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Redacted Public Version

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

STATE OF CALIFORNIA,

Plaintiff,

v.

VALERO ENERGY CORPORATION, VALERO ENERGY PARTNERS LP, and PLAINS ALL AMERICAN PIPELINE, L.P.,

Defendants.

Civil Action No. 17-cv-3786 (WHA)

DEFENDANTS' OPPOSITION TO PLAINTIFF STATE OF CALIFORNIA'S MOTION FOR PRELIMINARY INJUNCTION

July 31, 2017

Date: August 16, 2017
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Plaintiff State of California's (the "State's") motion for preliminary injunction fails to meet the exacting standards for the extraordinary relief it seeks. At the eleventh hour, just before the transaction was set to close, the State asks this Court to block Valero Energy Partners LP's ("VLP's") planned acquisition of two petroleum terminals (the "Terminals") from a subsidiary of Plains All American Pipeline, L.P. ("Plains"), an acquisition that the Federal Trade Commission ("FTC") thoroughly investigated and determined not to challenge. The Court previously denied the State's Motion for a TRO. (Doc. No. 13).

The State cannot satisfy any of the factors for the drastic relief it requests. *First*, it has not, and cannot, demonstrate that it is likely to succeed on the merits. The State's challenge to this transaction is based on its hypothesis that VLP, after it pays [redacted] for the Terminals, might sacrifice its own profits by restricting third parties' access to the Martinez Terminal on the hope that VLP's majority owner, Valero Energy Corporation ("VLO"), will be able to recoup these foregone profits by increasing gasoline prices at a downstream location, Concord. This theory is pure hypothesis unsupported by and, in fact, belied by hard facts. To prevail on a Section 7 Clayton Act claim, the State must show a loss of competition in a relevant market that is "sufficiently probable and imminent." *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 623 n. 22 (1974). But, after some ten months of investigation, even the State's own expert can only go so far as to claim that the transaction "might" or "could" cause the effects alleged. *See* Hayes Decl. at 1, 2, 11 ("the proposed transaction has the ***potential*** to harm competition . . . .[A] restriction on access to the terminal ***could*** reduce the supply of these fuels . . . Valero . . . ***might*** earn greater profits if access to the terminal were restricted") (emphasis added).

As demonstrated below, no such effects are plausible, much less likely. VLP will have the incentive to operate the Plains terminals at least as competitively as Plains does today, and fully intends to do so. Consistent with this outcome, VLP also plans to increase terminaling capacity at Plains' Martinez Terminal ("Martinez Terminal") [redacted] a procompetitive output expansion that demonstrably [redacted].

Making the State's theory all the more speculative is that 100% of the customers—all large, sophisticated entities like [redacted], [redacted], and [redacted]—that use the Martinez Terminal are protected by long-term contracts that govern pricing and access to the terminal until at least [redacted]. Thus, none of the theorized effects can even begin to occur until after that date, a fact that the State nowhere addresses and *that the State instructed its expert to ignore*. *See* Hayes Decl. at 2 ("the topics of potential efficiencies, existing contracts, and declining demand for gasoline … have not been included within the scope of my assignment"). It is no wonder that, after carefully investigating the transaction, including investigating the State's theory, the FTC declined to take any action to block or modify the proposed acquisition.

Second, the State has failed to establish any imminent irreparable harm that would occur if preliminary relief is denied. The State admits that any possible harm to consumers would occur "in the long run" and that any effects "might not be felt during the pendency of this action." Mem. at 18. Irreparable harm is highly unlikely. Long-term contracts governing customer pricing and access to the Martinez Terminal preclude any of the transaction's alleged anticompetitive effects from occurring between now and trial. Moreover, an effective remedy, including divestiture if necessary, would be fully available to the State in the unlikely event that it prevails because VLP will operate the Plains terminals as stand-alone, autonomous assets.

Third, the balance of equities weighs decidedly against a preliminary injunction. Compared to the absence of any interim harm shown by the State, Defendants face significant harm from a preliminary injunction. [redacted]. Plains will be unable to use the proceeds necessary to timely pay down debt and will need to start the auction process anew.

Fourth, the State has failed to establish that a preliminary injunction serves the public interest. Among other goals, the purpose of the FTC's Hart-Scott-Rodino Act inquiry was to examine the effect of the proposed transaction on the public interest. Having completed its investigation, the FTC's decision is consistent with the Defendants' belief that the proposed transaction will serve the public interest. In fact, the transaction will serve the public interest because VLP would immediately begin expanding capacity and output at the Plains Terminals.

STATEMENT OF FACTS

I. The Parties and the Proposed Transaction

Plains owns and operates the Richmond and Martinez Terminals in the Bay Area. Plains' only business in the Bay Area is the provision of terminaling services – throughput and storage – to refiners and traders of light petroleum products ("LPPs"), which include motor fuel, diesel fuel, and jet fuel. Declaration of Cambyses Movafagian ¶ 4.

VLO owns and operates a petroleum refinery at Benicia, California (the "Benicia Refinery"). VLO's only business in the Bay Area is the production and sale of petroleum liquids, including LPPs. Declaration of Richard Lashway ¶ 23. VLO does not sell terminaling services in the Bay Area. *Id.* ¶¶ 23, 25. The Benicia Refinery includes a minimal quantity of operational tankage that is dedicated entirely to the refinery. *Id.* ¶ 25. These tanks are fully utilized solely for internal, operational purposes. *Id.* ¶¶ 25-26. VLO has no plans to expand these tanks. *Id.* ¶ 26.

