BP's ability to price discriminate, *i.e.*, to target specific refineries for supracompetitive
22 prices, is the foundation for defining a product market composed of sales to those customers.[14]
23 BP itself recognizes that its practice of delivered distribution and price discrimination
24 distinguishes sales to West Coast refiners from a so-called "global market."
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[14]*See Merger Guidelines* § 1.12; *Eastman Kodak Co. v. Image Technical Servs., Inc.,* 504 U.S. 451, 475-77 (1992) (price discrimination in sales of parts to different classes of customers supports separate market for sales to customers facing discrimination); P. Areeda & H. Hovenkamp, IIA ANTITRUST LAW ¶ 534d, at 183-85 (1995).

[

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PX 203 at 4. [ ] ANS crude oil is insulated from full competition from alternative crude oils.

Absent price discrimination, BP [

]. The fact that BP has already raised the price of ANS crude above a "competitive" price to targeted refineries sufficiently establishes a relevant product market of sales to those refineries. As Chief Judge Posner has explained, the ability to price discriminate demonstrates that a firm possesses market power:

> Price discrimination implies market power, that is, the power to charge a price above cost (including in "cost" a profit equal to the cost of equity capital) without losing so much business so fast to competitors that the price is unsustainable. The reason price discrimination implies market power is that assuming the lower of the discriminatory prices covers cost, the higher must exceed cost.[15]

BP [ ] firms up prices on the West Coast by exporting oil to Asia in order to short supply on the West Coast:

[

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PX 212 at 3. BP exports to Asia at netbacks [ ] per barrel *less* than it could realize on the

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[15] *In re Brand Name Prescription Drugs Antitrust Litigation*, 186 F.3d 781, 786 (7th Cir. 1999) ("manufacturers of brand name prescriptions engage in price discrimination, showing that they have market power"). *See also Coal Exporters Ass'n v. United States*, 745 F.2d 76, 91 (D.C. Cir. 1984) ("the ability of a firm to price discriminate is an indicator of significant market power"); *Transamerica Computer Corp. v. IBM,* 481 F. Supp. 965, 977 (N.D. Cal. 1979) (monopoly power indicated when firm is a "price maker" and can "set price according to utility to the customer"); H. Hovenkamp, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE 130 (1994) ("the presence of persistent price discrimination is pretty good evidence that a seller has market power in the high priced markets."); F. Scherer & D. Ross, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 489 (3d ed. 1990).

1 West Coast spot price. PX 207 at 5.[16] BP has systematically shipped ANS crude oil to customers
2 outside the West Coast not because those sales themselves were profit-maximizing, but to [
3] on the West Coast:
4 [
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6
7
8][17]
9 If BP did not have market power over its crude sales, BP's exports would not make economic
10 sense. BP would simply lose money as its customers switched to alternative crudes. The fact that
11 BP finds it profitable to export ANS crude to boost West Coast prices is proof that the relevant
12 market is not world-wide – imports are not able to defeat BP's export strategy.
13 BP also takes it upon itself to mop up "excess" supplies of ANS [
14
15] [18]
16 In sum, BP's market power is amply demonstrated by its pattern of systematic and
17 successful price discrimination against targeted West Coast refiners and its exports of ANS crude
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[16]*See also* PX 211 at 1 [
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[17]PX 221 at 2. When authorizing the construction of the TAPS, Congress banned the export of ANS. In 1996, Congress removed that ban. PX 417 at 16.

[18]PX 426 at 1-3; PX 250 at 2; PX 54 at 253; PX 269 at 1 [
]; *id.* [
] In 1997, BP purchased a total of [ ] barrels (the equivalent of [ ] MBD) of ANS from ARCO. PX 234 at 11-24. *See also* PX 263 [
]

to Asia, at lower netbacks, to maintain tight supplies on the West Coast. Here we have "[d]irect proof of market power" as described by the Ninth Circuit in *Forsyth v. Humana,* 114 F.3d at 1475: price discrimination directed at targeted refiners, and a restriction of supply on the West Coast in order to elevate price.[19]

2. BP's Acquisition of ARCO Will Eliminate the Firm Most Likely To Constrain BP's Exercise of Market Power

ARCO is the firm most likely to limit BP's exercise of market power. ARCO is BP's most aggressive competitor in bidding for, finding and producing oil in Alaska. ARCO sells ANS crude oil to other refiners from time to time and can disrupt BP's pricing. BP's acquisition of such a close competitor is likely substantially to reduce competition.[20]

