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MEMORANDUM

TO: JOINT SPECIAL COMMITTEE MEMBERS

**FROM: WILLIAM C. MACLEOD
JOHN B. WILLIAMS
COLLIER, SHANNON, RILL & SCOTT, PLLC**

RE: PROPOSED BP AMOCO/ARCO TRANSACTION

The recent Charter for Development of the Alaskan North Slope ("Charter") describing divestitures and other actions proposed by BP Amoco, ARCO, and Governor Knowles does not resolve the competitive concerns raised by the combination of the two largest integrated oil companies in Alaska. The commitments contained in the charter are so vague that BP Amoco will not be obligated to create meaningful competition. Even if every term in the Charter could be enforced to the maximum benefit of Alaska, the result would be a market that will not perform as well as it does today. As it stands, the Charter is neither in the form or substance of an agreement that meets typical antitrust standards.

1. The Charter Does not Contain Critical Components and Characteristics of FTC Consent Decrees.

The general type of remedies negotiated in the Charter do not meet the standards of remedies that the FTC has accepted in earlier consent decrees involving companies in other oil industry mergers.

1. The Charter Should Either (a) Identify the Assets to be Divested and Entity That Will Buy Them, or (b) Provide the Alaska the Right to Approve the Divestitures and Purchasers.

The typical antitrust order either identifies the precise divestiture transaction or gives the reviewing agency the right to approve potential purchasers of divested assets. The Charter makes

so such provision. Instead, it provides for BP Amoco to divest interest in leases to any company meeting one of two requirements: 1) current interest owners; or, 2) energy companies with minimum asset levels. Whereas the Charter establishes percentages of certain fields that the parties must divest, it fails to identify which portions of those fields BP Amoco would be obligated to sell. Such parameters do not give any confidence that the ultimate purchaser of divested interests will become a viable competitor to BP Amoco. The Charter only allows the state to object to a divestiture plan and would not permit a court to sustain an objection based on the competitive weakness of a proposed buyer.

2. The Charter Should Be An Order of State or Federal Court.

The Federal antitrust agencies do not use contracts to obtain competitive relief. The preferred instrument is a consent order or decree which can be enforced quickly and efficiently if the need arises. Because the Charter is simply an agreement between the parties, the state would have to commence an action de novo, and assume all the burdens of production and proof that any plaintiff must bear. In an enforcement proceeding under an order, the defendant bears a burden to show that it has not failed to comply with the order.

3. The Order Should Be Accompanied by A Complaint

In the typical settlement of an antitrust case, a complaint precedes a consent order or decree. The terms of the complaint are incorporated by reference into the obligations of the order. A court determining whether the terms of the order have been satisfied can inquire whether the defendant has remedied the competitive concerns identified in the complaint. Because there is no complaint attached to charter, the compliance with its terms must be measured entirely against the specificity of the terms themselves.

2. Specific Issues Raised by the Charter.

The competitive concerns in Alaska created by BP Amoco's acquisition of ARCO result from the loss of ARCO as the single most important integrated in-Alaska competitor to BP Amoco. ARCO is integrated in-Alaska in that it: 1) successfully bids for substantial acreage in State and NPRA auctions of exploration and development ("E&D") leases; 2) owns the majority interest in and is the leader of major E&D projects; 3) owns the majority interest in and is the operator of several major production units on the North Slope; 4) owns processing facilities and feeder lines to TAPS on the North Slope; 5) is a large-interest holder in TAPS; 6) operates a major Jones Act tanker fleet to carry its crude oil from Valdez to the West Coast; and, 7) is a major marketer of ANS and other crude oil on the West Coast and in other areas. A divestiture based solution to the competitive concerns created by BP Amoco's acquisition of ARCO would require creation of a new large and aggressive integrated in-Alaska competitor to BP Amoco.

The Charter does not propose a divestiture plan that will create such a large integrated in-Alaska competitor for BP Amoco. Instead, the Charter leaves too much discretion with BP Amoco as to the character of the assets it will divest and selection of the companies it will sell the assets to. At best the Charter creates two weaker companies that will not be able to constrain BP Amoco's resulting market power.

1. Establishment of "Buyer A" Will Not Result in an Effective Integrated In-Alaska Competitor to BP Amoco.

The Charter identifies a large "Buyer A," who would purchase 125,000 barrels per day of the production interests currently held by BP Amoco and ARCO. However, this proposed divestiture is limited and insufficient to ensure adequate competition. Of the 125,000 bpd of production, about 93,000 bpd would originate at Kuparuk. This amounts to just above 40% of Kuparuk's expected year 2001 production, which would mean that BP Amoco would remain the majority interest owner at Kuparuk. BP Amoco would then exclusively determine the source of the remaining 32,000 bpd of production sold to Buyer A, and could allocate those barrels throughout the North Slope.

2. The Charter Does Not Invest Buyer A with Exploration and Development Interests Necessary for It to Become an Effective Integrated In-Alaska Competitor to BP Amoco.

Buyer A will purchase capacity on TAPS and its feeder lines sufficient to allow Buyer A to transport its production to Valdez. But, under the terms of the Charter, BP Amoco need not sell Buyer A anything else (even though BP Amoco has committed to sell both 400,000 net acres of its undeveloped State on-shore leases and 220,000 acres of its NPRA leases). As a result, Buyer A could potentially purchase the 125,000 bpd crude oil production without making the same substantial commitment to exploration and development in Alaska that would result from a buyer also obligated to acquire substantial lease holdings.

3. The Charter Does Not Grant Buyer A with Marine Transportation Interests Necessary for it to Become an Effective Integrated In-Alaska Competitor to BP Amoco.

BP Amoco is not obligated to sell any Jones Act tanker assets to Buyer A that would allow Buyer A to transport its ANS crude oil to the West Coast. The proposed Charter results in Buyer A becoming a minority production interest holder in Kuparuk, and several other production areas, dependent on BP Amoco to provide it with tanker transportation services from Valdez to the West Coast. As such, Buyer A would not be an ARCO-like competitor for BP Amoco.

4. The Establishment of a "Buyer B" both Fails to Create an Effective Integrated In-Alaska Competitor to BP Amoco and Also Further Detracts from the Likelihood that Buyer A Could Become Such a Competitor.

The Charter's proposal to sell enough Alpine production (the Colville River Unit) to give a smaller buyer (Buyer B) a 40% production interest, will not result in a competitive constraint on BP Amoco. In fact, by denying Buyer A the ability to purchase essential production and E&D lease assets, the sale of such assets to a smaller Buyer B could be detrimental to creating a Buyer A that would be an ARCO-like competitor.^{1/} Since BP Amoco has no incentive to divest any more assets than are absolutely necessary to satisfy its contractual obligations, we must assess whether the Charter requires BP Amoco to create an ARCO-like competitor. Neither Buyer A nor Buyer B as described in the Charter seems to qualify.

In general, the divestiture plan proposed in the Charter fails to create a large vertically integrated in-Alaska ARCO-like entity that would assume the role as the primary competitor to BP Amoco. Instead, the Charter would create two smaller producers, Buyer A and Buyer B, who would not be fully vertically-integrated in Alaska. The Charter gives BP Amoco substantial discretion regarding which assets it will sell and to whom. Since it is contrary to BP Amoco's business interest to create a competitor in Alaska that would essentially replace ARCO, BP Amoco would almost surely use its discretion to ensure that an ARCO-like competitor would not result from the sale of divested assets. To do anything more than the Charter requires would be to diminish the market value of BP Amoco.

C. An Effective Consent Decree Should Contain Mechanisms that will Ensure the Establishment of a Large Integrated In-Alaska Competitor to BP Amoco.

An effective divestiture based solution must first identify one or more major oil companies that would want to become an aggressive integrated in-Alaska competitor to BP Amoco. Next, based in part on their existing asset holdings, such candidate companies would need to identify the type and extent of assets that they would need to buy from BP Amoco to allow them to assume an ARCO-like competitive position. The Alaskan assets held today by BP Amoco and ARCO fit together because those holdings have resulted from profit driven business decisions in a competitive

^{1/} BP Amoco has pledged to sell 100,000 acres of the NPRA leases to either Buyer A or to the smaller Buyer B who would be allowed to purchase up to a 40% interest in the production of Alpine. But, as a BP Amoco representative stated in testimony before the Alaskan Legislative Committee, it would make sense for BP Amoco to sell the NPRA acreage to Buyer B.

environment. The purchasers of the divested BP Amoco and ARCO assets must similarly be permitted to assemble assets that fit together.

For divestiture to have a chance at creating a viable ARCO-like competitor the antitrust authority must have the right to approve or disapprove the companies seeking to fill ARCO's shoes. Such approval or disapproval would be based on factors which would include: 1) the current assets of the company; 2) the company's plan to become a large-scale integrated in-Alaska competitor; and, 3) the BP Amoco assets that the company claimed it needed to buy in order to become a large-scale integrated in-Alaska competitor. While the task of identifying potential buyers would remain with BP Amoco, the authority would be able to review the competing bidders and satisfy itself that companies of requisite size, commitment and vision to become a large integrated in-Alaska competitor were properly considered. If Amoco's choice of the winning bidder appeared to be less than satisfactory, it could be assessed against the alternatives that were available.

D. Conclusion

In sum, a viable remedy to the competitive threat posed by the BP Amoco-Arco combination must involve firm commitments by BP Amoco to sell specified assets to a specified buyer that the Alaska has approved as sufficient to present competitive force that Arco provides today. At a minimum, the buyer would have to become a large integrated in-Alaska competitor. The Charter does not accomplish this essential objective. BP Amoco has no incentive to create a more vigorous competitor than the Charter requires. Indeed the company's business interest will be to do nothing more than it is legally required to do. The competition that is lost through this merger is unlikely to be restored via the Charter.

TO: JOINT SPECIAL COMMITTEE ON MERGERS

**FROM: FREDERICK H. BONESS
JOSEPH K. DONHUE**

DATE: November 30, 1999

**SUBJECT: THE LEGISLATURE'S OPTIONS CONCERNING RESPONSE TO THE
GOVERNOR'S PROPOSED CHARTER**

You have asked for a brief memorandum outlining the Legislature's options for further action relating to the Governor's Charter and our thoughts on the relative merits of each option. At the risk of over simplifying a difficult decision, the Legislature has three options.¹ First, the Legislature could endorse the Charter without modification. Second, the Legislature could recommend that the Governor make changes to the Charter. Third, the Legislature could conclude that the Charter does not resolve the basic antitrust problems posed by BP's acquisition of ARCO and recommend to the Governor and others that the Charter be abandoned in favor of the filing of a lawsuit to block the merger. We discuss each option below.

A. Blocking the Merger by Filing Suit

1. Assuming the State Has A Reasonably Strong Antitrust Case, the Results of Blocking the Merger Must be Compared to the Terms of the Charter.

Although all litigation involves uncertainty, it is noteworthy that neither the Administration's in house experts nor its nationally recognized experts on antitrust matters have indicated that the State must settle for the terms set forth in the Charter because they believe the State does not have a strong enough antitrust case to block the merger. If we assume the merger could be preliminarily enjoined by the State, the possible outcomes following the injunction are:

- BP and ARCO may abandon the merger.
- The litigation could result in a settlement agreement.
- The litigation proceeds to judgment and the merger is permanently enjoined.
- The litigation proceeds to judgment and the merger is allowed to occur.

¹ We do not discuss legislative options that the legislature might want to consider to be able to better deal with any future mergers or with the consequences of this merger should it proceed. Such matters could include legislation to better define the Governor and Attorney General's role and power to enter into Charter type agreements in future mergers, the obligations of companies who hold State leases and who seek to merge with other companies holding state leases, right of way renewal legislation and tax policies, among others.

2. The Merger is Abandoned, Enjoined or a Settlement Agreement is Reached.

Kevin Meyers of ARCO recently testified to the Committee that if the merger is blocked, it is likely that ARCO would then be acquired by another company because the management and shareholders of ARCO have determined that the company should be sold. Accepting Mr. Meyers' statements as correct, there are several differences between the Charter and a scenario in which ARCO remains as a separate company. These include:

- A. Any new company acquiring ARCO's assets would be acquiring **all** of ARCO's North Slope assets not just some of them. There would be no need for the State to attempt to recreate a portion of the ARCO holdings and hope that it sufficient to establish an "ARCO-like" competitor on the North Slope.
- B. The acquiring company would be publicly known **before** the acquisition is completed and the Alaskan public would have an opportunity to evaluate the merger based on the stated intentions of the acquiring company. If the acquisition was not viewed as good for Alaska, the State would have an opportunity to oppose the merger based on concerns specific to the known buyer.
- C. In the short run substantially more of ARCO's Alaska's staff and personnel would survive as an operating entity with all of the knowledge and experience that goes with ARCO Alaska as an operating unit. Only BP has as much knowledge about North Slope operations as does ARCO. Thus, of all the potential companies that might acquire ARCO, only BP does not need a fully functional ARCO Alaska.² Any other acquiring company will in the short run want to maintain the experience and knowledge of ARCO's existing employees and operating units.
- D. If the litigation is settled, the State could pursue a reduction in the TAPS tariffs as part of its remedy. Since this was an original term of the conditions set forth by the Governor in August, it seems reasonable to suggest both that the Governor's analysis saw a legal basis for such a remedy, and that in the litigation context the Governor would be able to pursue this objective more successfully. Additionally, settlement of a state antitrust action would require a consent decree between the companies and the State. Unlike the Charter approach, this procedure requires a 60 day public comment period and approval of the settlement by the court.

In short, from the perspective of competition on the North Slope, we believe that the outcome of such litigation will bring about a situation on the North Slope at least as competitive as will the Charter and in all likelihood a more competitive situation.

² We do not mean to suggest that the knowledge and experience of ARCO employees who are not retained by BP will be totally lost if the merger occurs under the terms of the Charter. It seems likely that that any company that acquires assets under the Charter will also seek to hire ARCO employees with knowledge of the assets acquired. However, this necessarily means a breaking of ARCO's staff and its operating units.

3. What would be lost if BP is not allowed to acquire ARCO?

A. The efficiencies BP has identified from a single operator of the Prudhoe Bay field would not be achieved immediately. However, with a saving potential to the Companies somewhere in the range of \$100 million, it is a virtual certainty that the Companies, either on their own or with prodding from DNR, will cause Prudhoe Bay to be operated by a single operator.