VLP does not currently own any assets or sell any products in California. *Id.* ¶ 22. VLP is a publicly traded master limited partnership (MLP) that owns and operates midstream oil and gas assets, including terminals and pipelines, mostly in the Gulf Coast region. *Id.* ¶¶ 1, 20. Through a subsidiary, VLO owns approximately 68% of VLP. VLP's other 32% is owned by unaffiliated third parties, including large sophisticated institutional investors. *Id.* ¶ 1.

On September 29, 2016, the Asset Purchase Agreement pursuant to which VLP would acquire the Terminals was executed. *Id.* ¶ 5. After the transaction, VLP will own and operate these facilities. *Id.* VLP's documents and testimony confirm that it is committed to do so in the same manner as Plains today, except that, unlike Plains, VLP plans to invest in expanding terminaling capacity at the Martinez Terminal [redacted] Lashway Decl. ¶ 8; Declaration of Harminder Bhullar ¶¶ 8-9. VLP's valuation model presented to its Board of

Directors to justify the transaction assumed that VLP would continue to operate the Terminals by maximizing throughput from third parties and that it would invest in capacity expansion at the Martinez Terminal. Bhullar Decl. ¶¶ 8-9. [redacted]. Movafagian Decl. ¶ 27; Lashway Decl. ¶ 8.

As a publicly traded MLP, VLP's incentive will be to continue to operate the acquired Terminals to maximize the throughput and revenue of those assets, as VLP will not receive any revenues from the downstream sale of LPPs. Lashway Decl. ¶¶ 13, 18; Bhullar Decl. ¶¶ 10-13. An important part of VLP's business plan is to diversify its revenue base by attracting third-party revenue while reducing its reliance on revenue from VLO. Lashway Decl. ¶¶ 4, 30.

All of the customers of the Martinez Terminal—[redacted]—have long-term contracts with Plains. The first of these does not expire until [redacted], with several customers having contracts extending well beyond that date. Movafagian Decl. ¶ 19; Lashway Decl. ¶ 19. [redacted] contracts with Plains do not expire until [redacted] has an option to extend the contracts until [redacted]. Movafagian Decl., Ex. 2. The prices and terms in all of these contracts cannot be changed unilaterally by Plains today or VLP post-transaction. Movafagian Decl. ¶ 19; Lashway Decl. ¶ 19. [redacted], the annual volume protected through these long-term contracts exceeds the annual historical volume delivered from the Martinez Terminal by more than [redacted]. Declaration of Dr. Elizabeth Bailey ¶ 59 & Ex. 10 thereto.

VLP does not intend to integrate the operations or infrastructure of the acquired Terminals with the Benicia Refinery or any other VLO assets. Lashway Decl. ¶ 14. Consistent with VLP's plans to operate the Terminals as Plains does today, VLP offered to both the FTC and the State to formalize certain commitments to facilitate timely clearance of the transaction. VLP offered, for example, to provide all current customers at the Martinez Terminal the option to extend their existing contracts by an additional ten years at current indexed rates and to commit to significantly expand capacity at the Martinez Terminal in the manner described above.

Lashway Decl. ¶¶ 11-12. The FTC allowed the transaction to proceed without finding any of these commitments necessary. *Id.* ¶ 33. California rejected VLP's offer. VLP is still prepared to make these commitments, which are all fully consistent with its plans for the Terminals.

If the Court were to enter a preliminary injunction, [redacted]. Declaration of Jeremy Goebel ¶ 4; Lashway Decl. ¶ 34.

II. Overview Of Petroleum Logistics In The Bay Area

In the Bay Area, most LPPs are refined from crude oil at one of five local refineries: the Benicia Refinery, along with refineries operated by Chevron, Shell, Phillip 66, and Tesoro. Each of these refineries has pipeline access to Concord Station, and each of these refineries will remain competitors after the proposed transaction. Unlike refineries, terminals, including the Richmond and Martinez Terminals, do not produce LPPs. Rather, terminals provide logistics services to third parties, including storage, product blending, and transfer to marine vessels and tanker trucks. Movafagian Decl. ¶¶ 4, 17-18; Lashway Decl. ¶ 27. Beyond the Martinez Terminal, there are at least three other terminals in the Bay Area operated by non-refiners with direct pipeline access to Concord: Kinder Morgan's Richmond Terminal, Nustar's Selby Terminal, and IMTT's Richmond Terminal. Movafagian Decl. ¶ 7. In addition, Chevron has a proprietary pipeline and terminal system that connects its Bay Area refinery to the same geographic area served by Concord Station. *Id.* In total, there are at least nine separate pipeline routes for LPPs to be transported to Concord Station and the area it serves. *Id.* ¶ 7.

As detailed in Dr. Bailey's declaration, there have been several significant structural changes to petroleum logistics in the Bay Area over the past decade. *First*, gasoline demand has declined significantly, resulting in significant and increasing excess supply of LPPs produced by Bay Area refineries, a large increase in exports to foreign destinations such as Mexico and Latin America, and a sharp decrease in foreign imports. Bailey Decl. ¶¶ 10-12 & Ex. 4. This declining demand is projected to continue well into the future, as confirmed by official California Energy Commission projections. *Id.* ¶ 10 & Ex. 4; Oliver Decl. Ex. 1. Remarkably, the State specifically excluded from its expert's assignment any consideration of this inexorable decline in LPP demand and resultant increase in excess capacity, even though Defendants repeatedly emphasized these conditions throughout the investigation. Hayes Decl. at 2.