BP and ARCO today have sharply divergent interests and incentives. PX 159 at 8; PX 131 at 3. BP ships ANS crude to Asia to short the West Coast market and elevate prices. ARCO, as an integrated refiner that normally uses more ANS in its refineries than it produces in Alaska, has an incentive to lower its crude costs by finding and producing new oil. And it has been successful. In 1994, ARCO found oil at Alpine, on the North Slope, the second largest discovery in Alaska in 12 years. PX 107-3. That field, which will begin producing oil this year, is expected to produce 80 MBD by 2001, PX 409, and increase ARCO's net production by [ ] MBD by 2004.[21] The additional supply on the West Coast would tend to put downward pressure on pricing.

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[19]*See also Re/Max Int'l, Inc. v. Realty One, Inc.,* 173 F.3d 995, 1017-21 (6th Cir. 1999) ("[A]n antititrust plaintiff is not required to rely on indirect evidence of a defendant's monopoly power (such as high market share within a defined market) where there is direct evidence that the defendant has actually set prices or excluded competition"); *Staples,* 970 F. Supp. 1082-83.

[20]*See FTC v. Staples*, 970 F. Supp. at 1082-83 ("the merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market, a factor which is certainly an important consideration when analyzing potential anticompetitive effects").

[21]PX 417 at 12. Estimates for 2001 and beyond show Alpine production at 80 MBD; ARCO owns 78% of this field (62.4 MBD), PX 33. The [ ] MBD net production figure takes into account declining production from ARCO's other fields, mainly Prudhoe Bay and Kuparuk. PX 417 at 12.

ARCO also can constrain BP's market power by increasing the supply of ANS crude available to targeted refineries by selling them ANS crude. In the past, ARCO has purchased some foreign crude at a favorable price to run in its refineries, and then sold ANS crude to other refiners on the West Coast. PX 401 at 1; PX 448 at 1. ARCO recently [ ][22] ARCO [ ] could sell [ ] MBD of ANS to BP's customers and substitute other oil – something other refiners cannot do because they do not have ANS production, infrastructure and transportation.[23] That [ ] MBD, together with ARCO's [ ] MBD of increased ANS production, would increase total crude oil available to targeted refineries by almost five percent – and vastly exceed the amount that BP has been exporting to Asia to tighten the West Coast market.[24]

This merger will eliminate these constraints on BP's market power. ARCO's spot market sales will be fully under BP's control. BP would have an incentive to use [ ] to manage ANS supplies on the West Coast to keep the market tight. It could choose to use ANS crude oil in ARCO's refineries instead of imported crude, and keep that much ANS crude off the open market, just as it exports ANS crude to Asia to maintain a tight West Coast market. By also eliminating its most aggressive competitor for oil and gas leases on the

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[22]PX 404 at 1. Before it agreed to merge with BP, ARCO [ ], including [ ] PX 298 at 2. ARCO [ ] when BP and ARCO agreed to merge. PX 77 at 93-94.

[23]ARCO also purchases ANS crude oil from independent producers that lack tanker capacity, (PX 401 at 1; PX 77 at 45-46), enabling it to resell that crude oil to other refiners. ARCO makes relatively small sales to refiners that lowers the spot market price and the prices under BP's term contracts (which are tied to the spot market price). PX 206 at 1. BP, on the other hand, [ ] purchase ARCO's excess crude, to keep ANS prices up. PX 269 at 1. ARCO has an incentive to reduce spot market prices because doing so will reduce severance taxes it pays to Alaska on all of its ANS crude production. PX 265 at 1; PX 289 at 1. Although BP must also pay taxes, it realizes enhanced profitability from higher spot market prices because its dominant role in selling ANS crude to West Coast refiners. PX 427 at 7-8.

[24]PX 211 at 3-4; PX 223 at 1; PX 224 at 1. ARCO's ability to substitute imported oil for ANS constrains BP, whether or not the substitution is actually made. PX 275 at 1.

North Slope, BP could simply leave the oil in the ground.

