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by Mike Cowie and Lawrence Reicher

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Slick Roads: Takeaways from the FTC's Approval of a Contentious Oil Industry Merger

By: Mike Cowie and Lawrence Reicher[1]

This Spring, the Federal Trade Commission ("FTC") cleared an acquisition combining California oil refineries without seeking a divestiture or any other relief. This transaction—Tesoro Corporation's ("Tesoro") acquisition of certain assets of BP p.l.c. ("BP")—cleared despite the FTC's history of aggressive enforcement in the very same product and geographic market, as well as heavy political opposition to oil -industry mergers. This article identifies takeaways or lessons for antitrust-sensitive transactions. While the setting is the oil industry in California, the lessons apply across a variety of industries and have particular importance when facing government skepticism and political opposition.

You will hear from the regulators. When Tesoro announced an agreement to acquire BP's oil refining business in Southern California, it was no surprise that intense scrutiny from regulators followed. In this business sector, consent decrees, divestiture, and significant scrutiny from state and federal agencies are the norm. For example, the FTC raised concerns about competition in California in challenging Shell/Texaco (Equilon) in 1997, Exxon/Mobil in 1999, Valero/UDS in 2001, and Chevron/Unocal in 2005.[2]

A recent FTC study confirms that oil-industry mergers have the unenviable distinction of inviting more attention at lower market shares than other industries.[3] The FTC data on second-request investigations by market concentration[4] show that more than 70% of oil sector second-request investigations involved markets with moderate or low concentration (i.e., with HHIs below 2400). The next closest sector was grocery, at 11%. For all sectors other than oil, the rate was just 2%. Indeed, over the past fifteen years, the FTC has challenged mergers in 90 markets with relatively low HHI levels by the FTC's own standard (i.e., with HHIs below 2000)—and the oil sector accounted for 100% of these. No other industry experienced an FTC merger challenge at these concentration levels. The FTC has even challenged

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[1] The authors are attorneys at Dechert LLP. Dechert served as antitrust counsel to Buckeye on the Georgia-Pacific/Buckeye merger and to Medco on the Express Scripts/Medco merger referred to below.

[2] http://www.ftc.gov/ftc/oilgas/press_room.htm.

[3] Federal Trade Commission, Horizontal Merger Investigation Data: Fiscal Years 1996-2011 (Jan. 2013), available at http://www.ftc.gov/os/2013/01/130104horizontalmergerreport.pdf.

[4] Market concentration is oftentimes quantified by the Herfindahl-Hirschman Index or "HHI". The 2010 merger guidelines classify three types of markets: (1) unconcentrated (below 1500); (2) moderately concentrated (between 1500 and 2500); or (3) highly concentrated (above 2500). The FTC study did not use the same HHI parameters when charting mergers it investigated.

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acquisitions in the oil industry where post-acquisition concentration was close to or even below the level considered low by current merger guideline proscription (i.e., with HHIs below 1800).[5]

You will not just be dealing with the FTC or DOJ. State attorneys general, politicians, and consumer groups may influence the terms of any settlement. State agencies and AGs play the most direct role and can directly challenge mergers that are also reviewed by federal regulators.[6]

For instance, the 2001 Valero/UDS agreement with the FTC also included stipulated judgments with the Oregon and California state AGs. While the transaction did not involve any physical plant within Oregon, "[s]ome of the gasoline produced in the [California] refineries [was] transported and sold in Oregon."[7] With this hook, the Oregon AG received reimbursement for the cost of its investigation and authority to review and approve the buyer of the refinery and gas stations that were divested as part of the consent decrees. Similarly, in 1999, fourteen states were part of the investigation into the Exxon/Mobil merger; four separate consent agreements with various states were reached before the deal was finalized.[8]

State-level scrutiny is not limited to the oil industry. Several other mergers illustrate the importance of working concurrently (and oftentimes creatively) with state enforcement agencies, even when the state agency's concern stretches beyond traditional notions of anticompetitive concern. In 2002, for example, Wal-Mart agreed to acquire Amigo, the largest grocery chain in Puerto Rico; the FTC approved the merger contingent upon the divestiture of four stores. However, the Puerto Rico Office of Monopolistic Affairs was not satisfied with this divestiture and sued to enjoin the transaction.[9] Wal-Mart settled with an agreement that included not only the traditional remedy (divestiture of two stores but also a far-reaching, ten-year commitment not to reduce its local labor force and to continue "to buy the vast majority of its food products, including local agricultural products, from local sources."[10]

Similarly, the Nevada Attorney General achieved concessions beyond those sought by the federal government when UnitedHealthcare acquired Sierra Health Services in 2008. United divested its

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[5] Mike Cowie and Michael Weiner, *Under the Spotlight: A recent FTC data report reveals that oil and pharmaceutical mergers attract a lot of attention when it comes to antitrust scrutiny*, Competition Law Insight, CLI Volume 12, inBrief 2 (Feb. 6, 2013). One explanation for challenges at this level of scrutiny has been the significant number of markets, coupled with the parties' willingness to accept remedies rather than litigate.