As the FTC observed after investigating and clearing Tesoro's 2013 acquisition of BP's southern California refinery, these trends – declining demand and increasing excess capacity – have significantly altered competitive dynamics in the California petroleum industry:

> CARB gasoline demand has declined over the last decade, and is projected to continue to decline, driven in part by improving vehicle fuel efficiency and the increasing use of renewable transportation fuels. This decline in gasoline demand has created excess refinery capacity marketwide that will constrain Tesoro's ability to raise CARB gasoline prices profitably post-transaction.

Oliver Decl. Ex. 2.

Second, the declining demand for gasoline in the Bay Area has removed capacity constraints on the pipelines into Concord and the area it serves. Bailey Decl. ¶ 11. *Third*, the number of traders and marketers using the Martinez Terminal has declined from [redacted] in 2010 to [redacted] in 2016, which further illustrates the large volume of excess supply and changing needs for the Martinez Terminal. *Id.* ¶ 12 & Ex. 5. *Fourth*, compared to a decade ago, there are now two additional independently operated LPP terminals in the Bay Area with pipeline access to Concord: Kinder Morgan's Richmond Terminal and NuStar's Selby Terminal. *Id.* ¶ 13.

III. FTC's Decision To Clear The Transaction and the State's Eleventh Hour Motion

Pursuant to its authority under the Hart-Scott-Rodino Act, 15 U.S.C § 18a, the FTC conducted a thorough investigation to evaluate whether the proposed transaction may substantially lessen competition. Oliver Dec ¶¶ 7-8. During its investigation, the FTC examined the same theories now advanced by California. *Id.* ¶ 8. Following this review, on June 30, 2017, the agency determined that it would not seek to either modify or challenge the transaction, letting the Hart-Scott waiting period expire and clearing the transaction to proceed. *Id.* ¶ 9

The State has known about this transaction for over ten months. Defendants have fully cooperated with the State in its investigation. Nonetheless, aside from a single brief teleconference on April 28, the State did not ask to have any meetings with Defendants, otherwise request to discuss the transaction's substance with Defendants, or make any attempt to seek preliminary injunctive relief until the very last day Defendants had agreed to postpone closing their merger. *Id.*; Declaration of L. David Rabinowitz ¶ 11.

ARGUMENT

A preliminary injunction is "an *extraordinary remedy* that may only be awarded upon a *clear showing* that the plaintiff is entitled to such relief." *Winter v. Nat. Res. Def. Council, Inc.*, 555 U.S. 7, 22 (2008) (emphasis added). The plaintiff "must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest." *Id.* at 20. The State has not met and cannot meet its burden on any of these elements.

I. The State Has Failed To Show a Likelihood Of Success On The Merits

The State's complaint is based on Section 7 of the Clayton Act, 15 U.S.C. § 18.[1] "Section 7 of the Clayton Act is concerned with preventing the creation or enhancement of market power." *FTC v. Lab. Corp. of Am.*, No. 10-cv-1873, 2011 WL 3100372, at *13 (C.D. Cal. Feb. 22, 2011) (citing *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967)); *see also United States v. Archer-Daniels Midland Corp.*, 866 F.2d 242, 246 (8th Cir. 1988).

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[1] Although not included in its complaint, the State belatedly claims that the transaction may violate state law, California Business and Professions Code § 17200. Mem. at 17-18. The State has not cited any cases enjoining a merger on these grounds, and the statute does not eliminate or reduce the State's burden to show that anticompetitive harm is likely. To prove a violation of § 17200, an antitrust plaintiff must demonstrate that the challenged act "threatens an incipient violation of an antitrust law," would have anticompetitive effects that are "comparable to or the same as a violation of the law," or would "significantly threaten[] or harm[] competition." *Cel-Tech Commc'ns, Inc. v. Los Angeles Cellular Tel. Co.*, 20 Cal. 4th 163, 187 (Cal. 1999). Any claim of "unfairness" under § 17200 "must be tethered to some legislatively declared policy or *proof of some actual or threatened impact on competition*." *Id.* at 186-87 (emphasis added).

The Supreme Court has admonished that, to prevail on a Section 7 claim, the State must show a loss of competition in a relevant market that is "sufficiently probable and imminent." *Marine Bancorp.,* 418 U.S. at 623 n. 22. Section 7 "deals in probabilities, not ephemeral possibilities." *Id.* at 622-23. "[A]ntitrust theory and speculation cannot trump facts." *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 116–17 (D.D.C. 2004).

The State fails to mention in its papers that the FTC thoroughly reviewed the transaction and took no action.[2] The FTC is an independent, bipartisan agency with antitrust expertise and a statutory mandate to challenge any transaction whose effect may be "substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18. We are certainly mindful that the FTC's decision is not determinative; nevertheless, courts consistently have afforded weight to the decisions of the federal agency. *See, e.g, Advocacy Org. for Patients & Providers v. Mercy Health Servs.,* 987 F. Supp. 967, 969, 974 (E.D. Mich. 1997) ("plaintiffs are not likely to succeed on the merits because neither the DOJ nor the FTC have challenged the merger"); *Pearl Brewing Co. v. Miller Brewing Co.*, No. 93-cv-205, 1993 WL 424236, at *3 (W.D. Tex. Mar. 31, 1993) (decision by expert federal antitrust agencies to take no action warrants consideration).