B. BP would undoubtedly be unhappy with the outcome but it does not follow that BP would abandon its investments in Alaska or even that BP would not seek to achieve the efficiencies it has identified and that can be achieved by rationalization of the operations on the North Slope through negotiations with ARCO or a company acquiring ARCO's North Slope assets.

4. The Legislature Has Only Limited Ability to Bring About Litigation.

If the Legislature believes that a better result can be achieved for Alaska by blocking the merger, the Legislature could recommend to the Governor that he file suit to oppose the merger, and that he encourage the FTC and others to do likewise. The Legislature itself does not have the authority to take this action on behalf of the State

If the Governor declines to do so, the Legislature could encourage the FTC and others who have standing to file an antitrust suit to block the merger.

B. Charter Modifications

The major adverse consequence in Alaska of BP's acquisition of ARCO is the loss of a vertically integrated oil company that has engaged aggressively in exploration and innovation on the North Slope and BP's increased control over all aspects of exploration, development and transportation of North Slope oil and gas. To ameliorate these impacts, the Charter requires BP to divest assets with the hope that the purchasers of the divested assets will be able to assume the role once filled by ARCO in the areas of exploration, innovation, production and transportation.

1. The Charter Does Not Permit the State to Know Whether the Acquiring Companies will Assume ARCO's Role.

While the assets that BP must divest are substantial, it is simply not possible to say whether the divestiture of these assets in the manner provided for in the Charter will lead to the goal of establishing one or more companies who can provide the competition once provided by ARCO. Nor can one say whether the companies that will purchase the assets will have such a goal as their reason for purchasing the assets. Indeed, **who purchases** the assets is as important

as what assets BP sells.³ Moreover, it is likely that what assets are needed by a purchaser will depend to some extent on who purchases them. Yet the Charter does little to assure that the assets will be sold to the buyer(s) who are best suited to achieve the goal of becoming an ARCO quality competitor.

2. The Charter Should be Modified to Identify the Purchaser(s) of the Assets Before the Merger Occurs.

We suggest that, at a minimum, the Charter be modified to require BP to arrange for the contingent disposition of the assets identified in the Charter **before** the merger occurs.⁴ Additionally, the divestiture process should include the requirement that the purchaser(s) be known to the public and approved by the State before the assets are sold to the purchaser(s). The Charter should be modified so that the particular assets identified in the Charter serve as a benchmark/minimum but that the final mix of assets be subject to the needs of the buyer (or buyers). A public review of the proposed disposition and an opportunity to hear from the company(s) that propose to buy the assets is necessary to assure the people of Alaska that the company seeking to acquire the assets will undertake a long term commitment to Alaska and be capable of fulfilling that commitment. Moreover, the need to complete the sale of these assets as a condition to agreeing not to file suit to block the merger will ensure that BP and all other parties will be motivated to complete the sale on terms favorable to the new companies and as expeditiously as possible.

Amending the Charter will not guarantee that the divestiture required by the Charter will bring companies to Alaska that can effectively fulfill the role once occupied by ARCO, but it will at least increase that likelihood. A public process during which the purchaser(s) can be asked about their future plans and commitments towards exploration and development in the State of Alaska will allow the State to assess which company is best suited to the needs of Alaska. Similarly, by giving the State approval authority the State can ensure itself that more than price is considered by BP in the sale of assets.

Additional amendments, such as incorporating the Charter into a consent decree, including a tariff reduction as the Governor originally stated, modifying the natural gas provisions and making the community and environmental provisions legally enforceable might also be recommended by the Legislature based on testimony the Committee received at its hearing and/or testimony given at the Governor's public comment sessions.

³ As Ken Konrad of BP testified at the Committee's hearing on November 18th, the sale of oil production is simply "the sale of a cash stream." It is not inconceivable that a company will seek to purchase the producing assets for purposes of diversifying its holdings and without a serious intent to engage in major exploration and innovation on the North Slope. It is also true that under the Charter, it is BP that will select the purchaser(s) of the assets and that the State does not have the right to block or control to whom the assets are sold.

⁴ We do not mean to suggest that changes relating to specific assets should not be made. However, whether such changes are necessary and whether they should be changes to the production acreage, exploration acreage or tankers are best defined by the company that seeks to establish itself on the North Slope rather than a generalized "one size fits all" approach as the Charter now contains. These changes therefore, are best incorporated only after the Buyer(s) is known.

C. Endorsement of Charter "As Is."

This option is self explanatory. In light of the questions which have been raised by members of the Legislature concerning the terms of the Charter, it is our understanding that the Legislature is unlikely to pursue this option.

D. Conclusion.

Whether the Legislature chooses to recommend to the Governor that he amend the Charter or abandon the Charter in favor of blocking the merger via litigation is not an easy choice. Many shortcomings with the Charter have been identified in the public comment sessions and in your Committee hearings. However, there has been very little discussion by the Administration or public about alternatives to the Charter. Yet, fundamentally the merits of the Charter can only be judged in comparison to some alternative. We believe that the most logical and appropriate alternative by which the Charter should be judged is the alternative of filing suit to block the merger. There are many reasons to believe that blocking the merger will yield a better long term future for Alaska than will BP's acquisition of ARCO even recognizing that ARCO may not remain as the company it once was.

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Official Business

ALASKA STATE LEGISLATURE

Joint Special Committee on Mergers

State Capitol
Juneau, AK 99801

Chairman: Senator Rick Halford
Vice Chair: Rep. Joe Green
Senator Drue Pearce
Senator Johnny Ellis
Rep. Brian Porter
Rep. Beth Kerttula
Rep. Jim Whitaker

January 24, 2000

Senator Drue Pearce, President of the Senate
Representative Brian Porter, Speaker of the House
Capitol Building
Juneau, AK 99801

Dear Senator Pearce and Representative Porter,

In May of 1999, the Joint Special Committee on Mergers was formed to consider the state's best interests with regard to the proposed BP Amoco/Arco merger. Currently, the FTC is still deliberating the merger and negotiating with BP Amoco. We do not have a final determination on the merger, nor do we know what form the companies will be in if the merger is approved by the FTC. Therefore, at this time, we cannot offer recommendations regarding statutes that should be changed to accommodate new industry alignments. The Committee plans to meet tomorrow, January 25, 2000 to consider the information we've received and potential actions.

Following is a report of committee actions to date. The first order of business for the committee was to assemble a team of expert consultants. The Committee retained Collier, Shannon, Rill & Scott, PLLC, (Collier) a Washington, DC law firm that specializes in antitrust law to advise on matters relating to the Federal Trade Commission review of the proposed BP Amoco/Arco merger and on federal antitrust law. Collier has 35 years of antitrust and trade regulation law experience, including defense of merging companies. The principal attorneys working with the Committee include William C. MacLeod and John B. Williams. Mr. MacLeod was a prior advisor to the Assistant Attorney General, Antitrust Division, U.S. Department of Justice; Director, Bureau of Consumer Protection, FTC; and director of a regional office of the FTC. Mr. Williams has extensive experience representing companies, including oil companies, in acquisitions and patent infringement actions.

The Committee also retained the Alaska firm of Preston Gates & Ellis, LLP (Preston) to advise the Committee on State of Alaska antitrust issues and on oil and gas law. Preston, which established an Anchorage office in 1979, has been very active in Alaskan matters and resource issues, including the *Exxon Valdez* oil spill litigation, and has experience in antitrust cases. The principal attorneys working on behalf of the

Committee are Frederick H. Boness and Joseph K. Donohue. Mr. Boness is very familiar with natural resource issues in Alaska. Prior to joining Preston, he held positions as Deputy Commissioner, Alaska Department of Natural Resources; and Assistant Attorney General specializing in natural resources and energy. Mr. Donohue has extensive experience with oil and gas tax issues and was previously Deputy Commissioner of Taxation, Department of Revenue; and Assistant Attorney General with the Business Regulation and Taxation section.

In addition, the Committee retained economists David Scheffman and George Schink to provide expert economic analysis. Mr. Scheffman is currently a Professor at Owen Graduate School of Management, Vanderbilt University; and former Director of the Bureau of Economics, Federal Trade Commission. Mr. Schink is an independent consultant and longtime expert on petroleum and pipeline matters, formerly associated with WEFA.

Through negotiations with the BP Amoco and Arco (the Companies) and the use of the Committee's subpoena power, the Committee obtained access to all of the documents and information Arco and BP Amoco produced to the FTC and state attorneys general. To the Committee's knowledge, this is the first time a state legislative committee has obtained access to Hart Scott Rodino materials for a major merger. Approximately 2,000 boxes of documents were produced, which were reviewed by Committee members and staff over the interim.

The Committee held a number of public hearings during the interim to listen to testimony by the Companies, the Administration, the FTC, and the public, on June 11, 1999; July 28, 1999; November 18, 1999 and November 19, 1999. In addition to these hearings, the Committee also held briefings while the Legislature was in session during the Second Special Session (September 24 and 25, 1999) and once the Second Session commenced (January 18 and 19, 2000).

In mid June, Senator Pearce, on behalf of the Committee and at the request of Senator Murkowski, presented testimony to United States' Senate Energy and Natural Resources Committee concerning issues identified as important for review as part of the FTC's analysis of the proposed merger. Senator Halford and Representative Kerttula and the Committee's staff have met with the staff of the FTC in Washington DC and Committee members and staff have been in frequent contact with the FTC staff, including meetings while the FTC staff were in Alaska. Senator Pearce, on behalf of the Committee, also met directly with some Commissioners of the FTC, including Chairman Pitofsky, in December, 1999.

The Committee and its staff have also met with members of the Knowles Administration on numerous occasions to discuss issues relating to the merger and to exchange information and ideas about ways to best protect the Alaska's interest in light of the proposed merger. However, the Committee and its staff did not participate (and

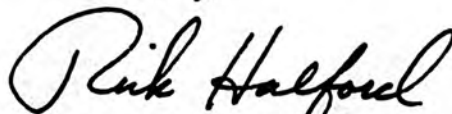
were not asked to participate) in the negotiations for the Charter Agreement. Once the draft Charter Agreement was released by the Administration for public comment, the Committee provided analysis and comment upon the Charter Agreement.

The Committee's staff prepared reports for the Committee based on the information produced by Arco and BP Amoco, which are confidential due to references to information protected by confidentiality agreements. The staff also prepared for the Committee reports which are more abbreviated in nature but contain the conclusions of the staff without reference to any confidential information. These reports have been made available to all members of the legislature and to the public.

The most recent actions by the Committee were the two meetings earlier this month. At those meetings, our consultants were asked to present their findings based upon review of the documents, public hearings, and conversations with FTC staff and Commissioners. In addition, the Companies and Administration were asked to present their positions with respect to the Charter Agreement and the merger. The Committee then asked the consultants, the Companies, and the Administration to provide written summaries of their positions and findings, which are enclosed.

As the FTC process continues, we will provide updated information to your offices and the legislature.

Sincerely,

A handwritten signature in black ink that reads "Rick Halford". The signature is written in a cursive, flowing style.

Senator Rick Halford
Chairman, Joint Special Committee on Mergers

Enclosures

RH: jl

**Final Report to
Joint Special Committee on Mergers
Of the Alaska State Legislature**

**Competitive Assessment of the Proposed Merger
Between
BP Amoco p.l.c. and ARCO**

January 24, 2000

**John B. Williams, Collier, Shannon, Rill & Scott, pllc
William C. MacLeod, Collier, Shannon, Rill & Scott, pllc
David I. Scheitman, Professor, Owen Graduate School of
Management, Vanderbilt University
George Schink, Independent Consultant**

I. Summary of Conclusions.

The focus of our investigation has been the effects of the proposed transaction on Alaska. Based on our knowledge and experience with the oil industry and antitrust analysis, and on a review and analysis of about 2000 boxes of discovery materials, the arguments and analyses put forth by BP Amoco/ARCO, and public sources, we have concluded that:

- BP Amoco's acquisition of ARCO would harm competition in Alaska.
- The State of Alaska is an affected party under the U.S. antitrust laws and any adverse effect on Alaska arising from a reduction in competition due to the merger is a harm recognized by the antitrust laws.
- The vertical integration of BP Amoco and ARCO in Alaska (*i.e.*, their involvement in all phases of the ANS crude oil business from lease bidding, exploration and development (E&D), field operation, TAPS, marine transport, and marketing) is critical to their competitiveness.
- The State of Alaska relies, at least in part, on *competition* at each vertical level of the industry:¹
 - Lease bidding.
 - E&D efforts.
 - Efficient operation of the fields.
 - TAPS tariffs.
 - Adequate, efficient and lowest cost provision of marine transportation services.
 - Marketing of ANS crude oil.
 - The state has tax, royalty, and regulatory oversight responsibilities and authority. BP Amoco and ARCO are large, multinational, vertically integrated companies. Exercise of the state's tax, royalty, and regulatory oversight responsibilities and authority is very difficult. The competition between BP Amoco and ARCO facilitates the State's ability to exercise its responsibilities and authority. It would be made considerably more difficult by the acquisition of ARCO by BP Amoco.
- BP Amoco and ARCO are unique in their role in the ANS crude oil business in terms of:
 - Size.
 - Vertical integration in Alaska (lease bidding, E&D activities, operatorship, production, pipeline and marine transport, and marketing of ANS crude).
 - As operators.
 - As major interests in TAPS and other pipelines and marine transport.
 - As the companies expending the lion's share of E&D expenditures.

¹ There is a great deal of joint and cooperative activity upstream in the oil industry, and in Alaska, specifically. This makes the *nature* of competitive forces and the workings of competition complex, but does not remove the forces and importance of competition in its many forms.