No other firm in Alaska today, or likely to enter in the future, can match ARCO's abilities or incentives. Exxon [ ] PX 108 at 4; PX 159 at 6 [ ]. Others have been leaving Alaska for a decade. PX 52 at 38-40 (Texaco, Amerada Hess, Conoco, Shell exiting). No other firm has the experience or assets in Alaska that BP and ARCO have.[25] BP and ARCO currently account for 67% of all State exploration acreage on the North Slope, PX 159 at 6, and more than 70% of all North Slope acreage (including production, exploration, State and Federal land), PX 110 at 25, most of the proven reserves, PX 108 at 3, and 74% of the barrels produced, PX 419 at 1-2; PX 420 at 2-3. After the merger, BP would be the only operator on the North Slope.

3. Entry by New Producers or Expansion by Current Producers Would Be Unlikely to Occur in a Timely or Sufficient Manner to Prevent the Anticompetitive Effects of the Acquisition.

Entry into the production and sale of ANS crude oil, or other crude oil to targeted refiners is unlikely to occur in a timely or sufficient manner to prevent BP from exercising its already significant market power.[26] Entry has not constrained BP's exercise of market power to date. Defendants admit that entry into Alaska production would take [ ] years. PX 413 at 3. Many major oil companies, including Shell, Amerada Hess, and Conoco, have tried and failed to succeed on the North Slope. PX 52 at 38-40; PX 156 ¶ 12. Given the difficulty of entry and

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[25]BP and ARCO own [ ] proprietary seismic and well data, which are essential in evaluating new properties. PX 112 at 1; *see also* PX 103 at 1; PX 126 at 7; PX 128 at 9; PX 129 at 1; PX 71 at 59. They are the only two operators of producing acreage, PX 159 at 9, which is a major advantage in further exploration and development efforts in the area. PX 142 ¶ 13; PX 52 at 45. They control most of the infrastructure necessary to produce ANS crude oil. *See* PX 159 at 5 (BP and ARCO have a majority interest in producing fields and infrastructure); PX 131 at 3 [ ].

[26]To defeat or deter the anticompetitive effects of an acquisition, entry must be likely to occur within two years, and at a sufficient scale to constrain the anticompetitive impact of the merger. *See FTC v. Cardinal Health, Inc.,* 12 F. Supp.2d 34, 55-58 (D.D.C. 1998); *United States v. United Tote, Inc.*, 768 F. Supp. 1064, 1071-80 (D. Del. 1991); *Merger Guidelines* § *3.*

expansion in Alaska, it is not surprising that the two early leaders of development and production on the North Slope -- BP and ARCO -- are the only firms with a significant presence over thirty years later. This is clearly the type of market "which requires onerous front-end investments that . . . deter competition from all but the hardiest and most financially secure investors." *See United States v. Syufy*, 903 F.2d 659, 667 (9th Cir. 1990).

Nor is it likely that producers of other crude oil will begin supplying West Coast refineries in a manner that would constrain BP's ability to exercise market power. The most compelling evidence that other producers would not enter is that they have not entered: although BP has been exercising market power against targeted refineries for at least five years, new entrants have not prevented BP from doing so.[27] When BP raised prices relative to WTI[28] by approximately $1 per barrel in 1995, other producers of other crudes did not prevent BP from doing so or restore BP's prices to pre-1995 levels.

B. BP's Acquisition of ARCO is Likely to Lessen Competition Substantially in Bidding for ANS Exploration Leases.

The merger will eliminate competition between the two most significant firms bidding for oil and gas leases on the North Slope. For over 30 years, fierce rivalry between these two firms has spurred active exploration and development on the North Slope. Their merger is likely not only to reduce the amount of money received in future lease sales, to the detriment of the State of Alaska and the Federal Government, but (as described above) also threatens to reduce long-term exploration, development and production on the North Slope. PX 157 (U.S. Department of Interior concerned about merger); PX 154 ¶¶ 4, 5 (State of Alaska concerned about lack of North Slope competition and entry barriers); PX 118 at 1 (Alaska Governor Knowles concerned about merger).

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[27]Entry into California crude oil production is likewise unlikely. PX 446 at 4.

[28]WTI is the principal pricing benchmark throughout the petroleum industry in the United States. PX 309 at 1.

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1. BP's Acquisition of ARCO Would Eliminate BP's Most Aggressive Bidding Competitor.