1. The State Cannot Establish a Prima Facie Case Based on a Horizontal Theory

The State claims that it has established a prima facie case under Section 7 by showing that the transaction is a horizontal transaction that would significantly increase concentration levels in a market defined as "unconstrained terminaling services that enable pipeline transport of LPPs to the KMSA [Kinder Morgan Service Area]." Mem. at 11. This contention fails on multiple grounds, including because the transaction is vertical, not horizontal.

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[2] The State does mention that, in 2005, Valero agreed to a consent order in connection with the FTC's investigation of a transaction that involved many more assets and vastly different market conditions. Mem. at 7-8. That resolution with the FTC specifically denied that Valero was admitting any facts other than jurisdictional facts. The factual allegations in those consent papers have no bearing in the present action. *See United States v. Armour & Co*. 402 U.S. 673, 681-682 (1971). In any event, the FTC's decision with respect to the current transaction is far more illuminating than its allegations about competitive conditions well over a decade ago.

a. The State Does Not Even Attempt To Prove that Plains Competes Against VLP or VLO In Any Relevant Market

The State's effort to rely on supposed changes in the Herfindahl-Hirschman Index ("HHI") to establish a prima facie case is fundamentally flawed. HHIs and changes to HHIs may be used to show a prima facie case only in *horizontal* mergers.[3] Here, VLP's proposed acquisition of Plains' terminals is vertical, not horizontal. Indeed, in its recent press release trumpeting the instant lawsuit, the State AG acknowledged that the acquisition is a "vertical transaction." Oliver Decl. Ex. 3. The State cannot simply assert, and baldly, that the transaction is "horizontal," as it has done in its brief. Mem. at 11. It must demonstrate with evidence that VLO's Benicia Refinery (including any of its facilities) and the Martinez Terminal compete in the same relevant market. The State has made no such showing.

"Horizontal transactions involve competitors in the same product and geographic market." ABA Section of Antitrust Law, *Antitrust Law Developments* 354 (8th ed. 2017); *see also United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 734 n.5 (D. Md. 1976) ("A horizontal merger is one between two actual competitors in the same relevant market.").

In assessing whether two products should be considered part of the same product market, the court must evaluate the willingness and ability of customers to substitute the second product in response to an increase in price. *California v. Sutter Health Sys.*, 130 F. Supp. 2d 1109, 1118-19 (N.D. Cal. 2001); *see also Rebel Oil Co., Inc. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1435 (9th Cir. 1995). As the *Horizontal Merger Guidelines* explain: "Market definition focuses solely on demand substitution factors, i.e., on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price

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[3] As the State acknowledges, HHIs are a metric used "in analyzing the effects of a horizontal merger." Mem. at 11 (citing *Saint Alphonsus Med. Ctr. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775, 786 (9th Cir. 2015)). The court in *Saint Alphonsus* applied the guidance outlined in the *Horizontal Merger Guidelines*, 778 F.3d at 785, which expressly "do not cover vertical or other types of non-horizontal acquisitions." United States Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* § 1, n.1 (Aug. 19, 2010).

change such as a reduction in product quality or service." United States Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* § 4 (Aug. 19, 2010).

In this case, it is undisputed that VLP holds no assets and conducts no business in the Bay Area. Further, the record is clear that customers that utilize the Martinez Terminal could not and would not substitute the on-site storage tanks at VLO's Benicia Refinery if prices at the Martinez Terminal increased by a small, but significant amount.[4] Bailey Decl. ¶¶19-22. Rather, as the State concedes, refiners use their refinery infrastructure "to support their own refining and marketing operations." Compl. ¶ 27. As Mr. Lashway further explains:

> The tanks at the VLO Benicia refinery are used in the refining and blending processes to produce light petroleum products. The tanks have never been utilized to accommodate the storage and throughput needs of third parties. . . . Third party storage operations would interfere with the complex operations of the refinery.

Lashway Decl. ¶ 25. If fees were to rise or access were to be restricted at the Martinez Terminal, customers would not substitute the captive tanks at the Benicia Refinery. Bailey Decl. ¶22.

Nor is there any evidence that VLO itself considers the Martinez Terminal as a substitute for its own on-site storage capacity at the Benicia Refinery. To the contrary, refiners that lease tankage at the Martinez Terminal, such as VLO, fully utilize their own internal tankage before considering third-party terminals, such as the Martinez Terminal or the NuStar Selby terminal. Oliver Decl. Ex. 9 (Simpson Trans. 341:25-342:5). VLO is unlikely [redacted]. Bailey Decl. ¶ 20. For example, VLO primarily uses the Martinez Terminal and NuStar Selby Terminal [redacted]. *Id.* Furthermore, VLO would [redacted]. *See* Oliver Decl. Ex. 8 (Stocksick Tr. 124:6-16);

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[4] Under the *Horizontal Merger Guidelines* and related case law, the concept of a "small but significant and non-transitory increase in price" ("SSNIP") is used to define the relevant market. *See Saint Alphonsus*, 778 F.3d at 784 (citing *Horizontal Merger Guidelines* § 4).