- BP Amoco and ARCO are important, perhaps, essential, as leaders or JV participants in major E&D efforts.
- The competition from and between BP Amoco and ARCO is very important to the State of Alaska in ensuring the most efficient development of Alaska's resources and in ensuring that the State of Alaska obtains the highest income from its resources.
- The economic research on lease bidding that was funded by the State Attorney General makes clear that ARCO is disproportionately important in bidding competition. Those results are consistent with our non-statistical analyses of the importance of ARCO in all areas of E&D activity.
- However, lease bidding and marketing (pricing) of ANS crude are just the "visible fingers on the invisible hand of competition." It is a mistake to focus exclusively on these two specific areas of competition.
 - BP Amoco and ARCO expend the lion's share of E&D resources.
 - BP Amoco and ARCO, or both, are leaders or important participants in any significant E&D project.
 - BP Amoco and ARCO are the only operators.
 - In 1999 BP Amoco and ARCO were the only companies that obtained drilling permits. Over the past several years, they have been, overwhelmingly, the companies leading E&D efforts.
 - The competitive dynamics within the various joint ventures and cooperative activities in E&D and production efforts are complex. However, BP Amoco and ARCO, by virtue of their histories in Alaska, size, vertical integration, knowledge and expertise, etc., are unique, and the competition from and between them is an important determinant of the outcome of these complex dynamics.
- The Charter represents an unprecedented restructuring of the Alaskan oil industry, accomplished outside the market forces that have created and shaped the industry. The divestitures are justified by the theory that one or two purchasers of the divested assets, although much smaller than ARCO and much different from ARCO in history, experience, expertise and knowledge in Alaska, and commitment to Alaska, would provide an adequate substitute for ARCO. The history of the Alaskan oil industry over the past few decades makes clear that companies of the size (in Alaska) of these eventual purchasers have not individually, or in combination, exerted the same influence or been a competitive force comparable to ARCO.
- One of the primary efficiency gains claimed as a result of the proposed merger, as modified by the Charter, results from moving to a single operatorship at Prudhoe Bay.
 - The merger, in itself, would not accomplish this goal (because other parties at Prudhoe would have to agree).
 - In principle, this objective could be achieved without the merger. For example, if ARCO can agree to be acquired by BP Amoco, why could the parties not agree to set up a single operatorship at Prudhoe Bay?
 - The cost reductions arising from consolidating Prudhoe are significant, but hardly of the size that would, themselves, justify a radical restructuring of the Alaskan oil industry.

- Absent the transaction, ARCO would be financially healthy and could continue to operate efficiently and effectively. Although absent this transaction, ARCO, or ARCO's Alaskan operations might be involved in some other transaction, no other transaction poses the problems for Alaska and competition of BP Amoco's acquisition, even under the Charter.

II. The Importance of ARCO and BP Amoco in Alaska.

ARCO is a major integrated oil company and also is integrated in-Alaska in that it: (1) successfully bids for substantial acreage at auctions of exploration and development ("E&D") leases; (2) owns the majority interest in and is the leader of major E&D projects; (3) owns the majority interest in and is the operator of several major production units on the North Slope; (4) owns processing facilities and feeder lines to TAPS on the North Slope; (5) is a large-interest holder in TAPS; (6) operates a major Jones Act tanker fleet to carry its crude oil from Valdez to the West Coast; and (7) is a major marketer of ANS and other crude oil on the West Coast and in other areas.

BP Amoco and ARCO are the two largest participants in the ANS crude oil business (at all levels) and both have been aggressive and effective in developing ANS crude oil production since the beginning. As a result of their continuous leadership and efforts in lease bidding, E&D activities, production facilities development and operation, TAPS, marine tanker transportation, and marketing of ANS crude oil, BP Amoco and ARCO today are the largest producers of ANS crude oil. (*i.e.*, ARCO and BP Amoco developed rather than purchased their current production). The positions of BP Amoco and ARCO in the various fields is shown in the attached map. The combination of BP Amoco and ARCO dominate virtually every field. One or the other is the operator of every field except Point Thompson which is undeveloped.

As shown in Chart 1, as of 2001, BP Amoco and ARCO would be the two largest producers of ANS crude oil by a very substantial margin. ARCO, the second largest, has almost a 36% share of 2001 ANS crude oil production while third place ExxonMobil has almost a 20% share. All the other producers combined in 2001 have a 5% share of ANS crude oil production (*i.e.* the big three account for 95% of 2001 ANS crude oil production). As shown in Chart 2, if BP Amoco or ARCO were to merge, they would have over 75% of total 2001 ANS crude oil production exceeding the second place ExxonMobil's almost 20% share by more than 55 percentage points.

Under the terms of the Charter, BP Amoco/ARCO would reduce their combined share of 2001 total ANS crude production from over 75% to 60%. Their remaining share of production is still more than 3 times the size of the second largest participant's (ExxonMobil's) share as shown in Chart 3. The production divestitures to Buyers A and B are illustrated in Chart 3 assuming that Chevron is Buyer A (Chevron is chosen simply for a basis of comparison) and that Anadarko is Buyer B. Buyers A and B are substantially smaller than ExxonMobil, and collectively they have a 16% share of total production. These two combined are less than one-half the size of the pre-merger ARCO (a 36% share of production). The ownership of ANS crude oil production is substantially more concentrated after the merger even with the Charter divestitures.²

² Measures of size in production are relevant, because the sizes of BP Amoco and ARCO are the result of their past E&D efforts. That is, their size in production relative to other companies in Alaska is an historical indicator of their importance in past E&D efforts.

BP Amoco and ARCO not only own a large share of *total* ANS crude oil production, their joint ownership interests account for at least 50% of the total ownership interest in 19 of the 21 production areas on the North Slope.³ Currently, BP Amoco has at least a 50% interest in 10 of the 21 production areas while ARCO has at least a 50% interest in 6 of the 21 production areas. Therefore, the proposed merger creates at least a 50% interest for BP Amoco/ARCO in several production areas where neither had a majority interest prior to the merger.⁴

ARCO and/or BP Amoco are the operators at 20 of the 21 production areas including Sandpiper in which neither has an ownership interest. ARCO is the sole operator in 10 areas, BP Amoco is the sole operation in 8 areas, and they jointly operate 2 areas (the Prudhoe Bay Oil Rim and the Prudhoe Bay Gas Rim). ExxonMobil is the operator of one production area (Point Thompson) which is undeveloped. All the areas that are currently producing crude oil or are under active development are operated by ARCO and/or BP Amoco.⁵

ExxonMobil is the only integrated in-Alaska competitor to BP Amoco other than ARCO that has substantial ANS crude oil production, but ExxonMobil has been reducing its commitment to Alaska over the past several years. ExxonMobil's reduced commitment to Alaska is evidenced by their small holdings of exploration (non-unitized) State lease acreage and by the projected decline in the ExxonMobil's share of total ANS crude oil production over the next several years.⁶ The ANS production of all of the other market participants in Alaska is small relative to BP Amoco, ARCO, and ExxonMobil who collectively, in 2001, are expected to account for 95% of North Slope crude oil production; BP Amoco plus ARCO alone are expected to account for 75%.⁷ Chevron and Phillips are market participants who are large integrated oil companies that conceivably could become major integrated in-Alaska competitors to BP Amoco, but their current ANS production is very small. However, Chevron has been active in recent lease activities and has substantial E&D lease holdings. Anadarko, the only other company with substantial lease holdings, is not a large integrated oil company.⁸ In exploration and development, as of April 1999, BP Amoco and ARCO combined held 67.2% of the exploration (non-unitized) leased State acreage on the North Slope (BP Amoco had 33.8% and ARCO had 33.4%). ExxonMobil does not have substantial lease holdings of non-unitized E&D lease acreage (ExxonMobil held only 0.9% of the total non-unitized acres). Chevron is the third largest non-unitized leaseholder with a 13.7% share followed by Anadarko with a 7.7%

³ ExxonMobil has a majority ownership interest in one (Point Thompson) and Murphy has a majority ownership interest in another (Sandpiper). Neither of these unitized production areas are developed or under development. Alaska Department of Natural Resources, *Historical and Projected Oil and Gas Consumption*, May 1999.

⁴ Alaska Department of Natural Resources, *Historical and Projected Oil and Gas Consumption*, May 1999.

⁵ Alaska Department of Natural Resources, *Historical and Projected Oil and Gas Consumption*, May, 1999.

⁶ Alaska Department of National Resources, *Historical and Projected Oil and Gas Consumption*, May 1999; State of Alaska, Briefing by State Officials, April 19, 1999, Juneau, Alaska.

⁷ Alaska Department of Natural Resource, *Historical and Projected Oil and Gas Consumption*, May 1999.

⁸ ARCO, BP Amoco, ExxonMobil, Chevron, and Anadarko combined account for 89.5% of total E&D (non-unitized) leased state acres on the North Slope. State of Alaska, Briefing by State Officials, April 19, 1999, Juneau, Alaska.

share.⁹ If BP Amoco acquires ARCO, there will be no other major North Slope producer who also has substantial exploration and development holdings of State leases. Only one other major integrated oil company (Chevron) has substantial exploration and development lease holdings, but Chevron's expected 2001 North Slope production accounts for only 0.3% of the total.¹⁰

ARCO and BP Amoco also are the leading interest companies¹¹ in most of the winning bids submitted in the State and in the NPR-A oil and gas lease sales. For example, in the May 1999 NPR-A lease sale, as shown in Chart 4, ARCO, as the leading interest company, submitted the winning bid for 92 of the 133 leases sold (or 69.2% of the winning bids). BP Amoco, as the leading interest company, submitted the winning bid for 25 of the 133 leases sold (or 18.8% of the winning bids). ARCO and BP Amoco combined submitted 117 of the 133 winning bids (or 88% of the winning bids). Only three other companies submitted winning bids: (1) Phillips had 8; (2) Anadarko had 7, and (3) R3 Exploration had 1. Therefore, ARCO and BP Amoco also are the dominant players in the acreage leasing arena.

In terms of control of the means of transportation from the North Slope to the primary market (the U.S. West Coast), BP Amoco and ARCO would own over 72% of TAPS capacity¹² and at least that share of the Jones Act tanker capacity required to transport ANS crude oil from the terminus of TAPS at Valdez to the U.S. West Coast. Almost all of the Jones Act tanker fleet is now controlled by BP Amoco, ARCO, and Exxon. OPA-90 requirements are expected to cause the other Jones Act tanker owners to exit leaving the entire Jones Act tanker fleet under the control of BP Amoco, ARCO, and Exxon. Given the large potential liabilities associated with transporting ANS crude and from Alaska to the U.S. West Coast, no entry is expected into the Jones Act tanker transportation business except possibly by a large-scale ANS crude oil producer. Currently, BP Amoco, ARCO, and Exxon are the only large-scale ANS crude oil producers.

III. Detailed Discussion of the Competitive Implications of the Proposed Merger.

The facts described in this report are derived from public sources. In order to gain access to non-public information, we agreed with the parties to maintain the confidence of materials disclosed to us in the course of our investigation. As a consequence we cannot describe in detail (just as the Attorney General has declined to do) the analysis that supports our conclusions. If necessary, we remain available to discuss, in executive session, our confidential analysis. We believe, however, that the information we have described here provides significant support for our conclusions, and we do not see facts or analysis in the BP Amoco or Administration presentations that cause us to alter those conclusions.

⁹ All the other lease holders have less than a 5% share. State of Alaska, Briefing by State Officials, April 19, 1999, Juneau, Alaska.

¹⁰ Alaska Department of Natural Resources, *Historical and Projected Oil and Gas Consumption*, May 1999.

¹¹ The leading interest company typically has a majority (or at least the largest interest) and is the company submitting the bid.

¹² Alaska Department of Natural Resources, *Historical and Projected Oil and Gas Consumption*, May 1999.

A. An Overview.

This merger generates upstream issues of the type that have been pursued by the FTC during other petroleum merger investigations. Thus, we do not take seriously the Administration's suggestion that the FTC is sacrificing the interests of Alaska to protect the interests of west coast refiners. Nor do we share the Administration's doubts that the antitrust laws protect the interests of Alaska. An upstream analysis assumes that the owners and or developers of crude oil and/or natural gas resources are captives to the service conditions and prices of the parties owning the gathering system closest to the crude or natural gas production. In Alaska, the State, the federal government and native corporations have royalty rights to crude and natural gas currently in production and are affected by the leasing prices of any lands offered for crude or natural gas leasing after the merger. By exercising market power in the ANS gathering system (the FTC's term for upstream analysis), the merging parties could reduce the netback earned from ANS resources, thus affecting current and prospective royalty (and tax) revenues from those lands. This impact would apply to areas already leased and to future lease sales.

The expert retained by the state to assess upstream effects of the merger apparently limited his analysis to leasing activity. However, the issues presented by this proposed transaction are unusually complex, since they involve an understanding of the effects of the proposed transaction on E&D and production activities beyond simply the bidding on leases.¹³

B. Reduced Competition in North Slope Lease Bidding, Exploration/Development, Production, and Gathering/Processing Facilities.

ARCO is an aggressive and dynamic competitor to BP Amoco on the North Slope in terms of lease bidding, exploration, development, and production. BP Amoco currently is the largest player on the North Slope, but ARCO is the dominant player in some areas of the North Slope. ARCO has larger North Slope State lease holdings than BP Amoco, and operates, in many ways, as an equal to BP Amoco on the North Slope despite BP Amoco's greater current ANS crude oil production levels. The history of E&D efforts indicates that either BP Amoco or ARCO are critical as leaders or important participants.

On at least one issue, there appears to be agreement between us and the administration. The effects of the transaction would include reduced bonus payments during bidding, as ARCO and BP Amoco have become the major participants in lease bidding on the North Slope. It is well known that fewer bidders, especially if the lost bidder is recognized as an aggressive one, results in reduced payments for mineral rights. The Administration's testimony that the Charter restores this competition by replacing ARCO with two smaller entities is based on a theoretical model that we have not been able to examine. Judging from the description we heard, however, we doubt that the model accurately captures the full impact of ARCO in the bidding.

BP Amoco and the Administration apparently have concluded that competition after the bidding is unimportant. We disagree. There are various indications that ARCO is a more active developer of ANS crude oil than is BP Amoco at various stages, from bidding, to E&D activities,¹⁴ to transportation, to

¹³ In terms of the issues involved, analysis of the transaction's effects on competition might be most appropriately addressed under the federal antitrust Guidelines for the Licensing of Intellectual Property. What we have here, in part, is something like an "R&D Race," with a number of competitors, but two players (BP Amoco and ARCO) that are relatively unique in a number of important dimensions.

development of natural gas. Alaska is very important to ARCO both in terms of current production and continuing exploration and development activities (*i.e.*, Alaska is a central focus of ARCO's long-term plans). BP Amoco has numerous international projects that could take precedence over its Alaskan projects (*i.e.*, unlike ARCO, BP Amoco is not centrally focused on Alaska).

BP Amoco and ARCO are the only two parties that currently are operators for the North Slope fields.¹⁵ Each effectively has had veto control over major changes on the North Slope, and their diversity of interests is a form of competition that plays out in joint and cooperative activities. While most all facility sharing agreements require near unanimous consent among the initial signatories, ARCO and BP Amoco likely counterbalance each other's presence as the two largest interest holders *across* the North Slope, because they have different interests in different facilities.

