Phillips 66 Legal

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VIA E-MAIL (mgalvin@portla.org) and U.S. MAIL

Mr. Michael Galvin
Director of Special Projects
Planning and Economics Development Division
Port of Los Angeles
425 South Palos Verdes Street
San Pedro, California 90731

Re: Phillips 66 Company Marine Terminal (Berths 148-151)
POLA Proposal to Consolidate Phillips 66 Operations with ExxonMobil

Dear Mr. Galvin:

Thank you for meeting with me via telephone last month to discuss Phillips 66 Company's ("Phillips 66") concerns regarding the Port of Los Angeles' ("POLA") proposed consolidation of our Los Angeles Marine Terminal ("Marine Terminal") operations with ExxonMobil's. This letter summarizes the concerns that we discussed during our telephone call and provides further detail regarding the legal risks that Phillips 66 faces if it were to combine its marine terminal operations with ExxonMobil's.

Marine Terminal Operations

The Marine Terminal consists of twenty-six storage tanks, extensive piping systems, motor-driven pumps and compressors, pump houses, a control room, an office building, a warehouse and change room, wharves and associated equipment, roadways, a truck loading rack, emergency equipment, and a guard shack. It has a total storage/handling capacity of approximately 800,000 barrels and encompasses POLA Berths 148 through 151, which, taken together, occupy 14.7 acres.

Phillips 66 uses the Marine Terminal to load and unload petroleum products (gas oils, lube oil stocks, gasoline/gasoline blend stocks, and diesel and jet fuels) onto or from ocean-going vessels. The Marine Terminal can accommodate vessels up to 75,000 DWT and up to 1,155 feet in length.

Ship and barge calls at the Marine Terminal have varied between 90 and 400 per year. The volume of materials transferred ranges from 10,000 to 400,000 barrels per vessel, carried out over a time period varying from between a few hours to several days per vessel. Annual volumes transferred have been as high as 25 million barrels per year.

The Marine Terminal is an essential operating component of the Los Angeles Refinery and is used by Phillips 66 almost exclusively to support refinery operations. Personnel responsible for Marine Terminal operations report up through the refinery manager and must closely coordinate Marine Terminal operations with refinery operations. Products are transferred via underground pipelines directly to and from the refinery's Wilmington Plant. The underground pipelines have isolation valves at both the refinery and the Marine Terminal.

The Marine Terminal supports the refinery and the Phillips 66 lubricants business in many ways. We import intermediate feedstocks to process at the refinery and lubricant blendstocks for our Phillips 66 Lubricants Plant in Gardena, California. We import gasoline and diesel blendstocks to help supply the region with transportation fuels. We also export gasoline and diesel material, as well as petroleum intermediates, to local and foreign markets.

Further, during refinery turnarounds (*i.e.*, planned maintenance periods) and unexpected refinery outages (*e.g.*, external power outages or unexpected refinery unit malfunctions), Marine Terminal infrastructure is critical for exporting or importing refinery feedstocks that cannot be handled by refinery process units. Such infrastructure is also critical for exporting refinery intermediates produced at the refinery that cannot be further processed because refinery units that typically take such intermediates are "down." Without this infrastructure provided by the Marine Terminal, further refinery unit shutdowns are more likely to occur, which can lead to further petroleum product supply disruption to Southern California and other area transportation fuel markets.

Phillips 66 operates eleven domestic refineries. All of our refineries with water access operate their own intermediates/products marine terminals. They do no share these terminals with competitors nor do they rely on a third party to operate the terminals for them.

POLA Proposal

Through its consultants, POLA prepared a December 27, 2011 document entitled "Port of Los Angeles Marine Oil Terminal Consolidation Study." One option described in this study, labeled "Alternative 2," is consolidation of Phillips 66's Marine Terminal operations with ExxonMobil's. Alternative 2 proposes moving our Marine Terminal operations from their current location at POLA Berths 148-151 to ExxonMobil's current location at POLA Berths 238-239. Under Alternative 2, Phillips 66 and ExxonMobil would then operate their respective marine terminal operations from that location either jointly or through some other type of operating arrangement.

Alternative 2 creates operational, competitive, and antitrust concerns for Phillips 66 (and presumably ExxonMobil as well). Our operational concerns have been and continue to be discussed with POLA personnel separately. The purpose of this letter is to summarize the competitive and antitrust concerns that Phillips 66 has with Alternative 2.