Lashway Decl. ¶ 26. Not surprisingly, Plains is [redacted] Movafagian Decl. ¶ 16.

The complete lack of substitution between VLO's captive tanks at its Benicia Refinery and the Martinez Terminal in response to price compels the conclusion that Martinez Terminal and the Benicia Refinery do not compete in the same relevant product market. The proposed transaction, therefore, is not horizontal and does not result in an increase in concentration in any relevant market, much less substantially enough to trigger a prima facie case under the *Horizontal Merger Guidelines*. *See* United States Dep't of Justice, *Non-Horizontal Merger Guidelines* § 4 (June 14, 1984) ("Non-horizontal mergers . . . produce no immediate change in the level of concentration in any relevant market."). Thus, the State has not met its burden in establishing its horizontal theory.

b. In Any Event, the State's HHI Calculations Are Arbitrary and Meaningless

The State's HHI calculations are not remotely accurate or meaningful, even assuming the State properly defined a relevant market in which both the Martinez Terminal and the Benicia Refinery compete. As detailed by Dr. Bailey, the State's HHI calculations are inaccurate or misleading, for at least four reasons. Bailey Decl. ¶¶ 24-40.

First, the HHI calculations combine non-overlapping assets at different levels of the vertical supply chain, ignoring the critical distinction between the LPP supplier that makes the economic decision to flow LPPs into Concord and the pipeline owner that determines the price these LPP suppliers pay to use the pipeline. *Id.* ¶¶ 27-30. The State attributes a percentage of throughput or capacity to only four firms: [redacted]. But Kinder Morgan—not [redacted]—owns the pipeline that delivers LPPs from those refineries into Concord Station. And each LPP supplier—not Plains—makes the economic decision regarding the volume of LPPs to transport via the Plains pipeline. *Id.* ¶¶ 28-30. There is no economically meaningful way to calculate HHIs for these non-overlapping assets, and the State cites no precedent for doing so.

Second, the State erroneously excludes as participants in its alleged relevant market those pipelines that today are sending less LPP throughput to Concord than they historically have shown an ability to do. *Id.* ¶ 32. A constrained pipeline can become unconstrained as the result of declining demand, and a decline in pipeline throughput to below historical levels indicates that pipeline has excess capacity today. [redacted]

Third, the State also incorrectly excludes from the asserted relevant market current and anticipated capacity expansions on existing pipeline routes into the KMSA, including [redacted]. *Id.* ¶ 33. The State fails to inform the Court that [redacted]. *Id.* [redacted] alleviate constraints and increase output available to consumers.

Fourth, the State's apparent basis for limiting the relevant market to only "unconstrained" terminaling services is that these are the participants that can "respond to price spikes by increasing the quantity made available for sale. This response mitigates the price increase." Hayes Decl. at 11. If that is the State's basis for defining the market, then the State's proposed market definition improperly excludes terminaling services that may be currently constrained but that would become unconstrained as a result of events, usually a refinery outage, that cause such a price spike. Bailey Decl. ¶¶ 34-36. The evidence demonstrates that, during supply disruptions that may lead to price spikes, the disrupted refinery purchases and brings incremental LPP into their refinery dock in order to utilize their pipeline into Concord. *Id.* ¶ 33.

Including the pipelines that the State improperly excludes from the market alone reduces the State's expert's HHI concentration statistics to only moderately concentrated levels, with a post-merger HHI between 1,830 and 1,962. *Id.* ¶ 39. Accounting for near-term expansion plans, as described above, would reduce these HHIs even further. *Id.*

* * * * *

In sum, the State's horizontal theory lacks merit. The parties do not compete in the same relevant market, and, even if they did, the State's purported market shares and concentration statistics are arbitrary and inaccurate, thereby failing to make out a prima facie case of harm to competition. Even if the State has a viable horizontal theory, it still must prove that the transaction is likely to harm competition. *See United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1111 (N.D. Cal. 2004) ("determining the existence or threat of anticompetitive effects has not stopped at calculation of market shares"); *Arch Coal*, 329 F. Supp. 2d at 130 (citing *United States v. General Dynamics*, 415 U.S. 486, 498 (1974)). In this case, the only theories of competitive harm the State has advanced are based on downstream effects in the sale of bulk LPPs to the KMSA, where Defendants also do not have overlapping businesses. *See* Hayes Decl. at 3, 10-13 (outlining two potential theories of competitive harm, neither based on a reduction in horizontal competition in terminaling services). For the reasons described in the following section, the State cannot prevail under any such theory.

B. The State Has Not Shown that the Transaction Is Likely To Lessen Competition In the Bulk Sale of LPPs

The State hypothesizes that, post-transaction, VLP might sacrifice its revenues and profits from providing terminaling services at the Martinez Terminal in the hopes that its majority owner, VLO, would benefit through increased downstream prices of bulk LPPs sold to the KMSA. According to the State, the transaction "has the ***potential*** to harm competition" by elevating LPP prices because VLP "***could*** reduce the supply of these fuels" flowing through the Martinez Terminal since VLO "***might*** earn greater profits if access to the terminal were restricted." Mem. at 9 (quoting Hayes Decl. at 2-3) (emphasis added). Neither the facts nor the law support this speculative theory.