C. Taps Competition.

The structure of TAPS relies, in part, on competition (in that different parties file their own tariffs). Beyond this competition, the effectiveness of regulatory oversight of TAPS depends, in part, on the independent activities and regulation of the separate companies. BP Amoco and ARCO, being the largest players in Alaska, and being large, vertically integrated international companies makes regulatory oversight challenging. Combining BP Amoco and ARCO would likely increase the challenge.

The Charter calls for BP Amoco and ARCO to sell Buyers A and B sufficient TAPS capacity to transport their purchased crude production. Further, given FTC precedent in oil company mergers, BP Amoco is likely to be required to sell the remainder of ARCO's TAPS interest to others before the merger would be approved by the FTC. Assuming that there would be two or more new owners of TAPS, the cost saving achieved by BP Amoco by closing down ARCO's TAPS operations could be to some extent offset by the costs incurred by the new TAPS owners in setting up their own TAPS operations.

D. Reduced Jones Act Tanker Transportation Competition: Valdez to the West Coast.

In recent years, BP Amoco and ARCO have had different approaches to accounting for marine transport. This has probably been a benefit to the State of Alaska. It is one example of how the diversity of interests of the two companies produces different results that may be material to the State.

The combined firm will control more than 70% of the Jones Act tanker capacity now carrying ANS crude. Due to the OPA-90 requirements for ANS service and declining ANS output, this tanker fleet has been declining. The end result is expected to be that all tanker owners, except BP Amoco, ARCO, and Exxon, exit the business. With 70% of the Jones Act tanker capacity, the merged firms would have presumptive power to affect the price for tanker services. BP Amoco/ARCO certainly would have the incentive to increase tanker rates, given that increased tanker rates could reduce ANS netbacks and

¹⁴ It was ARCO that stated an objective of "No decline in '99."

¹⁵ ExxonMobil is the operator for one area (Point Thompson) which is undeveloped. ARCO and/or BP Amoco are the operators at all other North Slope areas. Alaska Department of Natural Resources, *Historical and Projected Oil and Gas Consumption*, May 1999.

thereby decrease royalty and severance-tax payments to the State. Because BP Amoco/ARCO would own enough capacity on TAPS and Jones Act tankers to transport their own crude, the merged firm could not be disadvantaged if tanker rates increased.

If other ANS producers must rely on BP Amoco/ARCO for tanker transportation services, higher tanker rates after the merger would provide increased revenues for the merged firm. Any increased tanker rates paid by third parties also would result in decreased netbacks for ANS crude, thereby lowering the State's revenues from severance taxes and royalties. The merger would remove a competitive alternative that is now available to existing North Slope producers and to those considering new investments on the North Slope. The loss of competitive alternatives reduces the negotiating leverage that these producers may have to obtain a higher netback for ANS crude purchased by BP Amoco/ARCO on the North Slope or at Valdez. The availability of competitively priced Jones Act tanker transportation from Valdez to the West Coast would be an important consideration for any potential competitor to BP Amoco/ARCO and Exxon who wanted to engage in exploration and development with the intent of ultimately producing a substantial amount of ANS crude oil.

E. The Merger May Affect ANS Natural Gas Development.

Both BP and ARCO have pursued different approaches to ANS gas development. Inevitably, the merger will result in one approach being canceled or at least placed on the back burner, eliminating parallel and independent analyses of the appropriate strategy for ANS gas. While BP has focused on the GTL and ARCO on LNG, both BP and ARCO have planned or built GTL demonstration plants. ARCO has built a 70-bpd demonstration plant in Washington. BP has proposed building a \$70 million 300-400 bpd demo plant on the North Slope. ARCO has a stronger interest and has focused its attention on the development of a gas pipeline and LNG project. The merger may make this approach less likely. In order to explore and stir up commitment to this line of development, ARCO formed an ANS Gas Sponsor Group to which it invited BP Amoco to join, but to which BP Amoco declined. However, Alaskan natural gas is not expected to be commercially viable for at least 5 to 10 years.

F. The Efficiencies Claimed to Arise from the Merger Do Not Appear to Depend on the Merger to be Accomplished.

BP Amoco and ARCO have claimed substantial efficiency gains in Alaska that would result from the merger. These include having a single operator for Prudhoe Bay, elimination of ARCO's separate Alaskan pipeline company, and a combination of BP Amoco's and ARCO's Jones Act tanker fleets.

Regarding the potential efficiency gains due to having a single operator at Prudhoe Bay, the proposed transaction (with or without the Charter) will not, itself, achieve this result. Further, it is plausible that this outcome would have occurred in the absence of the merger. The general evolution towards a single operator on the North Slope has been considered by the major owners for several years and is well known in Alaska. Undoubtedly, a consolidated operatorship would occur in the next few years. Of course, if the merger could lead to consolidation faster, that is a benefit of the transaction, but that must be balanced against the radical restructuring of the industry arising either from the original transaction, or from the transactions arising from the Charter.

Regarding the potential efficiency gains that can be accomplished by combining the BP Amoco and ARCO Jones Act tanker fleets, such a combination is possible without a merger of the owners. The

possibility of combining the BP Amoco, ARCO and Exxon tanker fleets was reported, long before the merger was announced. Therefore, the efficiency gains due to combining the BP Amoco and ARCO Jones Act tanker fleets presumably could be accomplished without the BP Amoco/ARCO merger.

IV. Discussion of the Charter and Suggested Changes to the Charter.

A. General Issues.

The apparent purposes and effects of the divestitures sketched in the Charter are to make BP Amoco smaller than it would otherwise be after the acquisition of ARCO, rather than to create a suitable substitute for ARCO. Overwhelmingly, in terms of value, the assets to be divested under the Charter are production. These divestitures do not insure any significant competitive benefits will arise from the divestitures. The Charter specifically did not have the objective of recreating ARCO in some form. A purchaser of this production could treat this asset as production that is part of a portfolio of production interests that is attractive from a diversification perspective (depending on the cost of acquisition), rather than a production basis for a vertically integrated entity committed to developing Alaska's resources. In addition, it might be in the interests of the acquiring party to engage in an exchange of its production with BP Amoco, which would take the party out of even marketing its ANS production.

Divestitures pursuant to resolving antitrust concerns of the FTC or Department of Justice always require the approval of the purchaser(s) by the agencies. The agencies engage in an extensive investigation of potential acquirers of divested assets to insure that the acquisition will restore competition sufficiently. The Charter does not solve the problem of what goes with what and to whom, so that an adequate replacement for ARCO is created. To do so would be necessarily highly complex, because it would require that legal negotiations substitute for market-determined choices.

B. The Charter's Divestiture Plan does Not Appear to Adequately Address the Competitive Concerns Raised By BP Amoco's Acquisition of ARCO.

A divestiture-based solution to the competitive concerns created by BP Amoco's acquisition of ARCO would require creation of a new large and aggressive integrated in-Alaska competitor to BP Amoco. The Charter does not propose a divestiture plan that will create such a large integrated in-Alaska competitor for BP Amoco. Instead, the Charter leaves too much discretion with BP Amoco as to the character of the assets it will divest and selection of the companies to which it will sell these assets. At best the Charter would produce one or more somewhat smaller competitors that do not provide an adequate substitute for ARCO.

The Charter identifies a large Buyer A, who would purchase 125,000 barrels per day of the production interests currently held by BP Amoco and ARCO. However, this proposed divestiture is limited and insufficient to ensure adequate competition. Of the 125,000-bpd of production, the revised (December 3, 1999) Charter indicates that Buyer A would get 50.01% of Kuparuk which, based on estimated 1999 production, would be about 130,000 barrels per day.¹⁶ Buyer A also would purchase capacity on TAPS and its feeder lines sufficient to allow it to transport its purchased production to Valdez.

¹⁶ Alaska Department of Natural Resource, *Historical and Projected Oil and Gas Consumption*, May 1999.

BP Amoco would sell 400,000 acres of State leases and 220,000 acres of NPR-A leases. It would sell Buyer A and Buyer B each at least 75,000 acres of its State leases and must sell Buyer A and Buyer B combined at least 250,000 State lease acres. If Buyer B purchased the minimum 75,000 acres, Buyer A would purchase 175,000 State lease acres. In addition, Buyer A or Buyer B, most likely the latter, would purchase 100,000 NPR-A lease acres including at least 50.01% interest in one of the identified sectors. BP Amoco can determine what acres are sold.

BP Amoco is not obligated to sell any Jones Act tanker assets to Buyer A or Buyer B that would allow them to transport their ANS crude oil to the West Coast. BP can fulfill its obligations under the Charter while leaving Buyers A and B dependent on BP Amoco to provide them with tanker transportation services from Valdez to the West Coast. As such, Buyers A and B would not be ARCO-like competitors for BP Amoco.

The Charter's proposal to sell 40% of Alpine production (the Colville River Unit) to a smaller buyer (Buyer B) and the pipeline capacity necessary to transport it to Valdez will not result in a competitive constraint on BP Amoco. In fact, by denying Buyer A the ability to purchase essential production and E&D lease assets, the sale of such assets to a smaller Buyer B could be detrimental to creating a Buyer A that would be an ARCO-like competitor.¹⁷ Since BP Amoco has no incentive to divest any more assets than are absolutely necessary to satisfy its contractual obligations, we must assess whether the Charter requires BP Amoco to create a competitor as strong as ARCO. It does not.

In general, the divestiture plan proposed in the Charter fails to create a large vertically integrated in-Alaska ARCO-like entity that would assume the role as the primary competitor to BP Amoco. Instead, the Charter would create two smaller producers, Buyer A and Buyer B, who would not be fully vertically integrated in Alaska. The Charter gives BP Amoco substantial discretion regarding which assets it will sell and to whom. Since it is contrary to BP Amoco's business interest to create a competitor in Alaska that would essentially replace ARCO, BP Amoco would almost surely use its discretion to ensure that an ARCO-like competitor would not result from the sale of divested assets.

C. The Planned Asset Package Sales Announced By BP Amoco.

In its presentation to the Alaska Legislature's Joint Committee on Mergers on January 19, 2000 (see page 21), BP Amoco provided planned definitions for the sales packages to Buyers A and B that conformed to the Charter's provisions. The planned package to be sold to Buyer A involved a 55% ownership interest in Kuparuk River production, the pipeline capacity needed to transport the purchased crude oil to Valdez, 244,000 State leased acres, 122,000 NPR-A acres, and up to three marine tankers. Buyer A also would be the operator at Kuparuk. The planned package to be sold to Buyer B involved a 43.1% ownership interest in Colville River (Alpine) production, the pipeline capacity to transport the purchased crude oil to Valdez, 143,000 State leased acres, 80,000 NPR-A acres, and up to one marine tanker. Buyer B also would be the operator at Colville River (Alpine).

¹⁷ BP Amoco has pledged to sell 100,000 acres of the NPR-A leases to either Buyer A or to the smaller Buyer B who would be allowed to purchase up to a 40% interest in the production of Alpine. But, as a BP Amoco representative stated in testimony before the Alaskan Legislative Committee, it would make sense for BP Amoco to sell the NPR-A acreage to Buyer B.

These planned packages conform to the requirements set forth in the Charter, which has been signed by the State and BP Amoco. If these packages as described are sold, Buyers A and B will have at least the appearance of integrated-in Alaska companies. However, Buyers A and B need not function as stand alone integrated-in Alaska companies that compete with BP Amoco across-the-board in the fashion that ARCO currently competes with BP Amoco. Instead, Buyers A and B could sell their production to BP Amoco/ARCO at Valdez (and not buy any marine tankers) and could turn over the exploration and development of their leased acres to BP Amoco/ARCO just as Murphy and Petrofina have turned over the exploration of development operatorship at Sandpiper to BP Amoco.

Further, BP Amoco need not sell the packages as described in their presentation to the Alaska Legislature. BP Amoco only needs to conform to the terms and conditions as explicitly laid out in the Charter. As a result, the packages actually sold to Buyers A and B need not even have the appearance of creating integrated-in Alaska companies that might become stand-alone independent companies that could provide ARCO-like competition to BP Amoco.

D. The Legal Form of the Charter Makes It More Difficult to Enforce.

The proposed Charter is simply an agreement or contract between the State and BP Amoco. As a result, if BP Amoco failed to honor any of the provisions of the Charter, the State would have to commence an action de novo, and assume all the burdens of production and proof that any plaintiff must bear. It is only after such a suit was won by the State that the court would order BP Amoco to honor these provisions. It is more typical in the settlement of an antitrust case, such as the matter of BP Amoco's proposed acquisition of ARCO, to enter a complaint and obtain a consent order or decree. The terms of the complaint are incorporated by reference into the obligations of the order. A court determining whether the terms of the order have been satisfied can inquire whether the defendant has remedied the competitive concerns identified in the complaint. Because there is no complaint attached to the proposed Charter, compliance with its terms must be measured entirely against the specificity of the terms themselves. If acceptable Charter terms can be negotiated, it is critical that its terms and provisions be accompanied by a complaint and that a consent decree or order be obtained. A consent order or decree can be enforced more quickly and efficiently than a civil suit over contract.

E. An Effective Consent Decree Should Contain Mechanisms that Would Ensure the Establishment of a Large Integrated In-Alaska Competitor to BP Amoco that is Committed to Developing Resources in Alaska.

An effective divestiture based solution must first identify one or more major integrated oil companies that would want to become an aggressive integrated in-Alaska competitor to BP Amoco. Next, based in part on their existing asset holdings, such candidate companies would need to identify the type and extent of assets necessary to allow them to assume an ARCO-like competitive position. The Alaskan assets held today by BP Amoco and ARCO fit together because these holdings were determined by profit-driven business decisions in a competitive environment. The purchasers of the divested BP Amoco and ARCO assets must similarly be permitted to assemble assets that fit together.

For divestiture to have a chance at creating a viable ARCO-like competitor, the antitrust authority must have the right to approve or disapprove the companies seeking to fill ARCO's shoes. Such approval or disapproval would be based on factors which would include: 1) the current assets of the company; 2) the company's plan to become a large-scale integrated in-Alaska competitor; and, 3) the BP Amoco assets

that the company claimed it needed to buy in order to become a large-scale integrated in-Alaska competitor. While the task of identifying potential buyers would remain with BP Amoco, the authority would be able to review the competing bidders and satisfy itself that companies of requisite size, commitment and vision to become a large integrated in-Alaska competitor were properly considered. If BP Amoco's choice of the winning bidder appeared to be less than satisfactory, it could be assessed against the alternatives that were available.

