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*Comments on the BP Amoco
Proposed Acquisition of Atlantic Richfield*

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**Testimony before
United States Senate
Committee on Energy & Natural Resources**

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COMMENTS ON THE BP AMOCO PROPOSED ACQUISITION OF ATLANTIC RICHFIELD

SUMMARY

The proposed acquisition is almost unique among large, integrated, company mergers since the two companies have virtually no overlap in the areas of refining and marketing, the two business segments that traditionally are scrutinized for effects on competition.¹ ARCO's refining and marketing operations are limited to the U.S. West Coast and adjacent states (PAD V). Its two refineries with a total capacity of 450 thousand barrels a day are both located on the Pacific Ocean. BP Amoco's downstream operations are all east of PAD V. Its 7 refineries, concentrated in the Midwest and the Gulf Coast, have a capacity of nearly 1.5 million barrels a day, equal to 9% of total U.S. refining capacity.

Upstream, BP Amoco produced 380 KB/D in the lower 48 states in 1998 and ARCO 180 KB/D. Together, this amounted to 11% of lower-48 crude production. Including Alaska, their combined U.S. crude and NGL production was about 17% of the U.S. total.

The unique feature of the proposed acquisition is its impact on ownership of oil reserves and production, and the key oil transport system, in one state, *Alaska*. The two companies currently account for about 70% of Alaskan production and 72% of the ownership of the Alyeska pipeline.

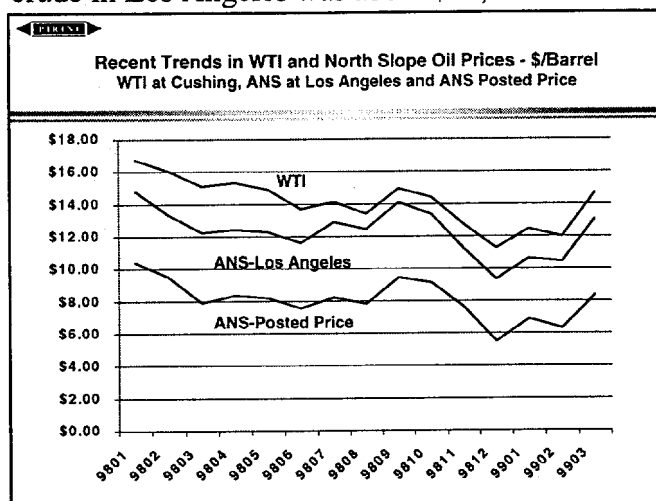
In my testimony, I will focus my remarks on the implications of such a concentration of ownership in that State. As will be shown, this concentration will not cause any negative impact on domestic oil production nor any upward pressure on oil prices. Indeed, the acquisition could lead to relatively higher production by reducing the financial vulnerability of Alaskan production to new rounds of depressed oil prices. Concerns regarding competition in Alaska, and on the West Coast, can be addressed under current law, and, if deemed necessary, by certain transition measures. The acquisition of ARCO will still leave BP Amoco as a major supplier of Alaskan oil to third parties, even if ARCO's two refineries were to run exclusively on Alaskan oil.

ALASKAN OIL IN THE MARKET PLACE

North Slope oil is further away from the major US markets than any other domestic supply source and first has to travel 800 miles by pipeline to the nearest ice-free port at Valdez before it can be moved by ship to market. About 90% goes to the West Coast. North Slope crude is heavy and sells at a discount relative to crudes such as WTI. The net result of distance and quality factors is that the value of the crude at the wellhead is relatively low and profitability relatively more sensitive than most other domestic production to changes in world oil prices. To illustrate this feature of Alaskan production, the chart on the next page shows prices from the

¹ Refining is especially sensitive on the West Coast where capacity is tight and, as was demonstrated earlier this year, the boutique nature of CARB gasoline makes the market difficult and expensive to supply from other sources. However, BP Amoco has no refineries on the West Coast. For a further discussion of California's unique problems, see the recent PIRINC report, Gasoline Price Developments: Once again California Leads the Way, April 1999.

beginning of 1998 through early 1999 for WTI at Cushing, Oklahoma, ANS delivered to Los Angeles, and, the wellhead posted price for ANS crude. At the beginning of 1998, the price of WTI was about \$17/barrel, the price of ANS crude in Los Angeles was about \$15, while the posted wellhead value of ANS crude was about \$10.40. World oil prices reached their most depressed levels toward the end of 1998. At that time, the WTI price averaged about \$11.25, ANS at Los Angeles about \$9.30, while the posted price for ANS fell to only about \$5.50. Of course, prices have recovered since their low point but there is no guarantee they won't fall again in the future. The BP Amoco acquisition of ARCO offers new opportunities to rationalize operations and thereby reduce direct and indirect costs of producing Alaskan oil as well as to achieve economies in other operations. Lower operating costs means reduced financial vulnerability of operating companies to low prices and in that sense, a more secure future for Alaskan oil production.



COMPETITIVE ISSUES IN ALASKA

While financial vulnerability of production would be reduced by the acquisition, there remain potential competitive issues. Anti-competitive behavior could manifest itself in two particular ways, restricting access by others to production opportunities and restricting access in some way to the pipeline. But current law and regulatory power are more than adequate to deal with such concerns.