1. Real-World Evidence Demonstrates that VLP Intends to Operate the Martinez Terminal At Least As Competitively As Plains

The following real-world evidence, undisputed by the State, shows that:

- VLP, not VLO, would be the acquirer of the Plains Terminals. VLP is an MLP whose unit holders, in addition to VLO, include sophisticated institutional investors whose incentive is to maximize the profits of VLP, not VLO. VLP's strategy is to increase third party (i.e., non-VLO) revenue and diversify VLP's customer base. Lashway Decl. ¶¶ 4, 30. If VLP fails to execute its business well, it will suffer the consequences through the loss of investors and the concomitant reduction of its unit price. *Id.* ¶ 18. VLO would also suffer financially. *Id.*
- VLP's financial model used to justify the transaction and purchase price to its Board shows that VLP intends to operate the Martinez Terminal in the same way as Plains, by continuing to maximize third-party throughput and revenues flowing through the Terminals. *Id.* ¶¶ 7-10.
- This model shows [redacted]. Bhullar Decl. ¶ 8.
- [redacted] an output expansion that [redacted]. Lashway Decl. ¶ 8; Movafagian Decl. ¶ 27. The capital required for this capacity expansion has already been approved by the VLP Board. Lashway Decl. ¶ 9.
- 100% of the customers today that are utilizing the Martinez Terminal to supply LPPs into Concord have long-term contracts at contractually fixed prices. Movafagian Decl. ¶ 19. These contracts cover LPP volumes significantly above historic annual levels. Bailey Decl. ¶59.

2. The State Cannot Demonstrate Unilateral Anticompetitive Effects

Against this undisputed record, the State relies on high theory. Its first theory, that the transaction would result in unilateral anticompetitive effects, Mem. at 14-15, is without merit. "Unilateral effects result from 'the tendency of a ***horizontal*** merger to lead to higher prices simply by virtue of the fact that the merger will ***eliminate direct competition between the two merging firms****, even if all other firms in the market continue to compete independently*.'" *Oracle*, 331 F. Supp. 2d at 1113 (citation omitted) (emphasis added). Here, as demonstrated above, the proposed transaction neither is horizontal nor would it eliminate "direct competition" between the companies. Equally important, there is no evidence that VLO would have the ability to increase prices "if all the other firms in the market continue to compete independently." *Id.* The evidence, in fact, shows exactly the opposite.

A unilateral effects theory presupposes that VLO itself would obtain pricing, or market, power for LPPs at Concord Station as a result of the transaction irrespective of the competitive responses of rival refiners. As the *Oracle* court stressed, in a unilateral effects case, "a plaintiff must demonstrate that the merging parties would enjoy a post-merger monopoly or dominant position, at least in a 'localized competition' space." *Id.* at 1118. But, in the alleged downstream market for LPPs, VLO and the Plains Martinez terminal would have a combined share, even accepting the State's calculations, of at most [redacted] Hayes Decl. Ex. 5.[5] This percentage is well below the share of supply needed to establish market power in the alleged downstream market. *See Rebel Oil*, 51 F.3d at 1438 (a share of 30% is "presumptively insufficient to establish the power to control price").

Furthermore, even using the State's flawed market definition and market share calculations, the portion of the alleged upstream market that would theoretically be foreclosed if VLP were to restrict access to the Martinez Terminal is no more than [redacted] of "unconstrained"

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[5] By the State's own calculations, LPP volumes flowing through the pipeline at the Martinez Terminal are only [redacted] of the total volume of LPPs transported to the KMSA, Hayes Decl. at 8, and LPP volumes flowing via the pipeline from the Benicia Refinery are only [redacted] *id.* at 20.

capacity or throughput, Hayes Decl. Ex. 6, 7, which is, in and of itself, legally insufficient to support a claim of anticompetitive effects. *See, e.g., McWane, Inc. v. FTC*, 783 F.3d 814, 837 (11th Cir. 2015) ("Traditionally foreclosure percentage of at least 40% has been a threshold" to show possible antitrust harm.); *Church & Dwight Co., Inc. v. Mayer Laboratories, Inc.*, 868 F. Supp. 2d, 876, 914 (N.D. Cal. 2012) (collecting cases where alleged foreclosure rates of 30-50% were insufficient to show likely harm to competition), *vac'd in part on other grounds*, No. 10-cv-4229, 2012 WL 1745592 (N.D. Cal. May 16, 2012).

Moreover, it is well-settled that excess capacity in the hands of rivals "precludes a finding that defendants could exert market power without facing the discipline of competition." *Pilch v. French Hosp.*, No. 98-cv-9470, 2000 WL 33223382, at *7 (C.D. Cal. Apr. 28, 2000); *see also Rebel Oil*, 51 F.3d at 1441. Here, the undisputed evidence shows that Bay Area refineries currently produce a large volume of excess supply, and these suppliers can and do quickly and effectively respond to any increase in price. Bailey Decl. ¶¶ 49-56. Two recent "natural experiments" analyzed by Dr. Bailey provide real-world evidence as to how excess LPP capacity in the Bay Area would defeat any attempt by VLP to exclude access to Martinez, thereby sacrificing its own profits, on the hope that VLO could later recoup those profits through higher LPP prices. *Id.* ¶¶ 49-54; *see Horizontal Merger Guidelines* § 2.1.2 ("The Agencies look for historical events, or 'natural experiments,' that are informative regarding the competitive effects of the merger."). Accordingly, Bay Area refiners' excess LPP capacity, resulting from undisputed declining demand, would render any transaction-related VLO market power at Concord Station even more implausible. Bailey Decl. ¶¶ 49-56. That is particularly so because long-term customer contracts governing the Martinez Terminal do not begin to expire [redacted], when even more excess capacity is likely to be available, given continuing decline in demand. *Id.* ¶ 10.