F. Conclusions Regarding the Proposed Charter and A Recommended Alternative.

The proposed Charter, unlike a typical antitrust order, neither identifies the precise divestiture transaction nor gives the reviewing agency the right to approve potential purchasers of divested assets. Instead, it provides for BP Amoco to divest its interest in production and leases to any company meeting one of two requirements: 1) current interest owners; or, 2) energy companies with minimum asset levels. Whereas the Charter establishes percentages of certain fields that the parties must divest, it fails to identify which portions of those fields BP Amoco would be obligated to sell. Such parameters do not give any confidence that the ultimate purchaser of divested interests will become a viable competitor to BP Amoco. The Charter only allows the state to object to a divestiture plan, but would not permit a court to sustain an objection based on the competitive weakness of a proposed buyer. If the buyers meet the minimum standards of the Charter, then Alaska will have no grounds to object, since the Charter releases BP-Amoco from any further antitrust proceedings arising from the merger.

A viable remedy to the competitive threat posed by the BP Amoco-ARCO combination must involve firm commitments by BP Amoco to sell specified assets to a specified buyer that Alaska has approved as sufficient to provide as effective a competitive force as ARCO provides today. At a minimum, the buyer would have to be a major oil company and would have to become a large integrated in-Alaska competitor. The Charter does not accomplish this essential objective. BP Amoco has no incentive to create a more vigorous competitor than the Charter requires. Indeed the company's business interest will be to do nothing more than it is legally required to do. The competition that is lost through this merger is unlikely to be restored via the Charter.

V. Absent the Merger, ARCO Would Be Financially Sound and would Continue Its Strong Alaska Focus.

A. The Effects of the Proposed Merger On ARCO's Performance.

While the pending merger between BP Amoco and ARCO almost certainly is a distraction to the ARCO and BP Amoco employees that will be affected by it in Alaska and elsewhere, there is no indication that this distraction has materially affected ARCO's performance. According to testimony before the Alaska State Legislature's Joint Committee on Mergers by Kevin Meyers, president of ARCO Alaska, Inc., on January 19, 2000, the ARCO three-year business plan that was finalized in early 1999 is being implemented on schedule, and ARCO plans to continue implementing this plan in 2000. Mr. Meyers said that ARCO had invested over \$500 million in Alaska in 1999 and planned to spend about the same amount in 2000. Moreover, ARCO's financial performance in 1999 has been very strong and is expected to be even better in 2000.

B. A Stand-Alone ARCO Was Financially Healthy in 1999 and Will Be Financially Healthy in 2000.

Our conclusion is that ARCO would survive and prosper in some form absent the transaction. This conclusion is consistent with various analysts' conclusions.

ARCO released its fourth quarter 1999 financial results on January 20, 2000 and reported earnings of \$1.64 per share which exceeded analyst's expectations.¹⁸ For all of 1999, ARCO's earnings were \$4.33 per share up from only \$1.40 per share in 1998. ARCO's strong 1999 earnings performance is due to a sharp rebound in crude oil prices (from less than \$11 per barrel in the fourth quarter of 1998 to more than \$25 per barrel in the fourth quarter of 1999) and due to cost cutting totaling \$400 million, according to ARCO chairman Mike Bowlin. ARCO plans to implement further cost cuts in 2000¹⁹ and crude oil prices are expected to remain in the vicinity of \$25 per barrel in 2000²⁰ signaling a financially strong 2000 for ARCO. As a result, stock analysts anticipate that ARCO's earnings per share will increase in 2000 relative to its 1999 value by 10% which exceeds the earnings growth expectations for the S&P 500.²¹

The market analysts following the proposed ARCO and BP Amoco combination do not view a collapse of the merger as potentially leaving a seriously crippled ARCO in its wake. A Bear Stearns analyst, Fred Leuffer, anticipated that, absent the merger, ARCO's stock price in 2000 would be in the \$75 to \$80 per share range which would produce a P/E multiple of 16x to 17x which is just below the average of 18x for the other domestic majors. ARCO's ice-to-cash flow multiple was anticipated to be 6.9x to 7.4x which exceeds the 5.5x value expected for the other domestics.²²

¹⁸ AP Wire, "ARCO Earnings Soar", January 20, 2000.

¹⁹ S & P DRI's Global Bulletin, January 2000.

²⁰ S & P DRI's Global Bulletin, January 2000.

²¹ Muttex Com., Inc., Ace Analysts Estimates, Atlantic Richfield Company, January 8, 2000.

²² Bear, Stearns & Co., Inc., December 13, 1999.

C. ARCO May Ultimately Engage in a Transaction with Another Oil Company if the BP Amoco Merger Is Not Consummated, but Alaska would Remain An Important Focus in Any Case.

ARCO was clearly a viable entity before the proposed transaction. It is certainly possible that absent the proposed transaction, ARCO would be involved in another merger. However, no other conceivable merger poses such problems for Alaska as those raised by the combination with BP Amoco. Since a substantial part of the value of ARCO to any party contemplating a transaction with ARCO would be ARCO's position in Alaska, such a transaction would likely result in a continued focus on Alaska.

ARCO's Alaska operations are a very large part of its total operations. ARCO's corporate focus on oil and gas exploration, development, and production features an Alaska focus. Alaskan crude oil production in 1998 accounted for almost 53% of ARCO's worldwide crude oil production. Net income in Alaska in 1996 and 1997 amounted to almost 50% of total ARCO net income. In 1998, which was a weak year for ARCO, Alaskan net income amounted to over 66% of ARCO's overall net income. ARCO's Alaskan net income in 1998 was \$300 million and ARCO's overall net income was \$452 million.²³

Alaska's importance to ARCO was emphasized in an early 1999 ARCO press release. According to this press release, ARCO's Chairman and CEO, Mike Bowlin, stated that ARCO remains committed to key projects on Alaska's North Slope despite the worldwide downturn in oil prices and a reduction in the company's capital budget." Chairman Bowlin referred to Alaskan operations as its "crown jewel" accounting for a large share of its worldwide production and being a low-cost leader.²⁴

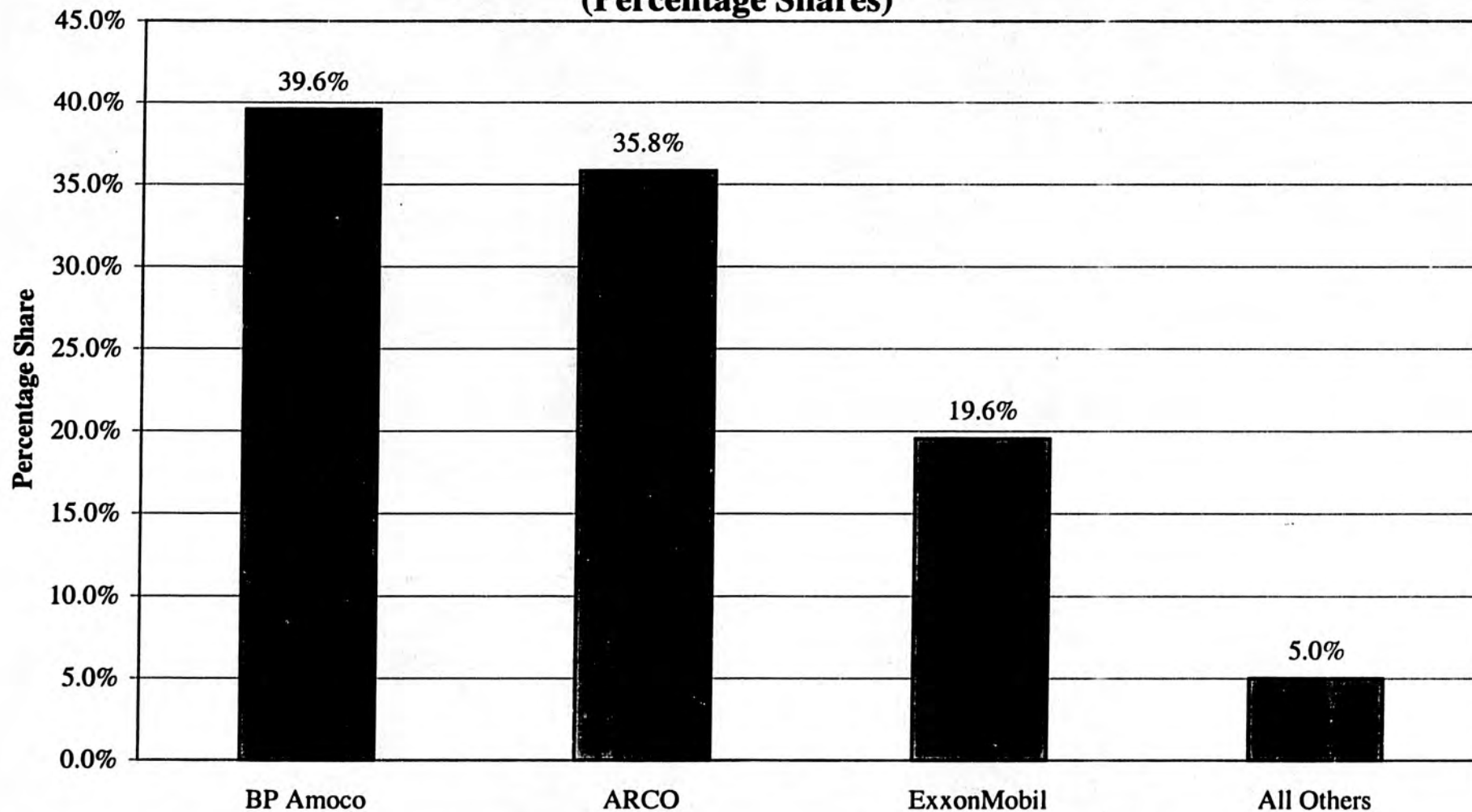
VI. Conclusion.

It is our conclusion that the only adequate protection for the State of Alaska's interests and for the protection of competition would require at least the sale of ARCO's *Alaskan* operations, as an integrated entity, with existing management, employees and organization to a large domestic oil company that would, after careful review, appear to be fully committed to extending ARCO's past history and position in responsibly developing Alaska's resources. As part of this sort of divestiture, BP Amoco could (subject to the consent of other parties) move to unified operatorship in Prudhoe. It is possible that there could be other rearrangements of the BP Amoco and ARCO assets and positions in Alaska prior to a spinoff, but those would have to be very closely scrutinized. The objective should be to preserve ARCO's Alaskan operations, or to preserve an entity with the same competitive force and vitality. We have no confidence that the Charter would accomplish this.

²³ ARCO website, ARCO.com, "About ARCO, 10 Years of Financial Statistics."

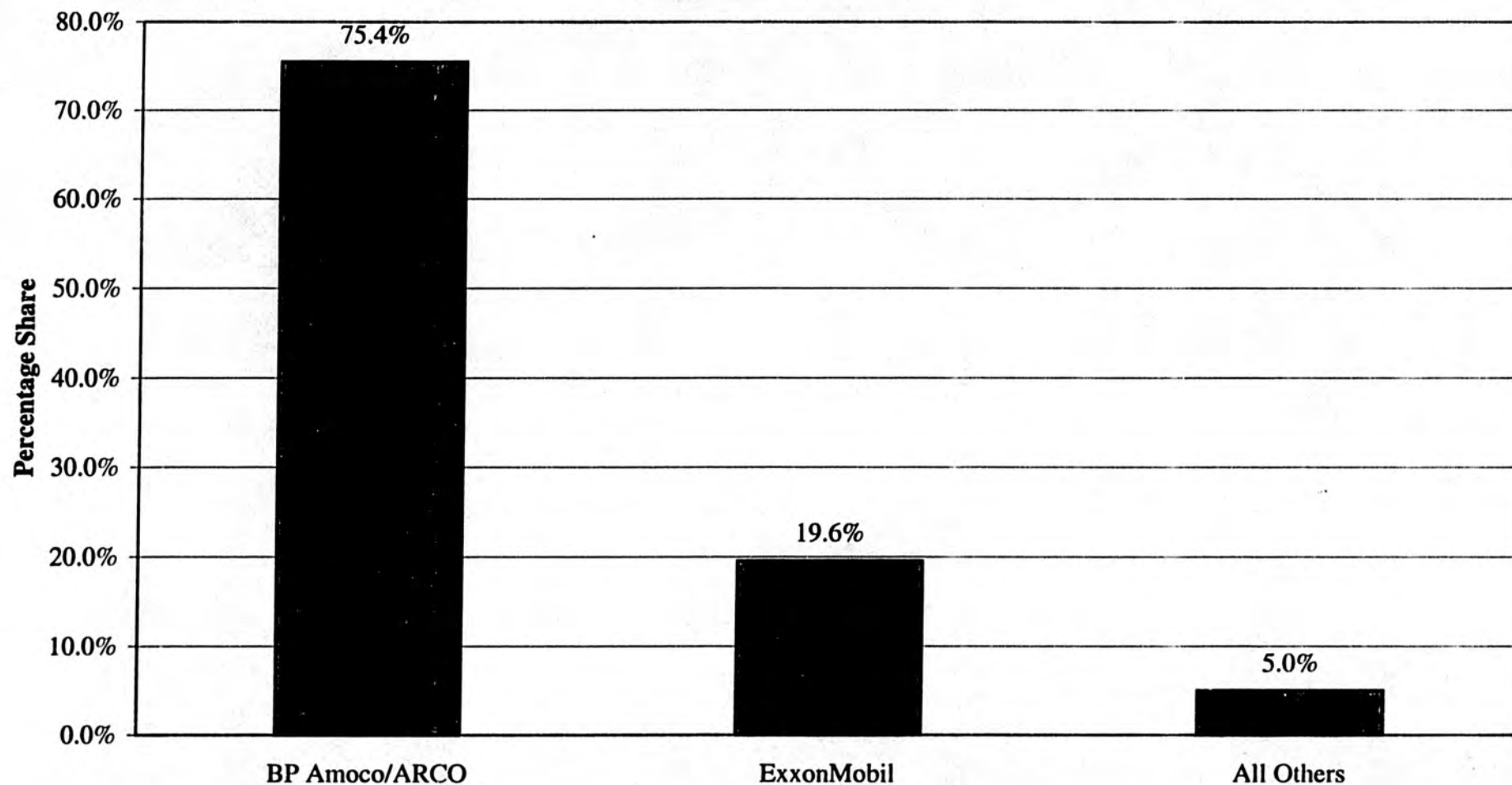
²⁴ ARCO Press Release, *ARCO Chairman Emphasizes Need for Cost Restraints to Encourage Investment in Alaska*, January 22, 1999.