[6] *California v. American Stores, Co.*, 495 U.S. 271 (1990).

[7] Attorney General Allows Valero/UDS Merger with Divestiture of Certain Holdings (Dec. 18, 2001), available at http://www.doj.state.or.us/releases/pages/2001/rel121901.aspx.

[8] Consent Decree & Final Judgment, *New York v. Exxon Corp.*, 99-cv-03183 (D.D.C. Feb. 16, 2000); Consent Decree & Final Judgment, *Alaska v. Exxon Corp*., A-99-618-CV (D. Alaska Nov. 30, 1999); Consent Decree & Final Judgment, *California v. Exxon Corp*., CIV-99-12466 (C.D. Cal. Dec. 1, 1999); Consent Decree & Final Judgment, T*exas v. Exxon Corp.*, 3-99-CV-2709-L (N.D. Tex. Dec. 3, 1999).

[9] *Wal-Mart Stores, Inc. v. Rodriguez*, 238 F. Supp. 2d 395 (D.P.R. 2002).

[10] Stipulation of Settlement between Wal-Mart Stores Inc. et al. and Anabelle Rodriguez, the Secretary of Justice of Puerto Rico, at 2, (Mar. 3, 2003), available at http://apps.americanbar.org/antitrust/at-committees/at-state/pdf/settlements/us-district/1st-circuit/pr-walmart.pdf.

Medicare Advantage business in the Las Vegas market, and also agreed to additional concessions with the Nevada Attorney General that were unrelated to underlying antitrust concerns. Most notably, the company agreed to provide $15 million in charitable contributions over five years to various Nevada organizations and agencies. The donations included: (a) $7.2 million for improving health care delivery and infrastructure for uninsured and underinsured Nevadans; (b) $4.5 million for wellness programs in the state; and (c) $500,000 for the creation of nursing scholarships at UNLV.[11]

In the Tesoro/BP transaction, intense antitrust scrutiny at the state level led the California AG to conclude that the "[t]he concessions we received from Tesoro will advance our efforts to protect competition, the environment, and jobs in the state of California."[12] Yet the initial concerns of the AG were focused solely on "the potential effect of the acquisition on competition."[13] The transaction closed without divestiture—the common remedy for anticompetitive concerns—but with more behavioral and regulatory impositions, such as (a) not reducing the capacity of CARB [California grade] gasoline for three years, (b) maintaining the historical average of daily production for Tesoro's Southern California refineries, (c) generating excess CARB gasoline to cover unplanned refinery outages, and (d) providing monthly volume data to the state for monitoring of compliance. Tesoro also agreed to maintain the ARCO brand as the "value leader" for Southern California retail gas. According to the California AG, "consumers [will] continue to reap the benefits of ARCO's lower prices for years to come."[14] These concessions, along with environmental and job security agreements with the California AG, are not typical of those ordinarily sought by a federal antitrust agency. This shows that solutions that are arguably beyond purely competitive concerns may alleviate state-level scrutiny and allow a transaction to close.

Politicians and "public interest" groups will draw attention. Because gas prices affect all consumers, politicians often focus on the industry, increasing the likelihood of regulatory scrutiny. Refinery outages and interruptions in California, in addition to consolidation in the past decade, have long led to concerns of market manipulation. As prices rose in 2012, California Senators Boxer and Feinstein joined a senatorial group calling on the DOJ to investigate potential market manipulation in California due to rising gas prices caused, in part, by supply disruptions at several of the state's refineries. The Senators told the DOJ that petroleum "markets are opaque and highly concentrated making them inefficient and subject to market power abuse."[15] While the Senators did not directly comment on the Tesoro/BP transaction, the politicized atmosphere was the milieu for the agencies' review.

[11] UnitedHealthcare/Sierra Health Insurance Merger Settlement, available at http://ag.nv.gov/About/Consumer_Protection/Health/.

[12] Letter from Kathleen Foote (on Behalf of Kamala Harris) to Robert B. Weisenmiller, Ph.D., at 1 (May 17, 2013), available at https://oag.ca.gov/system/files/attachments/press%20releases/AG%20Letter%20to%20CEC%20(Tesoro).pdf ("Foote Letter").

[13] *Id.*

[14] *Id*. at 2.

[15] Letter from Senators Cantwell, Wyden, Feinstein, Murray, Boxer, and Merkley to Attorney General Eric J. Holder, Jr., at 1 (Nov. 27, 2012), available at http://www.feinstein.senate.gov/public/index.cfm/files/serve/?File_id=417b93b1-014b-41a7-abf4-c23f865316e8.