3. Post-Transaction Coordinated Effects Also Are Implausible

The State's other theory, alleged "coordinated effects," is equally flimsy. That theory supposes that, after the proposed transaction (again, presumably after the long-term contracts begin to expire [redacted]), VLP will abandon the model upon which it based the transaction by sacrificing profits at the Martinez terminal in the hope that its parent, VLO, can and would offset this profit loss *by coordinating with all the rival downstream suppliers of bulk LPPs*. Mem. at 16. To prove such a claim, the State would need to prove that the alleged market for bulk LPPs is susceptible to coordination *and* that the transaction facilitates anticompetitive coordination. *See Arch Coal*, 329 F. Supp. 2d at 140. The State's theory fails on both fronts.

Coordination requires two critical elements: "(1) reaching terms of coordination that are profitable to the firms involved and (2) an ability to detect and punish deviations that would undermine the coordinated interaction." *Id.* at 131. "[C]oordination will not be possible when any significant firm chooses, for any reason, to 'go it alone.'" *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 239 (U.S. 1993) (citation omitted).

Multiple features of the Bay Area petroleum industry make successful coordination highly unlikely. *First*, the large volumes of excess capacity give each LPP supplier a strong incentive to "cheat" on any collusive arrangement. *See, e.g.*, *FTC v. Owens-Illinois, Inc.*, 681 F. Supp. 27, 49 (D.D.C. 1988), *vac'd and remanded on other grounds*, 850 F.2d 694 (D.C. Cir. 1988); *see also Brooke Grp.*, 509 U.S. at 238. That is especially true where, as here, demand for LPPs in the Bay Area is in a state of sustained decline, which will only increase the amount of excess capacity in the future, especially [redacted], when the long-term contracts begin to expire. As the Supreme Court stressed in *Brooke Group*, both declining demand and excess capacity "tend to break down patterns of oligopoly pricing and produce price competition." *Id.* The FTC similarly emphasized the importance of declining demand and excess capacity in clearing a recent refinery acquisition in Southern California. Oliver Decl. Ex. 2 (observing that the "decline in gasoline demand has created excess refinery capacity marketwide that will constrain Tesoro's ability to raise CARB gasoline prices profitably post-transaction").

Here, the State's expert openly admits that the State specifically excluded from "his assignment" any consideration of either declining demand for gasoline or the existence of long-term contracts applicable to the Martinez Terminal. Hayes Decl. at 2. Yet, as discussed above, it is undisputed that there is declining demand and, correspondingly, excess capacity of LPPs produced in the Bay Area, both of which create strong incentives to cheat on any collusive scheme. Bailey Decl. ¶¶ 65-67. As a result of declining demand, the amount of excess capacity is only likely to grow such that, by the time the long-term contracts expire [redacted] the amount of excess capacity and corresponding incentives to cheat on any attempted coordination will be even greater. Indeed, at least one refiner, [redacted] is already in the midst of [redacted] creating incentives to u[redacted]. Bailey Decl. ¶ 33. The State's expert's inexplicable failure to consider these undisputed dynamics alone renders his coordinated effects theory pure supposition. *See Brooke Grp.*, 509 U.S. at 242 (discounting expert's testimony regarding coordinated effects in the face of contradictory facts).

Second, differences in the business operations among competing LPP suppliers would make it difficult, if not impossible, to agree on the terms of any coordinated agreement. Bailey Decl. ¶¶ 71-72. The refiners in the Bay Area have different cost structures, different selections of product delivered into Concord, and different allocations among types of refined products (among gasoline, aviation fuel, and diesel). *Id.*; Declaration of Andrea Simpson ¶ 7. Furthermore, there are a large volume of non-public transactions involving many grades of gasoline, diesel fuel and jet fuel for different durations and quantities at Concord each day because Concord is an active trading hub, and prices fluctuate continuously. *Id.* ¶ 69. As a result, competing suppliers would be unlikely to be able to agree on the reference point for any coordinated agreement, making successful coordination even more unlikely. *Id.* ¶¶ 69-71; *see Brooke Grp.*, 509 U.S. at 238-39.

Third, even if the suppliers could come to an agreement, LPP suppliers do not have access to information necessary to monitor each other's pricing and output decisions and to detect and punish cheating. As the *Arch Coal* court stated, "'where detection or punishment is likely to be slow, incentives to deviate are enhanced and coordinated interaction is unlikely to be successful.'" 329 F. Supp. 2d at 131 (citation omitted). Thus, successful coordinated interaction requires the availability of key information on a timely basis concerning market conditions, transactions, and individual competitors. *See id.* at 141.