Chart 1
An Absent the Merger Comparison of
Estimated 2001 Percentage Shares of ANS Crude Oil Production
for BP Amoco, ARCO, ExxonMobil, and All Others
(Percentage Shares)



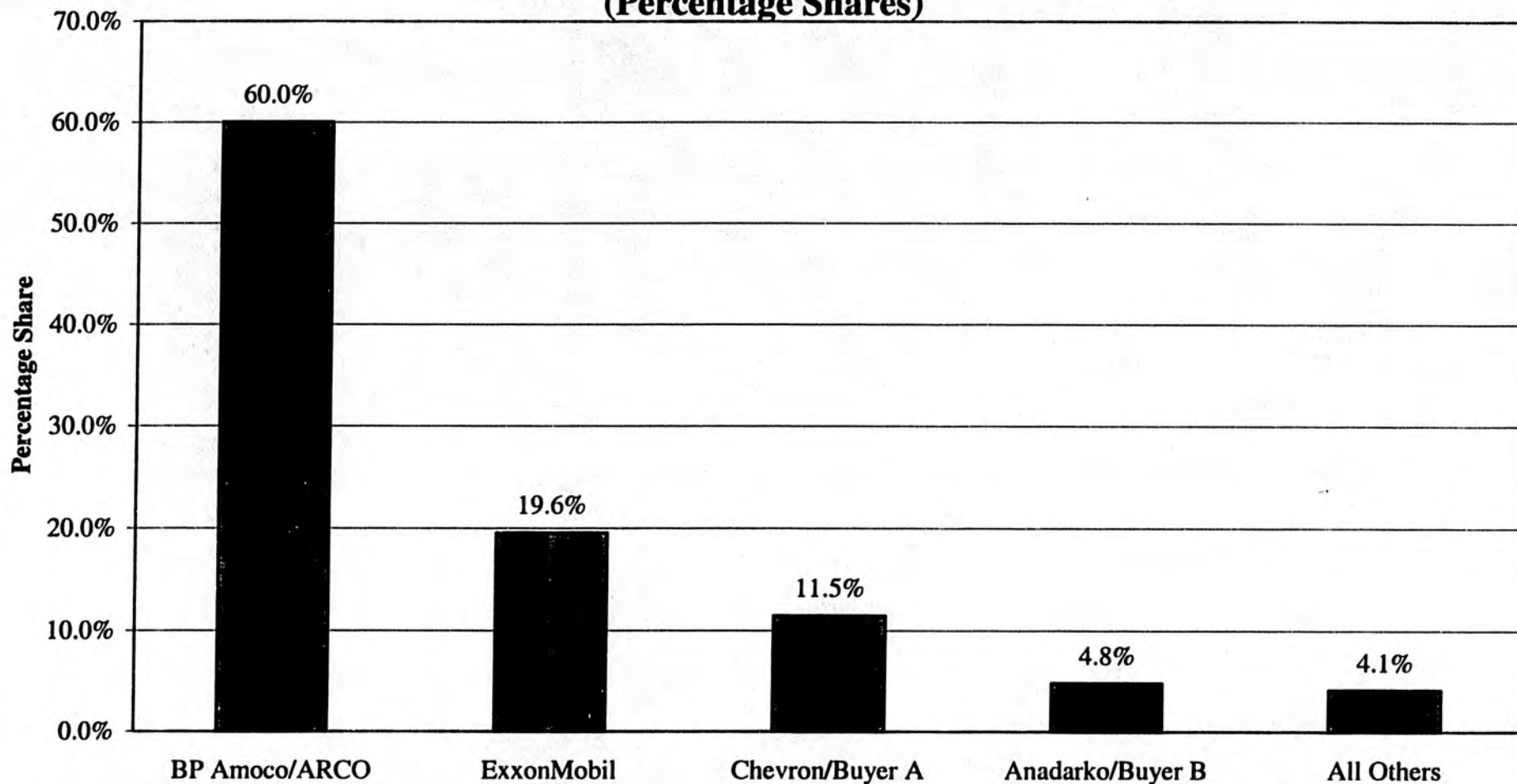
Sources: Alaska Department of Natural Resources, Historical and Projected Oil and Gas Consumption, May 1999;
Charter for the Development of the Alaskan North Slope, December 2, 1999.

Chart 2
A With the Merger and No Divestitures Comparison of
Estimated 2001 Percentage of ANS Crude Oil Production
for BP Amoco/ARCO, ExxonMobil, and All Others
(Percentage Shares)



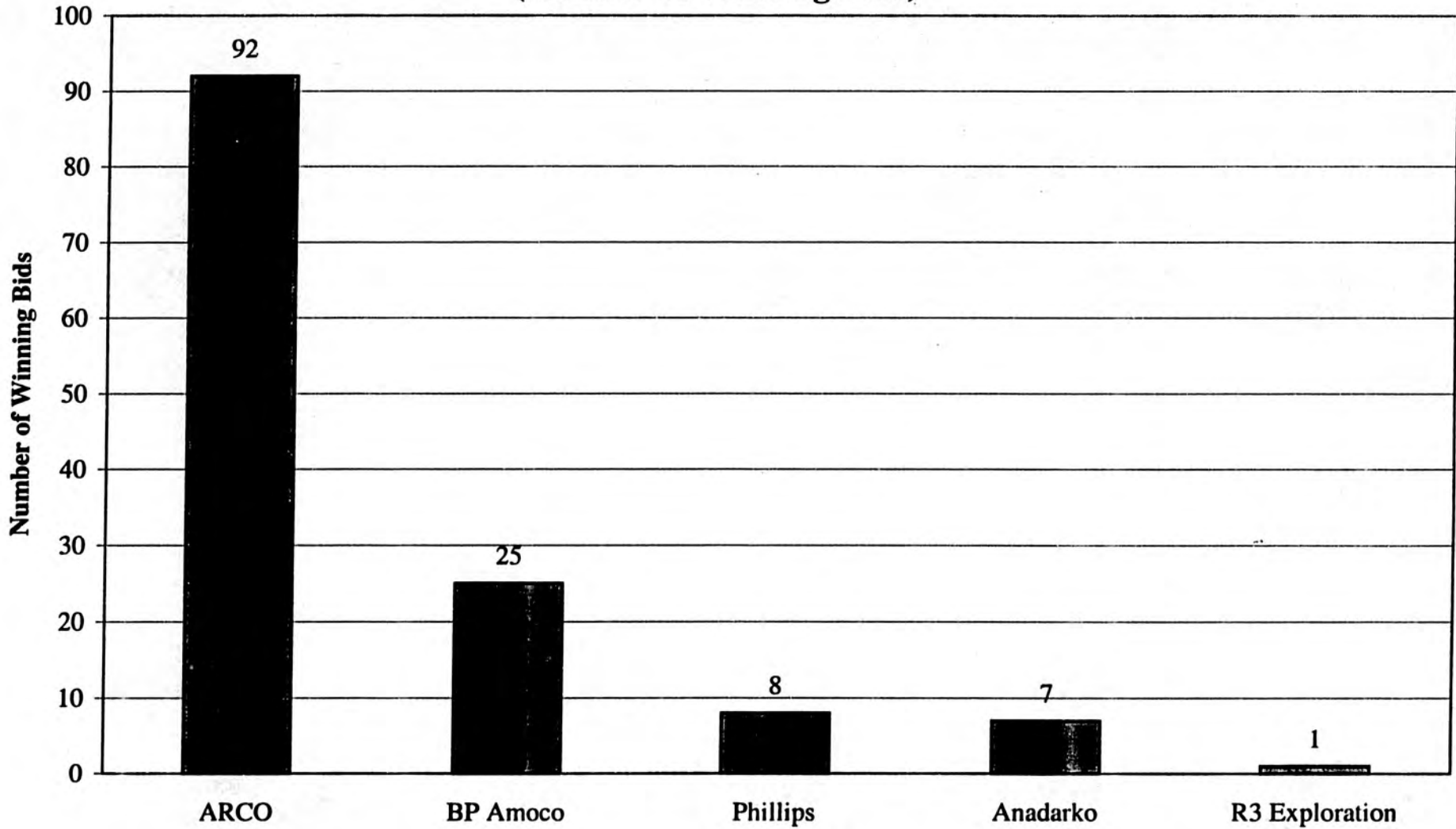
Sources: Alaska Department of Natural Resources, Historical and Projected Oil and Gas Consumption, May 1999;
Charter for the Development of the Alaskan North Slope, December 2, 1999.

Chart 3
A With the Merger and Charter Divestitures Comparison of
Estimated 2001 Percentage Shares of ANS Crude Oil Production
for BP Amoco/ARCO, ExxonMobil, Chevron as Buyer A,
Anadarko as Buyer B, and All Others
(Percentage Shares)



Sources: Alaska Department of Natural Resources, Historical and Projected Oil and Gas Consumption, May 1999;
Charter for the Development of the Alaskan North Slope, December 2, 1999.

Chart 4
The Number of Winning Bids by Leading Interest Company
at the May 1999 NPR-A Oil and Gas Lease Sale
(Number of Winning Bids)



Source: U.S. Department of Interior, Bureau of Land Management, BLM Alaska NPR-A Oil and Gas Lease Sale, May 5, 1999.

STATE OF ALASKA

TONY KNOWLES, GOVERNOR

DEPARTMENT OF LAW

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January 21, 2000

The Honorable Rick Halford, Chairman
Joint Special Committee on Mergers
State Capitol, Room 121
Juneau, AK 99811

Dear Chairman Halford and Members of the Special Committee:

Thank you for this opportunity to provide a written statement of the Administration's position regarding BP Amoco's proposed acquisition of ARCO, to be included as part of the Joint Special Committee on Merger's final report. As all Alaskans by now know, the Governor heard a broad cross-section of citizen views on this issue, which is of utmost importance to the State and to its economic future. I discuss these views in detail in my Report to the Governor on the public hearing process, dated November 30, 1999, and attach that report for your convenience rather than repeat its findings. While there is no solution that all Alaskans would embrace, the Charter For Development of the Alaskan North Slope achieves the two objectives the Governor established at the outset of this process: first, that any agreement with BP ensure competition in future North Slope bidding and development; and second, that it reflect an enhanced commitment by BP to the community, commensurate with its new status. I will briefly review how the Charter achieves these objectives. I will also provide comments on the views expressed by the Special Committee's outside consultants, to dispel some of the confusion that those views may have engendered.

THE CHARTER, COMPETITION, AND COMMUNITY COMMITMENT

The Charter provides the foundation for continued competitive development of Alaska's North Slope petroleum resources by eliminating BP Amoco's ability to stifle competition through its acquisition of ARCO and by creating a more competitive environment for the future than presently exists on the North Slope. The following features of the Charter are intended to ensure that the North Slope competitive environment is revitalized:

➤ **DIVESTITURE OF PRODUCTION AND ACREAGE**

- At least 175,000 barrels a day of production will be divested to other companies
- There will be new operators for the Kuparuk River Unit and the Colville River Unit (Alpine)
- At least 250,000 acres of undeveloped State leases must be divested to the company or companies that acquire production and the right to operate at Alpine and Kuparuk
- BP must divest at least 50.01% of the working interests at Kuparuk
- BP must divest at least 50.01% of a significant play fairway in NPRA, to the new operator at Alpine or Kuparuk
- One of the new operators of Kuparuk or Alpine will gain leases on at least 100,000 acres in the NPRA
- At least 220,000 acres of NPRA leases and at least 400,000 acres of states leases will be sold to other companies
- The Charter adds two new exploration operators on the North Slope
- Any company seeking to explore the North Slope will have timely access to BP Amoco's and ARCO's proprietary seismic data
- BP must allow access to its North Slope facilities by other producers on commercially reasonable terms, and must accede to binding arbitration on those terms if other producers believe BP is being unfair
- BP must purchase the production of smaller producers, up to 30,000 barrels per day, at a price established by the State
- The new operators of Kuparuk and Alpine will receive shares of TAPS and all relevant intermediate pipelines
- Other producers on the North Slope will have an opportunity to purchase a share of TAPS
- BP is required to offer any surplus marine tankers to other North Slope producers.

➤ **DEVELOPMENT OF NATURAL GAS**

- **The price target provision in the draft Charter was removed and replaced with the concept of "fair market price"**
- **BP is required to negotiate in good faith with the newly established Port Authority, Yukon Pacific Corporation, and any other company or group that proposes to build a qualified gas treatment and transmission project, to determine a fair market price or transportation charge for the gas, in sufficient quantities to support the project**

➤ **OTHER SIGNIFICANT PROVISIONS**

- **Proprietary seismic and well data developed before 1975 will be made available to the public at no charge**
- **BP must reimburse the State for the approximately \$1.5 million in expenses it incurred as part of its investigation and review of the transaction**
- **The State may incorporate any additional concessions negotiated by the FTC directly into the Charter**

For the foreseeable future, the opportunities for significant new oil discoveries on the North Slope will likely be concentrated in the West, including the NPRA. The divestitures of NPRA lands are structured so that the purchasers will have both the incentive and the means to aggressively develop these lands. Moreover, one purchaser will get not just NPRA leases, but also the production base and infrastructure of Alpine or Kuparuk to support its operations. In addition, the Charter opens State lands to further competition. Under the Charter, the divestitures of State lands must be done in a manner that will result in two exploration operators.