Alternative 2 Increases the Disclosure Risk of Competitively Sensitive Information

Phillips 66 and ExxonMobil are competitors. Under Alternative 2, competitively sensitive information ("CSI") of each company will be at increased risk of becoming known by the other company. Such CSI goes beyond pricing information and includes the following types of information:

- production and/or operating costs;
- profit margins;
- production output and/or capacity;
- refinery turnaround scheduling;
- inventory levels;
- types and qualities of materials imported or exported;
- marketing, production, distribution, strategic, and/or other business plans; and
- identification of customers.

Under Alternative 2, all or a subset of the CSI described above for each company is at risk of becoming known to the other company because of their shared presence at a singular marine terminal. This CSI exposure could occur many different ways. For example, Company 1 might observe what types of intermediates and blend stocks are being imported and from where, which would provide insight into Company 2's production costs. Knowing the production costs of a competitor provides a competitive advantage to the company possessing such knowledge.

Other competitive risks arise from the scenario described in the paragraph above. Company 1 would acquire knowledge regarding the origin (or destination) of Company 2's imports (or exports), providing Company 2 CSI with which to use in its negotiations with importers (or exporters), which ultimately gives it a competitive advantage over both its direct competitors and those contractors and/or customers with which it deals.

Joint operations also require joint planning, which can lead to disclosure of CSI. For example, if Company 1 intends to expand its imports in a manner that requires operational or infrastructure changes, such as increased tankage of a particular type, both companies will need to discuss those needs (giving Company 2 CSI regarding Company 1's expansion plans).

Alternative 2 Creates Antitrust Risk for Phillips 66

Phillips 66 conducts its operations in strict compliance with Federal and state antitrust laws. Not only is strict compliance with antitrust laws the "right thing to do" and consistent with our core values, non-compliance with antitrust laws exposes the Company to significant civil and criminal enforcement, as well as reputational damage.

As you are probably aware, the energy industry faces heightened scrutiny from antitrust enforcement agencies. Relatively high and/or rising gasoline prices often trigger increased scrutiny and, in the face of such prices, even innocent communications and/or perceived access to CSI between energy industry competitors can form the basis of an antitrust investigation and enforcement action.

If Alternative 2 were chosen, Phillips 66 would be at increased risk of facing potential allegations of antitrust violations or investigations concerning compliance. For example, the companies would need to coordinate the arrival and movement of vessel traffic, as well as utilization and draws from marine terminal tankage. Although such coordination would have a legitimate business purpose made necessary by POLA's combination of the two companies at one marine terminal, an antitrust enforcement agency or private plaintiff may attempt to characterize such coordination as an agreement to limit output by coordinating the timing of their access to feedstocks. This risk increases whenever market demands cause retail gasoline prices to rise and is present as a result of the real or perceived exposure to a competitor's CSI as described above.

Firewalls Do Not Eliminate Risks of CSI Exposure and/or Antitrust Enforcement

It is conceivable that companies forced to share a marine terminal pursuant to an arrangement such as Alternative 2 could enact firewalls designed to minimize the exposure of Company 1's CSI to Company 2. Such firewalls could conceivably even include a third-party marine terminal operator. For the reasons described below, however, such firewalls have their own inherent problems and, ultimately, do not fully eliminate antitrust enforcement risk or the possibility that CSI is disclosed.

First, if antitrust enforcement is taken, the accused company will have the burden to prove that the firewall(s) existed and was effective. This is a difficult burden of proof because it requires "proving the negative" – *i.e,* it requires proving that no information alleged by the government or a private plaintiff to have been shared between the companies was actually shared.

Second, firewalls are not always 100-percent effective, even with the best intentions and program design. Risk exists that, even with a third-party operator, Company 1's CSI could inadvertently become known to Company 2.

Third, firewalls impose additional operating costs. This is especially true when utilizing a third-party operator. Although there are circumstances where utilizing a third-party operator is economically feasible or even desirable, such is not the case with respect to the Marine Terminal, which is essentially a sole-support facility for Los Angeles Refinery operations.

Thank you again for the opportunity to discuss our concerns with you. Please do not hesitate to contact me regarding the issues raised in this letter if you have any questions or would like to discuss these issues in greater detail.

Sincerely,

James R. Greene

cc: via e-mail

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