The State of Alaska and the Federal Government own mineral resources on the Alaska North Slope and offshore Alaska's north coast. These governments exploit these resources by auctioning exploration leases to oil companies. For these government owners of natural resources, who would be injured by the loss of competition, the relevant product market is exploration leases, and the relevant geographic market is where the resources are – the Alaska North Slope and offshore waters.[29] "The exercise of market power by buyers ("monopsony power") has adverse effects comparable to those associated with the exercise of market power by sellers." *Merger Guidelines* § 0.1.[30] In this case, BP's acquisition of ARCO may substantially lessen competition in the bidding for oil leases on the North Slope of Alaska.

The merger would combine the two most significant competitors on the North Slope. As described above, they own or control all exploration, development and production assets, and they won over 60% of all state lease auctions over the last decade (by dollar value). The top four firms (premerger) won 75%. PX 110 at 10.[31] BP's acquisition of ARCO would increase

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[29]A relevant market can be defined based on bidding for purchases among competing buyers. *See City of Long Beach v. Standard Oil Co.*, 872 F.2d 1401, 1405 (9th Cir. 1989) (reversing summary judgment for oil companies on an antitrust claim alleging they had agreed to depress prices paid for oil to the City of Long Beach and the State of California); *Reid Bros. Logging Co. v. Ketchikan Pulp Co.*, 699 F.2d 1292, 1296-99 (9th Cir. 1982) (affirming a lower court's verdict finding a Sherman Act violation in agreement to depress timber price paid to loggers).

[30] *See, e.g. Vogel v. American Soc'y of Appraisers,* 744 F.2d 598, 601 (7th Cir. 1984) ("[M]onopoly and monopsony are symmetrical distortions of competition from an economic standpoint"); *Addamax Corp. v. Open Software Foundation, Inc.,* 888 F. Supp. 274, 280 n.9 (D. Mass. 1995) (monopsony is the mirror image of monopoly).

[31]Courts have used value of winning bids to measure concentration in bid markets. *See, e.g., FTC v. PPG Industries, Inc.,* 798 F.2d 1500, 1504-05 (D.C. Cir. 1986) (bid market for aircraft transparencies); *Langenderfer, Inc. v. S.E. Johnson Co.,* 917 F.2d 1413, 1442-1443 (6th Cir. 1990) (bid market for road construction materials).

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concentration by over 1700 HHI[32] points to a post-merger level of over 3900. Similar market shares and concentration levels on the buyers' side have led courts to find clear violations of Section 7 of the Clayton Act.[33]

The parties' own documents confirm that BP and ARCO are the only significant competitors. ARCO sees the competition with BP[ ] PX 137 at 9. BP views ARCO as [ ] on the North Slope. [ ] PX 106 at 2; PX 103 at 1 [ ]. Other firms, including even those still producing on the North Slope (such as Exxon, Mobil, Marathon, Unocal, Conoco, Texaco, and Amerada Hess), have exited bidding. PX 120 at 1.

2. Entry by New Developers and Expansion by Current Producers Would Not Be Sufficient, Timely or Likely to Prevent the Anticompetitive Effects of the Acquisition.

Entry into bidding will not be timely, likely or sufficient to undermine the anticompetitive effects of this acquisition. [ ] five percent decrease in the price of exploration leases would not encourage a firm to enter. PX 122 at 1. Preparation for bidding competition takes at least three years. PX 156 ¶ 8 [ ]; PX 141 ¶ 8 ([ ]). After 30 years in Alaska, BP and ARCO have three advantages that new bidders would need to overcome in order to be as significant in bidding as is ARCO: information, infrastructure

[32]The HHI is calculated by squaring the market share of each competing firm and summing the results. The Merger Guidelines define a market with an HHI between 1000 and 1800 as moderately concentrated and one with an HHI of more than 1800 as highly concentrated. Mergers that produce an increase in the HHI of more than 100 in a moderately concentrated market or more than 50 points in a highly concentrated market potentially raise significant competitive concerns. *Merger Guidelines,* Section 1.51.

[33]*See United States v. Rice Growers Ass'n,* 1986-2 Trade Cas. (CCH) ¶ 67,288, at 61,465 (E.D. Cal. 1986) (post-merger firm would have controlled 61% of purchases and top four firms had accounted for 98% of purchases in most recent year); *United States v. Pennzoil Co.,* 252 F. Supp. 962, 982 (W.D. Pa. 1966) (post-merger firm would control 54%; top three firms controlled 77% of refining capacity and 85% of oil production).