While the divestiture of assets and other requirements designed to ensure healthy North Slope competition are at the heart of the Charter, it also includes numerous provisions reflecting BP's enhanced commitment to the people and communities of Alaska. These commitments are beyond anything currently required under state or federal law and anything the State could have obtained through litigation of its antitrust claims. The community commitment provisions include:

➤ ENVIRONMENTAL PROVISIONS

- BP must spend \$10 million to clean up abandoned hazardous sites
- BP must spend \$5 million on additional abandoned site clean-up, spill research, or corrosion experts as requested by the Alaska Department of Environmental Conservation
- BP must replace all of their existing single-hulled tankers with double-hulled tankers one year earlier, on average, than required by the Oil Pollution Act of 1990 (OPA 90)
- BP must repudiate any trade association effort to weaken OPA 90 standards
- BP must continue to support the ship escort response vessel system in Prince William Sound
- BP must report annually on environmental issues

➤ ALASKA HIRE

- The Alaska hire provisions currently applicable to the Northstar development are extended to all of BP's Alaska operations
- BP acknowledges its continuing support for the recruiting, training and hiring of Alaska Natives

➤ CHARITABLE GIVING

- BP commits to establish a charitable foundation, which it will fund in perpetuity based upon a formula tied to oil production and price, but which today reflects an increase of approximately 50% over BP's and ARCO's current combined charitable contributions

The Charter unquestionably enhances the competitive dynamics on the North Slope and is superior to alternative remedies that could have been employed, including simply blocking the merger in its entirety. Under the Charter, ARCO will be replaced on the North Slope by a number of new players. Competition in leasing, exploration and development of the North Slope will be greater than it is today. Moreover, the Charter enables BP to achieve significant efficiencies in the Prudhoe Bay Unit, and allows the realignment of the current interests in the oil rim and gas cap in a way that should encourage even greater

incremental investment in that field. This should lead to greater overall production, which is good news for all Alaskans.

RESPONSE TO OPINIONS OF CONSULTANTS HIRED BY THE SPECIAL COMMITTEE

The Special Committee has released two 5-page memoranda and heard testimony from two law firms ("Preston Gates" and "Collier Shannon") that purport to address the merits of the Charter. Their conclusions are, for the most part, speculative and lack any foundation in sound antitrust analysis or the reality of Alaska's oil environment. The reason for those flaws is apparent. The consultants started with the view that the State could receive a better deal if it litigated first and negotiated later.

The Charter is a settlement. It is, by definition, a compromise between two potential litigation outcomes. If the State litigated its antitrust claims, the BP-ARCO merger either would be held unlawful or it would be approved. The Preston Gates memorandum argues that the Charter should be measured against only the first of these two possible outcomes. Of course, no compromise looks particularly good when measured against the alternative of a complete victory. As Preston Gates acknowledges, however, "all litigation involves uncertainty." If the State were to challenge the BP-ARCO merger and lose, then it would have nothing to show for its efforts. Measured against this benchmark, the Charter provides enormous benefits to Alaska and its citizens.

The Charter should not be measured against either of these two extremes, of course, but as a negotiated solution that attempts to capture the maximum potential benefit for Alaskans while nevertheless avoiding the time, expense and risk of litigation. Against this standard, the Charter's achievements are extraordinary. It enables the merging parties to achieve efficiencies that will benefit not only BP, but Alaska as well. At the same time, it preserves competition on the North Slope, and achieves a variety of additional objectives—ranging from environmental clean-up to increased charitable contributions—that could never have been achieved through litigation.

The following section of this report discusses the specific arguments made by Collier Shannon and Preston Gates at the behest of the Special Committee. Because the testimony of the Committee's consultants parroted the views expressed in the two 5-page memoranda the Special Committee released, it is unnecessary to address that testimony separately.

THE COLLIER SHANNON MEMORANDUM

The Charter Ensures that the Ultimate Purchasers of Kuparuk and Alpine Will be Viable Competitors

The Collier Shannon memorandum argues that the Charter fails to resolve the merger's competitive problems because it does not give the State "any confidence that the ultimate purchaser of divested interests will become a viable competitor to BP Amoco." This is simply incorrect. The sheer size of the production to be divested will ensure that at least two companies with the means to be robust competitors to BP will take ARCO's place.

Weak competitors would not have the resources to purchase 125,000 barrels of production per day, or to operate either the Kuparuk or the Colville River Units. Moreover, the Charter provides that the prospective buyer of the Kuparuk River Unit interest must be either a current interest owner (Chevron, Exxon, Mobil, or Unocal) or an energy company with assets of not less than *\$8 billion*, and that the prospective buyer of the Colville River Unit interest will be either a current interest owner (Anadarko) or an energy company with assets of not less than *\$3 billion*. Any company meeting these standards will have the means to compete aggressively.

In order to preserve the competition that would otherwise be lost as a result of the merger, it is not necessary to "recreate ARCO," as your consultants claim. Rather, the relevant task is to ensure that competition is preserved in those areas where it makes a difference to Alaskans. If the loss of ARCO's presence in certain markets has no effect on competition, there is no need to recreate ARCO's presence in those markets.

For the State, preserving competition in leasing, bidding, and developing North Slope lands is of paramount importance. This is where new State revenues and jobs will be found. In contrast, preserving BP and ARCO as separate entities in currently producing fields would have little, if any, positive impact on the State. From the State's revenue perspective, royalties and severance tax levels are already set—the presence or absence of ARCO will not affect those levels. The merger also will not negatively affect production levels, as the AOGCC and the DNR both have powers to require working interest owners to produce oil in a manner that prevents waste and maximizes the total amount of recoverable oil and gas resources. Indeed, the efficiencies and the alignment of interests in Prudhoe Bay resulting from the merger should actually result in increased production.

Therefore, the main objective for the merger review team was to ensure that the merger did not diminish competition for leasing, bidding and development on the North Slope. The Charter achieves that objective. The Charter ensures that ARCO is replaced by at least two companies that will have the means to aggressively compete against BP in exploring North Slope lands. Under the Charter, the new operator or operators of Kuparuk and Alpine will acquire substantial exploration lands. These new operators will have the incentive and the means to aggressively explore and develop lands within these units and beyond, as a consequence of their size, their desire to obtain an adequate return on their investment, and their desire to minimize costs by operating their facilities at full capacity.

The Charter Does Not Need to be an Order of the State or Federal Court

The Collier Shannon memorandum implies that when the FTC resolves its competitive concerns through agreement with the merging parties it files a consent decree with a court. This is not the case. When the FTC enters into agreements with merging parties to resolve competitive concerns, it issues an FTC order. This order is not filed with any Court. In the event that one of the parties to the merger subsequently violates the agreement, the FTC must go to court in order to seek relief. It must then prove that the party or parties did indeed violate the agreement. The same is true with the Charter. If BP violates the competitive provisions of the Charter, then the State can seek relief through the Courts for the violation of the Charter. It should be emphasized that the State does not need to prove an antitrust case *de novo*; it simply has to show that BP has violated the Charter.

A Complaint is Unnecessary

A Complaint can be a useful aid in those instances where a consent decree merely orders a divestiture and does not specify the precise manner in which the divestiture is to be carried out. Here, the Charter not only identifies what divestitures are necessary but also the specific manner in which the divestitures must be carried out. For example, the Charter requires that BP divest State acreage in a manner that creates two new exploration operators on significant geologic play fairways. The Charter is sufficiently detailed so that there is no need for a complaint as an interpretive aid. The State elected to specify exactly what it wanted in the Charter so that "interpretive aids" were not necessary.

The Buyer of the Kuparuk Interests Will be an Effective Competitor

Collier Shannon argues that the proposed divestiture involving the Kuparuk unit will not ensure that the purchaser will be an adequate competitor because: (1)

BP could possibly retain a majority interest in Kuparuk; (2) up to one quarter of the divested production could be from other units; (3) BP is not required to sell the purchaser production acreage; and, (4) BP is not required to sell the purchaser any tankers. The first three points are now moot. Under the final Charter, the Kuparuk purchaser will have a majority ownership interest in Kuparuk and BP will be required to divest significant exploration acreage to the new Kuparuk operator. And, as discussed below, prohibiting BP from divesting production outside of Kuparuk to the new Kuparuk operator, or forcing BP to sell tankers to that operator whether that operator wants them or not, would not have enhanced the new operator's ability to be an effective competitor.

Production From Other Portions of the North Slope

The Collier Shannon memorandum contends that the Charter allows 1/4 of the minimum production to be divested to the new operator of Kuparuk to come from another source, and that this will somehow place the new operator at a disadvantage. This is not the case. For one thing, the production from Kuparuk for 1999 is approximately 260 mbd. Because BP and ARCO have to divest over 50% of that, the production divested at Kuparuk will exceed the minimum production volume of 125 mbd that must go to the Kuparuk operator. While that is a minimum production volume, and BP could divest production from other fields to the Kuparuk operator on top of that, this would hardly diminish the Kuparuk operator's competitiveness. Under any scenario permitted by the Charter, that operator will have a significant presence on the North Slope and will have an incentive to build on that investment. The fact that the operator could obtain other production interests from a number of other units will only increase its competitiveness.

Marine Transportation

According to the Collier Shannon memorandum, the Charter should have required BP to sell the Kuparuk buyer tankers in order to make it an "ARCO-like" competitor. First, the Charter is not intended to "recreate ARCO;" it is intended to preserve competition on the North Slope. Second, the Charter requires BP to sell its surplus tankers to any North Slope producers that want them. The divestitures required by the Charter will clearly leave BP with surplus tankers, so the Kuparuk buyer will be able to acquire the tankers if it sees that it is in its interest to do so. The Kuparuk buyer will be purchasing an immense quantity of petroleum. It will not make such a purchase unless it has a way of transporting it to destination markets. Thus, either the purchaser will have the ability to get its own tankers or BP will have to sell it sufficient tanker capacity in order to fulfill its obligations under the Charter.

The Buyer of the Alpine Interest Will be a Viable Competitor

The Collier Shannon memoranda contends, without any analysis, that the buyer of the Alpine production will not be a viable competitor *vis a vis* BP. This contention cannot be sustained. First, the Charter is expressly designed to permit the buyers of Kuparuk and Alpine to be the same company. Second, even if the Alpine purchaser is different than the Kuparuk purchaser, it will be receiving significant production (approximately 32,000 barrels per day), it will become the operator of that field, and it will acquire significant exploration acreage. A buyer will not make such a significant investment unless it is willing and able to compete. Moreover, BP will not control any facility that would allow it to adversely affect the buyer's production operations.

The Charter Was Tailored to Reflect Industry Realities

The Governor, his Merger Review Team, and its staff, between them, personally interviewed virtually all of the major oil companies in the world. The Charter's provisions were formulated after those interviews were completed. The Merger Review Team tailored the divestiture packages to inject viable competition into the North Slope, relying largely upon the views of BP's potential competitors regarding what it would take to be competitive in Alaska. Notably, the Collier Shannon memorandum does not point to any *oil industry* evidence that the Charter fails to fulfill the competitive objectives of the State. In addition, the State continues to retain the right to reject any proposed divestiture that does not achieve the competitive objectives of the Charter.

THE PRESTON, GATES MEMORANDUM

The Preston Gates Memorandum Assumes Victory But Acknowledges That Litigation Is Uncertain

The Preston, Gates memorandum assumes that the merger could be preliminarily enjoined by the State. It contains no antitrust or litigation analysis to back up this assumption. A more sophisticated approach would examine each of the potential outcomes of bringing litigation against the likelihood of their occurring. Nevertheless, for purposes of further discussion of the Preston Gates memorandum, we will assume their assumption is correct, despite the lack of any legal analysis.

The Charter gives the State certainty and lays the foundation for a more competitive environment for the future of the North Slope—leasing and development of additional North Slope lands. It also allows BP to achieve efficiencies that will make Alaskan oil more competitive in the world market.

Given these concrete results, the Charter benefits all Alaskans and is superior to the ~~market~~ uncertainty of litigation.

Blocking The Merger Will Not Inevitably Result In A More Competitive Outcome

The Preston Gates memorandum, in commenting upon the testimony of an ARCO representative, states that purchase of ARCO by a company other than BP would have advantages over the Charter, including an opportunity for the State to review and, if necessary, oppose the merger. This statement completely overlooks the fact that any other company that might acquire ARCO, with the possible exception of Exxon, would not present major antitrust issues in Alaska because there would be little or no competitive overlap. Absent antitrust issues, there is no basis for opposing the merger. The State simply would not have anywhere near the bargaining strength that it does with respect to the BP-ARCO merger. There would be no "opportunity to evaluate the merger based on the stated intentions of the acquiring company." Moreover, there is no guarantee that a different company acquiring ARCO would be an "ARCO-like" competitor; the company might acquire ARCO simply to exploit its production assets and not be interested in making investments in exploration.

There is also no way to know in advance whether one company or more than one would acquire ARCO or parts of ARCO or, if one company initially acquired all of ARCO, what parts it would keep and what parts it would spin off. The related statements in the Preston Gates memorandum about what staff the unknown acquirer would retain are mere conjecture. In addition, the Preston Gates memorandum suggests that a litigation settlement might provide an opportunity to pursue a reduction in the TAPS tariff. Through divestiture, the Charter achieves a competitive solution to the TAPS issue; an approach that the FTC apparently favors. As my report on the public comment process states, I was advised that a reduction in the TAPS tariff was a disfavored behavioral remedy in the eyes of the FTC. (Report of the Attorney General on the Public Hearing Process, etc., dated November 30, 1999, at 11-12.) For the same reason, Preston Gates is careful, I assume, not to state that antitrust litigation could result in a lowered TAPS tariff, which is highly unlikely. All it suggests is a settlement might present an opportunity to pursue a reduction in the tariff, which is not saying very much. I discuss other reasons why the Charter solution to the TAPS issues is preferable in my November 30, 1999 report to the Governor.

What would be lost if BP is not allowed to acquire ARCO?

The Preston Gates memorandum suggests that the savings of a single operator will occur inevitably, with or without the merger. The merger, Preston

Gates suggests, merely makes that process certain and sooner in all likelihood. Yet aside from this bald assertion, Preston Gates does not put forth anything to support this conclusion. The transition to a single operator is "inevitable" only because at some point, perhaps far into the future, Prudhoe Bay will not have enough production to support the cost of two operators. This issue has divided the owners of the Prudhoe Bay Unit for 25 years. There simply is no reason to believe that this alignment was "inevitable," within any sort of a reasonable timeframe, absent the merger. In our view, moving to a single operator now is likely to generate significant value for the State compared to an approach that delays the transition to a single operator into the indefinite future.

Preston Gates also misses the importance of aligning more closely the disparate interests of the oil rim and gas cap participating areas of the Prudhoe Bay Unit, something that, absent a Major Gas Sale (as defined in the Unit Operating Agreement) is likely to occur only if the BP and ARCO merger is consummated. Because of the various cost allocation provisions under the Prudhoe Bay Unit Operating Agreement, BP's per barrel lifting costs are significantly different than ARCO's or Exxon's. That misalignment can create transactional costs that hamper incremental investments. The merger goes a long way toward eliminating that misalignment.