One advocacy group, Consumer Watchdog, vocally decried the Tesoro/BP deal as anticompetitive on its face and asked the state AG to stop the transaction: "A California refining market that is already concentrated and uncompetitive will become a duopoly, with even higher retail gasoline prices and greater market control by the industry.…California's drivers and the state economy will pay the price for this merger at the pump."[16] The president of Consumer Watchdog penned an op-ed in the Los Angeles Times two days later, writing that "[t]here's a simple policy fix to the gasoline woes in California: more regulation and less consolidation." Should the state and federal government not block the Tesoro/BP deal, it "would be like writing a blank check from California drivers to the oil industry."[17] Understanding the political climate—a concern over market manipulation, a fragile job market, and significant desire to reduce emissions and greenhouse gases—may enable a company to complete a merger without requiring divestiture. Still, the Tesoro/BP deal instructs that closing a transaction may require patience, especially when a deal involves politically-charged industries.

Prepare for a marathon, not a sprint. The FTC issued a second request. The parties and various third parties produced "millions of pages of documents and voluminous amounts of data."[18] The investigation took nine months.[19]

A lesson from Tesoro/BP is that you will need to give the agencies substantial time to develop the record needed to close investigations in markets with this kind of regulatory history. Nine months for a merger investigation without any relief is unusual. For deals in which the FTC undertakes a challenge, the average time period is seven months.[20] For some large, visible merger investigations, the agencies have completed investigations and prepared for litigation on a much faster track. For example, the Justice Department challenged the AT&T/T-Mobile merger in less than five months.[21]

The duration of this investigation is more striking when accounting for market structure or low concentration. As the FTC recognized, "the acquisition does not change the number of gasoline refiners on the West Coast —seven refiners supply the West Coast today and will continue to do so after the acquisition."[22] The acquisition increased concentration some by shifting capacity from BP to Tesoro, but

[16] Letter from Consumer Watchdog to Attorney General Kamala Harris and Senior Assistant Attorney General Kathleen Foote, Re: Acquisition of Tesoro, Inc. of BP refinery, ARCO stations (Oct.10, 2012).

[17] Jamie Court, *How to Refuel California*, Los Angeles Times, at 1 (October 12, 2012).

[18] Foote Letter at 1.

[19] Statement of the FTC, In the Matter of Tesoro Corporation/BP p.l.c., at 1, May 17, 2013, available at http://www.ftc.gov/os/closings/comm/130517tesoro_bpstmtofcomm.pdf (hereinafter "FTC Closing Statement").

[20] Dechert Analysis of FTC Merger Investigations, 2006 to 2010. The seven -month sum is for prospective mergers (that is, it excludes consummated merger investigations) that became the subject of an FTC enforcement action and consent order.

[21] *United States v. AT&T*, Complaint at ¶ 2 (filed Aug. 31, 2011), available at http://www.justice.gov/atr/cases/f274600/274613.htm.

[22] FTC Closing Statement at 2.

did not reduce the number of competitors. For most industries, transactions with this minor of a change in market structure rarely if ever undergo nine-month investigations.

Change is your friend. Until Tesoro/BP, there had not been a substantial merger investigation into California refineries since 2007. In explaining its closing decision, the FTC emphasized "that the market dynamics for CARB gasoline have changed in important ways since the early 2000s."[23] Demand for CARB gasoline declined over the past decade and federal and state regulators projected continued decline.[24] This created excess capacity that constrains any ability to elevate prices.[25]

Undue reliance on agency precedent may have deterred this deal from going forward in the first place. Advocating for merger clearance is not like arguing a constitutional law case before the Supreme Court. Understanding the agency precedent in the industry is important, as is understanding the pressures the agency faced in the past that are particular to the industry. Yet the current marketplace realities carry more weight than dusty precedent.

"Target on the back" concerns may be overstated. This acquisition also offers lessons for deal negotiations. Often the seller will insist that the buyer make a divestiture commitment—e.g., the buyer agrees to divest a plant if necessary for antitrust approval. This gives the seller assurance that the deal will close and the seller will be paid. Sellers typically incur more harm—through last customers, lost employees, and brand dilution—when enduring a protracted antitrust investigation followed by a collapsed deal. A divestiture commitment provides peace of mind that the deal will close.

Buyers often resist divestiture commitments on the grounds that they would put a "target on the back" of the deal. The concern is that agency lawyers, upon learning of the divestiture commitment, will treat that as the floor for antitrust relief.

Tesoro agreed to divest a plant if the FTC challenged the acquisition. Such a commitment turned out to be unnecessary, and Tesoro kept both Southern California refineries. This is a useful example to show that the "target on the back" concern may be overstated. Other recent deals with the same conditions—a merger that cleared unconditionally despite a divestiture commitment in the agreement—include Express Scripts's acquisition of Medco and Georgia-Pacific's acquisition of Buckeye. This suggests that agency staff will conduct an investigation on the merits, without giving undue weight to the parties' allocation of antitrust risks.

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[23] *Id.* at 1.

[24] *Id.*

[25] *Id.*