1 and interest:

2 – *Information.* BP and ARCO would have [ ] proprietary

3 three-dimensional seismic data, *see* n. 27 *supra*, which is critical to understand the geology

4 and thereby estimate the value of lease properties. PX 52 at 71, 77; PX 71 at 13, 59; *see*

5 n. 27 *supra*. They also have [ ] interpreting Alaska's oil

6 resources. PX 52 at 78; PX 71 at 52. The merger will raise the entry barrier even further

7 by widening the knowledge gap between the merged company and other bidders.

8 – *Infrastructure.* As the only operators and largest owners of oil interests in

9 Alaska, BP and ARCO control the production infrastructure (*e.g.,* equipment, roads,

10 facilities), *see* n. 27 *supra*, control the terms on which potential bidders would have access

11 to that infrastructure, (PX 154 ¶¶ 5-6; PX 141 ¶ 16; PX 142 ¶¶ 19, 22), and thereby deter

12 new entry and expansion by existing firms.

13 – *Interest.* Alaska is remote and highly regulated, compared to other exploration

14 venues (such as the Gulf of Mexico). Firms seeking to invest exploration dollars in new

15 areas will see higher costs relative to the likelihood of discovering substantial oil reserves

16 in Alaska than in other opportunities. *See* PX 154 ¶ 5; PX 142 ¶¶ 19, 21-22; PX 141 ¶ 7,

17 14-16; PX 156 ¶ 13.

18 Lacking these assets, other firms that have not explored in Alaska are unlikely to do so in the

19 future.

20 **C. The Merger Would Significantly Increase BP's Ability to Manipulate the**
Price of WTI Crude Oil Futures.

21

22 The NYMEX light, sweet crude oil futures contract is the world's most actively traded

23 futures contract of any physical commodity and one of the most important markets serving the

24 petroleum industry. PX 309 at 1; PX 306 ¶ 6. Because of its liquidity and price transparency, the

25 NYMEX light, sweet crude oil contract and its underlying commodity, WTI crude oil, is a

26 principal pricing benchmark throughout the petroleum industry in the United States and the

27 world. PX 309 at 1; PX 306 ¶ 6. [

28] PX 310 at 3. The existence of a highly liquid futures market in

crude oil makes it easier (and thus less costly) for oil companies to negotiate and price crude oil transactions. *See* PX 306 ¶ 12. Should that futures market become subject to manipulation, these benefits would be lost – increasing transaction costs throughout the industry.[34]

This merger presents that danger – that BP, as a result of this merger, would be increasingly able to manipulate the price of NYMEX crude oil futures. The merger would give BP greater control of the crude oil transportation and storage infrastructure in Cushing, Oklahoma, which underpins the NYMEX futures contract. PX 301 at 7; PX 309 at 1; PX 307 ¶ 11. [ ] and BP's previous acquisition of Amoco at the end of 1998 gave it control at that time of one of the major pipelines into Cushing[35] and [ ]% of the terminal storage at Cushing. PX 319 at 4. This merger would give BP control of the Seaway Pipeline, the only route by which imported crude oil can reach Cushing, ARCO's in-line transfer business at Cushing, and additional storage.

After the merger, BP would have increased strength to manipulate the WTI futures market. PX 306 ¶ 13; PX 307 ¶ 14.[36] Futures markets are tied to physical commodity markets by the obligation to take (or make) delivery of the physical commodity by the expiration of the contract month. *See* PX 307 ¶ 11. The NYMEX light, sweet crude oil futures contract thus requires the parties to make and take delivery of WTI crude oil in Cushing by the expiration of the contract. PX 301 at 7. However, nearly all futures contracts are closed by acquiring an offsetting

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[34]Manipulation makes prices less informative and increases the volatility of futures prices thereby distorting consumption and production decisions and reducing the hedging effectiveness of a futures contract. *See* S. Pirrong, *THE ECONOMICS, LAW, AND PUBLIC POLICY OF MARKET POWER MANIPULATION* 125, 132 (1996). Section 3 of the Commodity Exchange Act, 7 U.S.C. § 5, states that "the transactions and prices of commodities on such boards of trade are susceptible to excessive speculation and can be manipulated, controlled, cornered or squeezed to the detriment of the producer or the consumer and the persons handling commodities and the products and byproducts thereof in interstate commerce."