Other gains from the Charter would also be lost if BP cannot acquire ARCO

Through negotiations, the State was able to achieve a package of benefits greater than what could reasonably be expected from an antitrust suit. These benefits include promoting gas commercialization, requiring environmental clean-up of abandoned hazardous waste sites, Alaska hire, and the charitable and community commitments. If BP does not acquire ARCO, and someone else does, the State will in all likelihood lose these benefits of the Charter. That is because, if the new company acquiring ARCO is anyone but Exxon, there is probably no antitrust issue, and hence no basis for negotiating an agreement as broadreaching and positive as the Charter. The new buyer could simply choose to exploit ARCO's existing business in Alaska, and could do so unfettered by the special obligations and requirements of the Charter.

Other Objections to Specific Terms of the Charter

Preston Gates argues that the Charter should have provided that only companies "who are best suited to achieve" the State's competitive goals are eligible to buy the assets, and required that the purchasers of assets be identified before the merger closes. These provisions are not necessary. Only a few companies are in the position to purchase the types and packages of assets that are being divested. Moreover, the State retains the right to reject any buyer that will

not satisfy the competitive purposes of the Charter. In addition, the packages of assets were designed with industry realities in mind, after confidential discussions with virtually every major oil company (apart from state-owned oil companies) in the world. Finally, it should be noted that the FTC allowed Exxon and Mobil to close their transaction before buyers for the divested assets were identified. The FTC presumably recognized that where, as here, it is possible to clearly identify a pool of eligible and interested purchasers, requiring a buyer before the merger is allowed to close is an unnecessary precaution.

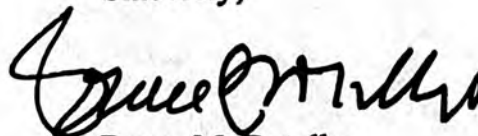
CONCLUSION

There was potential both for benefit and risk to Alaska in the merger as it was initially proposed. Alaska could benefit from the combination's financial strength and expertise, and the cost reductions contemplated by the merging companies could have made Alaska more attractive for investment in a global oil marketplace. But Alaska would, absent the Charter, lose a unacceptable measure of competition, diversity and balance in the leasing, exploration, and development of North Slope resources.

The Charter balances the benefits and risks posed by the merger in a way that protects and enhances the interests of all Alaskans. The Charter addresses the risks posed by the merger by providing for greater competition and diversity in the leasing, exploration, development and production of Alaskan North Slope oil and gas. It also makes Alaska more competitive globally by capturing the most important cost savings anticipated from the merger.

Thank you for allowing me this opportunity to express the administration's views. Please call me if you have any questions.

Sincerely,



Bruce M. Botelho
Attorney General

BMB:kh

Summary of BP's Presentation to the Joint Committee on January 19, 2000.

Introductory Overview. The merger will make Alaska more competitive globally and more attractive for industry investment by lowering the fixed cost base. This new and continued investment will enhance production and significantly extend the productive life of the North Slope. This enhanced production will result in more work activity and state revenues over a longer time than without the merger. Finally, the central concerns expressed in Alaska about the merged company have been fairly addressed by the Charter. The power and advantage of the merger is it will lead to lower costs, more investment, more production, more work, more jobs and more state revenue for a longer period of time.

Presentation:

As of last year this time, the North Slope was at risk of losing its position as an attractive place to invest new exploration and production capital and was at risk of becoming a sub-par global prospect.

The exploration and development market is global, unconcentrated and highly competitive. ANS crude oil is part of a global crude oil market, of which exploration and development of the Alaska North Slope is a component. BP and ARCO combined are only a small portion of this global market, with only about 1.1% of total worldwide crude oil reserves and about 5% of worldwide crude oil production. Using 1997 as an example, exploration and production investment in Alaska is about 2.5% of world total. The worldwide crude oil exploration and development market includes the world's largest privately owned companies and major oil producing countries, such as Saudi Arabia, Iran, Nigeria and Venezuela.

Capital in this global market moves quickly to areas of high prospectivity. Alaska competes in this global market for the investment dollar of oil and gas companies. "The industry competes for exploration funds on a worldwide basis" (Petroleum News Alaska, June 1999, at p.A14, citing Jim Konst, Alaska Operation Manager, Phillips Petroleum). As a recent local example, Shell and Texaco left Alaska in the early 1990's because of opportunities elsewhere.

Cost is a critical component in the risk/reward analysis of capital allocation. E&P investment decisions are made, in BP's industry experience, based upon: cost of finding, developing and producing oil; size of the oil field; level of government "take" in taxes, tariffs and royalties; and the stability of the host government. Of these, only cost can be materially influenced by a private company.

Alaska is a high cost region by global standards. The cost of finding, developing, producing and transporting oil to market from Alaska is approximately \$10 per barrel, compared to a range of \$4-\$6 per barrel in the lowest cost world regions of the Middle East and Venezuela. Venezuela is currently "open for business" to private energy

companies and others are at various stage of considering greater openness. These other regions have cost advantages as producers competing for finite demand and corresponding power to flood markets with low cost crude as a competition tool, which is an additional factor in making investment decisions in higher cost regions.

Alaska's mature fields are declining. Alaska's mature fields are characterized by the dual challenge of increasing absolute costs (gas, water, etc.) and declining volumes. For example, oil production at Prudhoe Bay is now less than half its peak rate and declining, while associated water and gas has more than doubled since peak oil.

Further cost savings options are limited. North Slope participants have largely exhausted available avenues for further fixed cost base savings under current ownerships. Consolidation to single operator at Prudhoe Bay has been attempted several times, but before the BP/ARCO merger, none of those efforts were successful.

The merger of BP and ARCO in Alaska has the potential to restore the North Slope as an attractive global exploration and production investment location.

The merger will reduce costs. The merger as originally proposed was projected to remove approximately \$1 billion per year in costs globally, \$200 million per year in Alaska. The merger as modified by the Charter is projected to remove approximately \$140 million in costs from the Alaska fixed cost base, which is still a material reduction that cannot be achieved by other methods. A reduction of this magnitude is significant, and makes investment in Alaska more attractive. Using \$15 per barrel oil - segmented to reflect producer's earnings of \$1.28, costs of \$9.70, and tax/royalty of \$4.02 - illustrates the materiality of a cost reduction of, e.g., \$.60 per barrel on earnings. Although oil prices have fluctuated in a wide range (\$9-\$25) during the past year, this example focuses on the relevant point for purposes of this analysis, as industry investment decisions are based on long-term price assumptions in this general \$15 range.

The merger improves alignment at Prudhoe Bay. The merger will also remove the cost - harder to quantify - of misalignment of gas cap and oil rim interests at Prudhoe Bay. Elimination of this cost should facilitate future investments at Prudhoe Bay by simplifying decision-making.

Reduced costs lead to a virtuous cycle. Reducing costs - of all kinds - is the first and most critical step in triggering the "virtuous cycle" on the North Slope. Reduced costs will stimulate and enable more investment, which leads to more production. More production spread over the same fixed cost base lowers unit costs on the North Slope for all participants, which in turn makes additional investment more attractive, leading to more production, leading to still lower unit costs.

The Charter is a fair result of a fair process and strikes a balance between considerations of global competition and local diversity.

The merger created the opportunity to improve efficiency and alignment. In early 1999, ARCO management made a decision to sell the company. ARCO had other options, but chose to approach BP regarding this merger. This gave BP and ARCO a unique opportunity to reduce the cost base and to improve alignment on the North Slope, with all the benefits to the companies and to Alaska that go along with those efficiencies, synergies and cost savings.

The merger gave the State an opportunity to re-engineer the industry structure. The merger review and Charter negotiation process gave the Governor and his Administration an unprecedented opportunity to re-engineer the industry structure on the North Slope for the benefit of Alaska and the nation, which all benefit from additional production. This process was greatly informed by the work of this Legislative Committee, the review of its experts and broad public input.

The Charter strikes a balance between local and global competition. The final Charter reflects a studied effort by the State and the company parties to find a reasonable balance between (a) ensuring broader participation and diversity in the exploration and development of North Slope oil, and (b) preserving the core efficiencies of the merger to keep Alaska competitive globally.

The Charter promotes competition and diversity on the North Slope. The Charter will create broad new participation on the North Slope, largely through the divestitures planned under the Charter. Planned asset packages, based upon discussions with the State and buyers include: Buyer A (Kuparuk) package - 55% of Kuparuk River Unit (including Greater Kuparuk Area interests and operatorship), 55% Oliktok Pipeline, 37% Kuparuk Pipeline, 10.4% TAPS, 244,000 state exploration acres, 122,000 NPRA acres and up to 3 tankers; and Buyer B (Alpine) package - 43.1% Colville River Unit (including operatorship), 43.1% Alpine Pipeline, 8% Kuparuk Pipeline, 2.3% TAPS, 143,000 state exploration acres, 80,000 NPRA acres and up to 1 tanker.

Charter divestitures will bring significant new participants to the North Slope. The Charter divestitures represent the largest sale of world class assets in the history of the oil industry. The packages are of a size that are attractive to buyers and will represent major holdings in their global portfolios. These new parties will be fully integrated within Alaska and significant participants in future North Slope exploration and development.

The Charter will result in a restructured North Slope. The assets to be divested were, for the most part, selected by the State. For example, BP/ARCO were initially firmly opposed to divesting majority ownership and operatorship of Kuparuk and Alpine, but the State insisted on these elements as fundamental to its vision of the restructured North Slope. The resulting combined packages of divestitures represents a comprehensive re-engineering of a major oil province without precedent in the United States, or even the world.

The Charter strengthens both cooperative and competitive potential. Some aspects of upstream exploration and production can benefit from diversity of individual view and effort - for example, in analyzing new prospects or in competitive bidding for new leases. Most aspects of the activity on the North Slope - that is, virtually all aspects of prospect development and production - are characterized by an essential pooling of physical, financial and human resources in a joint, cooperative effort where cost reduction, joint efficiencies, regional alignment and global competition for investment capital are the key drivers. The Charter strengthens the potential for both aspects.

The Charter promotes broad participation by more than divestitures. The Charter contains other provisions to ensure enhanced participation by other companies in the future. For example, BP and ARCO will make proprietary seismic data publicly available to stimulate broader participation in future State lease sales. BP and ARCO have made specific new commitments for facilities access, including arbitration to resolve disputes. BP and ARCO have agreed to purchase oil at PS1 from small producers at a State-established price.

The Charter promotes gas development. The Charter also ensures active efforts and opportunities to commercialize North Slope gas. Under the Charter, BP and ARCO have agreed with the State to make gas available at an acceptable price to viable projects. BP is also bringing its global gas technology group to Alaska and establishing a natural gas business unit dedicated to commercialization of North Slope gas.

This proposed merger is the result of irreversible trends in our ever increasingly global economy.

The trends which drive this merger are irreversible. The energy industry will continue to become more global in all of its aspects, from capital allocation to marketing. Energy companies, like all companies, will continue to consolidate to reduce costs, in order to compete globally with other companies that are also driving out costs and becoming more efficient through mergers and otherwise. Exxon-Mobil is the most recent example. Energy companies will continue to merge to achieve the scale necessary to invest in the largest scale projects without sacrificing reasonable portfolio diversification. Energy markets will continue to be volatile and to experience periods of oversupply and undersupply and the price shifts (sometimes extreme) that go with that. Energy companies will, increasingly, need to be configured and sized to remain viable through the full range of potential price shifts. Private energy companies will increasingly need to be able to compete with State run oil companies.

Harnessing these trends can lead to the full development of the North Slope. BP, ARCO and Alaska all need to respond to these realities. The result of failing to respond constructively to these trends and to the ongoing evolution of the world economy would likely be the stagnation and decline of the North Slope. Acknowledging and harnessing these trends, as BP and ARCO have done in their proposed merger and as the

Administration has done in the Charter, is a realistic and practical way to move towards the fullest possible development of the North Slope.

The merger will ensure the prolonged future of the North Slope. These trends support this merger. The quicker the merger is completed, the quicker Alaska can get back to making the investment decisions that will preserve and extend the future of the North Slope.

BP's Reaction to Positions Advocated by the Joint Committee's Retained Lawyers and Economists.

The Committee-retained lawyers and economists opined at the January 18 hearing that the merger in any form is not in Alaska's best interest. This view was based on their conclusions that : (1) Proper analysis of this matter should be limited strictly to Alaska. (2) Alaska is a "consumer" for the purposes of antitrust analysis. (3) BP and ARCO compete across the full range of Alaska activities. (4) Any merger efficiencies in Alaska can also be expected without the merger. (5) The status quo is better than the Charter because the upstream oil business in Alaska is too complicated to know whether the Charter result is better.

BP believes that their conclusion is wrong and their analysis is flawed because:

Forces outside Alaska need to be considered in any analysis of the impact of the merger on Alaska. The competition for exploration and production capital, and the forces which determine this capital flow, are global. The successful competition for global capital for investment in Alaska is essential to the long-term future of the North Slope.

Alaska is not a "consumer" for purposes of antitrust legal analysis. The relevant consumers in that context are retail gasoline buyers on the West Coast, who are not injured in any way by this merger. The only area for even arguable antitrust analysis in Alaska is with respect to leasing, and here Alaska is a seller or supplier, not a consumer. No antitrust problem arises from the merger in this area as the group of actual and potential buyers includes numerous companies in addition to BP and ARCO both locally and globally, the sellers (Alaska and federal government) have broad powers not available to normal private sellers, and the merger will, in all events, have no downstream effects on consumers.

The unsupported conclusion that BP and ARCO compete across all activity sets in Alaska is simply untrue. Other than with respect to leasing, activity in Alaska is either characterized by cooperation on joint development and production or by regulated activities where no competition between BP and ARCO has historically existed or been expected by regulatory design. Particularly in the area of joint activities, Alaska has been benefited by cooperation and elimination of redundant costs and inefficiencies. This joint activity is not remarkable, but rather the long-established nature of responsible upstream resource development and management.

The conclusion that merger efficiencies such as realignment of interests and a single operator at Prudhoe Bay can be expected to occur naturally without a structural consolidation such as the merger is contrary to the view of more experienced observers and participants.

Finally, the Charter structure was developed by people representing in the aggregate many lifetimes of North Slope experience and close familiarity with the particular assets involved. These persons, and most other industry participants and observers, all concur in the view that the Charter result is superior to the pre-merger status quo.