State law limits the onshore and offshore lease acreage any one company can hold to 500,000 acres each. Since the two companies in combination hold 850,000 acres onshore, they would have to divest acreage to the benefit of competitors. With respect to bidding for new acreage, the acquisition would combine two large producers with extensive experience into one. But the two companies are by no means the only companies holding and winning leases in Alaska. As the State of Alaska's own figures show, companies other than BP Amoco and ARCO, were high bidders on just over 40% of the total North Slope acreage offered in lease sales over the past 10 years. It should also be kept in mind that the winners in any auction are not necessarily the biggest but the most optimistic. As an ultimate safeguard, the State always reserves the right to reject bids.

The regulatory regime in place for the pipeline, as well as economics, protects against competitive risks in this area. The pipeline is a common carrier with published tariffs. The Alaska Pipeline Commission already has statutory authority to...“investigate upon complaint or on its own motion the rates, classifications, regulations, prices, practices and facilities of pipeline carriers”...and to require just, fair and reasonable rates, etc. From an economic standpoint, the main consideration is that the pipeline has plenty of spare capacity. Alaskan production is currently about 1.2 MB/D versus a maximum throughput capability for the pipeline of about 2.14

MB/D. With such spare, which will grow as the production decline continues, it is in the owners' interest to maximize throughput.

CONDITIONS ON THE WEST COAST

The acquisition could have an impact on the placement of Alaskan oil on the West Coast. Currently, the two ARCO refineries (at Los Angeles, California, and Cherry Point, Washington) have crude throughputs of about 450 KBD, or about 100 KBD higher than its North Slope production. BP Amoco has no refineries on the West Coast and thus disposes of its North Slope crude through transactions with third parties. (The third parties could include ARCO). The acquisition would enable the combined company to reduce third party transactions and direct more oil to its own refineries. But since BP Amoco produces about 450 KBD of North Slope crude and the ARCO refineries could shift at most 100 KBD to BP Amoco, the combined company would still remain a significant supplier of North Slope crude to others. Nonetheless, other West Coast refiners who have made investments to run North Slope crude could face problems if they had to suddenly make new arrangements to switch crude sources and quality.

| | |
|-----------------------------------|----------------|
| ARCO Alaska Production | 347 KBD |
| ARCO Refinery Throughput | 450 |
| BP Amoco Alaska Production | 454 |
| <i>All figures for 1998</i> | |

It is not clear just how important this concern might be but the government could guard against it by requiring BP Amoco to offer supply contracts to current purchasers for a limited period to ease any transition problems.²

Overall, the West Coast market for crude---in contrast to refined products---is an open market with a significant and growing share of requirements supplied by imports. The table on the right summarizes recent trends in the PAD V crude oil balance. With production declining in Alaska, the West Coast is drawing on increasing volumes of crude imports to meet requirements. Between 1997 and 1998, net imports rose from 331 to 453 KBD and in the first quarter of this year, reached 512 KBD. Thus the region is turning increasingly to alternatives to Alaska North Slope oil, and in what is a global market with diverse supply possibilities, doing so with no difficulty. Thus, ANS crude, like all U.S. crudes, must be sold

| | <u>1997</u> | <u>1998</u> | <u>1999 Q1</u> |
|---------------|-------------|-------------|----------------|
| Production | 2,228 | 2,104 | 2,039 |
| Refinery Runs | 2,505 | 2,515 | 2,373 |
| Net Imports | 331 | 453 | 512 |

² Although not the subject of this hearing, the EXXON Mobil merger would not raise the same concerns. Both Mobil and Exxon have refineries in California (at Torrance and Benicia respectively.). But the Torrance refinery is designed to process Mobil's own production of very heavy California crude. In 1997, Mobil and Shell combined their California production in a joint venture. Mobil's share of production from the joint venture was 104 KBD, not far below the 130 KBD capacity of the Torrance refinery. Exxon's West Coast production includes Alaska and California and amounted to about 300 thousand barrels a day in 1998, far in excess of the Benicia refinery capacity of 130 KBD.

at competitive world prices to find a market. ANS crude is a price taker, not a price maker. At the U.S. West Coast, which takes 90% of Alaskan oil shipments, it must compete with local production and increasingly with imports from Latin America, the Middle East, and the Far East.

CONCLUSIONS

On balance, the acquisition will have a potentially positive impact on domestic oil prospects. It will lower operating costs while enhancing the capital and technological base supporting production in Alaska, thereby reducing the financial vulnerability of Alaskan current and future production to low oil prices. Current statutes and regulatory authority are sufficient to prevent any anti-competitive concerns. There may be a concern regarding changes in supply patterns for West Coast refineries but the issue can be dealt with by requiring the new company to offer to continue supply arrangements to third parties for a transition period.

POSTSCRIPT ON THE MAIN ISSUE FOR ALASKAN OIL: ANWR

I want to close with a comment on what I believe is the most critical concern regarding Alaskan oil, ANWR. The main policy issue for Alaskan oil is not the merger of its two prime producers but the ongoing decline of its current resource base and the need to reverse or arrest it for the benefit of the country as a whole as well of course as for the State of Alaska.

The U.S. is currently importing about 57% of its crude oil requirements. All forecasts predict an increase in both share and volume over the next decade as domestic demand rises further while domestic production, including Alaska's, keeps falling. The Administration has deemed this trend a threat to our national security but has not proposed any action to alleviate it. However, such action may be possible in Alaska; namely opening the Arctic National Wildlife Refuge (ANWR). For the past 12 years there has been a national debate on whether to open Area 1002 of ANWR. So far, the opponents have won. Yet Area 1002 is estimated to contain enough oil to produce 700,000 to 1,000,000 B/D for several decades before tapering off.

The primary beneficiary of ANWR production would of course be Alaska. But the whole nation would benefit from the ongoing reduction in our oil import requirements.