[35]The Amoco Pipeline system transports up to 200 MBD of crude oil from East and West Texas into Cushing. PX 302 at 3.

[36]In 1998, BP was fined by the International Petroleum Exchange for manipulation of the Brent crude oil futures. PX 325 at 1.

position rather than by actual delivery,[37] and indeed the volume of trading in NYMEX crude oil futures vastly exceeds the amount of WTI crude oil available in Cushing to make delivery. PX 307 ¶ 11.[38]

This fact creates the opportunity for a squeeze. Futures markets can be manipulated by a "squeeze" when a trader acquires a large long position in expiring futures contracts, exceeding the physical supply of oil available for delivery. PX 303 at 2; PX 50 at 53, 61a, 61b.[39] By holding an open position rather than liquidating it, the long firm drives up the costs for holders of short positions, since there is insufficient deliverable crude to satisfy the outstanding contracts. PX 303 at 2. The large long trader then profits when he sells his remaining futures contracts at the higher price. [

] PX 311 at 2. The change in supply of a relatively small number of barrels can affect the price of WTI. PX 318 at 2.[40]

BP's increased control of the infrastructure used to deliver crude oil to Cushing increases its ability to manipulate crude oil futures, by giving BP greater information about the current and future amount of WTI available in Cushing, and greater control over the amount of WTI that

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[37]Participants in the crude oil futures market are either speculating on oil prices generally, or seeking to hedge their own crude oil production or needs elsewhere in the world. PX 307 ¶ 11; see PX 328 at 3.

[38]For example, on February 2, 2000, the "open interest," representing outstanding futures contracts on the March contract was 133 million barrels. Wall Street Journal, Feb. 2, 2000, at C-20. BP's estimate of deliverable pipeline supply plus storage is approximately [ ] million barrels of crude oil. See PX 302 at 6; PX 319 at 8; PX 330 at 2.

[39]The seller of a futures contract is called a "short," obligating the seller to make delivery in the specified month; the buyer is called a "long," obligating the buyer to receive delivery. PX 301 at 8, 9; PX 310 at 6, 8.

[40]Under CFTC and NYMEX rules, traders are not able to take a sufficiently large long position to affect a squeeze. see PX 328 at 4; see PX 306 ¶ 11. BP, however, is able to take large positions in the ordinary course of its petroleum business, because [

] PX 50 at 56, 57; PX 306 ¶ 11; PX 319 at 4.

reaches Cushing. PX 306 ¶ 11; PX 307 ¶¶ 14, 17. This merger would give BP control of significant new facilities and access to nonpublic information about the WTI supply handled by those facilities – in particular, the Seaway and Basin pipelines;[41] and ARCO's Cushing in-line transfer business.[42] BP would know more than others about the amount of WTI likely to be available in Cushing for delivery, and therefore would be better able to know when and how hard to squeeze the market.[43]

ARCO operates, and owns 50% of, Seaway Pipeline, which transports up to 350 MBD of crude oil, including foreign crude oil, into Cushing from the Gulf Coast. PX 302 at 3; PX 306 ¶ 10; PX 307 ¶ 9. Because domestic onshore crude oil production is rapidly declining, the incremental barrel of oil needed to satisfy the NYMEX contract will be foreign oil. PX 307 ¶ 9. As an ARCO employee explained to a NYMEX official, foreign crude oil is also necessary to maintain liquidity of futures and prevent price squeezes. PX 311 at 4. Therefore, Seaway will increasingly become the primary source of foreign crude oil supply to Cushing. PX 70 at 12; PX 306 ¶ 10.[44]

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[41]ARCO operates Seaway, which requires shippers to nominate the amount of capacity they want to use up to 90 days in advance. PX 70 at 29. As operator, BP would manage the nominations process. PX 312 ¶ 9. BP also would have access to information about shipping volumes and types of oil coming into Cushing on ARCO's share of Basin (approximately 40 MBD). PX 302 at 3.

[42]ARCO's in-line transfer business is a means of transferring title to crude oil in pipeline transit. BP's acquisition of this business would give BP's traders information about the quantity of WTI available in Cushing, and who owns it. PX 307 ¶¶ 15, 18; see PX 70 at 51, 52.

[43][ ] PX 50 at 26, 27. [

] PX 51 at 37.

[44]ARCO also has an approximately [ ] undivided joint interest in the Basin Pipeline (meaning that it controls the marketing of its portion of capacity), which carries crude from West Texas to Cushing at a capacity of 350 MBD. PX 302 at 3. Thus, BP and ARCO have ownership interests in all three of the major pipelines into Cushing. BP currently owns [ ] percent of overall (continued...)

1 After the merger, BP would succeed ARCO as operator of Seaway and continue to
2 operate its own Amoco pipeline system. PX 312 ¶ 7; see PX 302 at 3. As operator, BP would
3 have discretion to control all aspects of the everyday business of the pipeline, including decisions
4 that affect the availability of capacity to ship crude to Cushing and the timing and scheduling of
5 these shipments.[45] PX 312 ¶¶ 7, 9; PX 51 at 8.
6 Storage tanks holding crude oil are also a source of supply of crude oil for delivery against
7 the NYMEX futures contract. BP is currently the largest single owner of tank storage at Cushing
8 with [ ] percent of total capacity, and ARCO owns about [ ]. PX 302 at 6. BP would have a
9 post-acquisition share of 42.2% of a highly concentrated market, and the top 4 firms would have
10 92.4%. Concentration in tank capacity, would increase by 220 HHI points, in a highly
11 concentrated market to a post-acquisition HHI of 3128.
12 Effective entry would require building new pipelines and tanks to address the potential
13 bottleneck at each level of the transportation infrastructure into and in Cushing. Apart from the
14 doubtful incentive to undertake the enormous cost of constructing such facilities, the time
15 required to construct pipelines, including obtaining the necessary permitting, would be
16 considerably longer than the two-year benchmark of the *Merger Guidelines*. PX 304 ¶¶ 2, 3, 4.
17 Thus, entry is highly unlikely to prevent competitive harm.
18 Thus, BP's increased control of pipeline and storage delivery capacity at Cushing would
19 increase BP's ability to manipulate prices in the crude oil futures market, increasing the cost of
20 using the NYMEX futures contract to hedge against adverse crude oil price movements, and
21
22 [44](...continued)
23 pipeline capacity into Cushing, and ARCO currently owns [ ] percent. After the merger, BP
24 would own 37.3 percent of pipeline capacity into Cushing. BP and ARCO currently operate the
25 Amoco and Seaway pipelines, respectively. After the merger, BP would operate pipelines that
account for 48.7 percent of total capacity into Cushing.

26 [45]A pipeline operator's responsibilities include scheduling of crude oil shipments; electing
27 when to use or not use drag reducing agents (DRAs), which increase capacity by up to 10%;
deciding on the timing of pipeline maintenance, which can also affect the pipeline's capacity; and
28 determining the amount of pipeline capacity to be allocated whenever the volume of requested
shipments exceeds pipeline capacity. PX 312 ¶¶ 8-11; PX 51 at 8, 15, 16, 18, 19.

impairing the functioning of this crucial market and its benefits to the petroleum industry.[46]

D. Defendants' Asserted Efficiencies Cannot Save This Transaction

The defendants asserted before the Commission that the proposed acquisition would result in significant efficiencies, but did not provide information sufficient to allow the Commission to verify these claims. The Supreme Court has stated that "possible economies cannot be used as a defense to illegality" in Section 7 merger cases. *FTC v. Procter & Gamble*, 386 U.S. 568, 580 (1967). *See also Philadelphia Nat'l Bank*, 374 U.S. at 371. Other courts nevertheless have held that in appropriate circumstances, a defendant can rebut the presumption that a merger "would substantially lessen competition" by proving "substantial efficiencies that benefit competition and, hence consumers," *FTC v. University Health, Inc.*, 938 F.2d 1206,1222 (11th Cir. 1991), just as the antitrust agencies consider pro-competitive efficiencies in evaluating a merger's likely competitive effect. *Merger Guidelines* § 4.0, at 18-20. All courts agree that the ultimate issue under Section 7 is whether a proposed merger is likely to lessen competition substantially in any line of commerce in any section of the country. If a merger would have such an impact, proven efficiencies, "however great, will not insulate the merger from a Section 7 challenge." *University Health*, 938 F.2d at 1222 n.29.

II. THE COURT SHOULD GRANT A PRELIMINARY INJUNCTION AGAINST BP'S ACQUISITION OF ARCO BECAUSE THE FTC IS REASONABLY LIKELY TO SUCCEED ON THE MERITS AND AN INJUNCTION IS IN THE PUBLIC INTEREST

Where, as here, the Commission has demonstrated a likelihood of success on the merits, it is entitled to a preliminary injunction to preserve the Commission's ability to adjudicate the merits and order proper relief. The courts recognize the strong public interest in effective enforcement of the antitrust laws and in preservation of competition while a transaction that poses a significant competitive threat is analyzed in detail. *E.g., Warner Communications*, 742 F.2d at 1165. Although private equities may be considered in the balance, courts "must afford such concerns

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[46]A recent DOJ consent agreement involving the merger of two large grain traders reflects similar concerns. *See U.S. v. Cargill, Inc.*, C.A. No. 99CV01875 (D.D.C. 1999).

little weight, lest [they] undermine section 13(b)'s purpose of protecting the 'public-at-large, rather than individual private competitors.'" *University Health,* 938 F.2d at 1225 (*quoting National Tea Co.*, 603 F.2d at 697 n.4). *See also Warner Communications*, 742 F.2d at 1165 ("private equities alone do not outweigh the Commission's showing of likelihood of success").

Potentially illegal acquisitions must be enjoined because a combined operation can seldom be reconstituted as separate, viable entities after the acquisition is consummated. As the Ninth Circuit has held, "denial of a preliminary injunction would preclude effective relief if the Commission ultimately prevails" in a full trial. *Warner Communications*, 742 F.2d at 1165.[47] A merger that threatens to reduce competition also should be enjoined to prevent the interim harm to competition that would result even if a suitable divestiture remedy could be devised. "Later remedies cannot remove retroactively the harm that has already occurred. Courts should, therefore, prohibit consummation of a merger pursuant to Section 13(b) where serious questions are raised about its legality."[48]

The parties' efforts to resolve the concerns of the State of Alaska through the Charter should in no way affect the Court's analysis or the Commission's ability to obtain a preliminary injunction from the Court.[49] As the Supreme Court stated long ago, the very words of Section 7 suggest that competition is best protected by restoring the merger parties to their premerger status as independent competitors. *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S.

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[47] *See also Marathon Oil Co. v. Mobil Corp.,* 530 F. Supp. 315, 320 (N.D. Ohio 1981) ("no satisfactory method exists that would restore Marathon to its present competitive position in the marketplace. The disruption of a business the size of Marathon cannot be ignored even in light of the remedy of divestiture").

[48] *FTC v. Bass Bros. Enters.*, 1984-1 Trade Cas. (CCH) ¶ 66,041 at 68,622 (N.D. Ohio 1984).

[49] *Consolidated Gold Fields, PLC v. Anglo American Corp.,* 698 F. Supp. 487, 502 (S.D.N.Y. 1988) (defendants' "announced intention" or promise to divest certain properties after the takeover "should properly be accorded no weight in a preliminary injunction hearing"), *aff'd in part and rev'd in part on other grounds,* 871 F.2d 252 (2d Cir. 1989); *Chemetron Corp. v. Crane Co.*, 1977-2 Trade Cas. (CCH) ¶ 61,717, at 72,930 (N.D. Ill. 1977) (settlement offer of divestiture properly considered "only if it appears that the divested business will continue as an independent entity whose competitive position in the newly structured market is comparable to or better than its predivestiture position").

316, 329 (1961) (holding that "the undoing of the acquisition is a natural remedy"). The Charter proposes a divestiture of only half the assets giving rise to competitive problems, and permits BP to add to its existing dominant share of ANS crude oil supply. The Commission has the statutory right and authority to conduct a plenary review of the transaction and, if appropriate, to order BP not to acquire any part of ARCO in the relevant markets.[50] A preliminary injunction is the proper route to protecting that authority.[51]

CONCLUSION

For the foregoing reasons, the Court should grant the Commission's request for a preliminary injunction.

Respectfully submitted,

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[50]The Commission has been given considerable discretion in crafting remedies for illegal mergers, and such orders are affirmed on appeal when supported by "substantial evidence." *See Olin Corp. v. FTC,* 986 F.2d 1295, 1307 (9th Cir. 1993).

[51]*See California v. American Stores Co.*, 495 U.S. 271, 295-96 (1990) (finding that California may seek more divestitures than FTC had obtained in consent agreement).