Refiners in the Bay Area lack the detailed and timely information required to successfully coordinate and monitor each other's behavior and punish cheating if it occurs. *See* Bailey Decl. ¶¶ 69-70. Although some pricing and other information is publicly reported, this information is insufficient to reach an agreement, or to detect and punish cheating, as there is minimal transparency into refinery output and "product slates," and any data that is available is not released in a timely manner. *Id.* ¶¶ 69-71; Simpson Decl. ¶¶ 7-8. Moreover, the ability to enter into secret term contracts would provide an attractive incentive to cheat for each individual supplier. Simpson Decl. ¶ 6. As a result, there is no realistic possibility of successful coordination after the transaction.

The State has not shown that the transaction would enable the competing LPP suppliers to overcome the indelible barriers to successful coordination that exist today and are likely to be even greater in [redacted] For the posited coordinated anticompetitive effects to be possible, the State would need to show *all* of the following but has shown *none*:

- When the long-term contracts begin to expire, [redacted], VLP would abandon its business model, disregard the interests of non-VLO partners, and sacrifice profitable third-party revenue at the Martinez Terminal;

- The alleged pipeline constraints for LPP supply to the KMSA will endure despite the continual decline in LPP demand at Concord and demonstrable efforts [redacted] and other market participants to [redacted];
- The competing LPP suppliers would be able to reach an agreement on price or output, despite asymmetrical operations, varying product portfolios, and the large volume of transactions across different petroleum types that occur each day;
- If an agreement is reached, the substantial excess capacity and declining demand will not create irresistible incentives to cheat; *and*
- The competing LPP suppliers could and would effectively monitor, detect, and punish any cheating on the agreement, despite limited and untimely information.

In short, the State's theory of coordinated effects is based on layer upon layer of speculation.

II. No Irreparable Harm is Possible Because Long-Term Contracts Protect Consumers and the State Would Have an Available Remedy if it Ultimately Succeeds

Regardless of the determination of any of the other requirements for an injunction, fatal to the State's motion is that it cannot, as it must, "demonstrate that irreparable injury is *likely* in the absence of an injunction." *Winter*, 555 U.S. at 22. Antitrust cases are no different in this regard: Plaintiff must "demonstrat[e] immediate threatened injury" absent preliminary injunctive relief. *Los Angeles Mem'l Coliseum Comm'n v. Nat'l Football League*, 634 F.2d 1197, 1202 (9th Cir. 1980) (reversing preliminary injunction).[6]

The State admits that any possible harm to consumers would occur "in the long run" and that any effects "might not be felt during the pendency of this action." Mem. at 18. The State's admissions as to the lack of imminent injury are fatal to its motion.

[6] The State cites *Boardman v. Pac. Seafood Grp.*, 822 F.3d 1011, 1022-23 (9th Cir. 2016), for the proposition that "[a] lessening of competition constitutes an irreparable injury," but as the Ninth Circuit emphasized in that case, the threatened injury must be immediate and the plaintiff must actually demonstrate rather than just allege the immediate, irreparable harm. In *Boardman*, the plaintiff met that burden because the specific facts demonstrated that the acquisition would have immediate effects on the market. *Id.* Those facts do not exist here, as the State admits.

No alleged injury is imminent. In its three short paragraphs devoted to this critical and essential requirement for an injunction, the State fails to identify any harm that could, much less would, arise between now and a trial on the merits should an injunction not issue. All of the customers of the Martinez Terminal have long-term contracts. These contracts ensure customers' access to the terminal through at least [redacted], with several customers having contracts extending well beyond that date. Movafagian Decl. ¶ 19; Lashway Decl. ¶ 19. The prices and terms in these contracts cannot be changed unilaterally by Plains today or VLP post-transaction. *Id.* Through at least [redacted], the annual volume protected through these long-term contracts is more than [redacted] greater than the historical annual volume delivered from the Martinez Terminal into Concord. Bailey Decl. ¶ 59 & Ex. 10. Thus, the State's hypothesized theory of harm could not even begin to occur [redacted].

Customers of the Martinez Terminal have confirmed in sworn declarations that they will not be harmed, because access and pricing is protected through long-term contracts:

- [redacted]
- [redacted]
- [redacted]

Because the State knows that no actual harm could possibly come to consumers before a trial on the merits, the State instead focuses on the amorphous notion that the harm is "irreparable" by asserting, without support, that the ownership of the Martinez Terminal will be "set in stone" if the transaction proceeds. Mem. at 19. The State's implied assumption is that "irreparable" harm exists in any acquisition—that once an acquisition closes, it cannot be undone. In fact, "[c]ourts have routinely permitted integration of certain assets where such integration would preserve the potential for divestiture in the future." *Lab. Corp. of Am.*, 2011 WL 3100372, at *23 (collecting cases). Where, as here, divestiture is feasible, "a preliminary injunction is particularly inappropriate." *Id.*; *see also FTC v. Great Lakes Chem. Corp*, 528 F. Supp. 84, 87, 99 (N.D. Ill. 1981) (denying preliminary injunction because divestiture would remain an available remedy).

The Terminals are distinct operational assets. VLP intends to operate them as a stand-alone business, in the same manner Plains operates them today. Lashway Decl. ¶¶ 8, 14. Even if that were not the intent of VLP, there is no way to physically alter or integrate the terminal into VLP's operations that could not be easily unwound. If the transaction closes and the court later determines that a divesture is necessary to restore competition, VLP could divest this freestanding business in a timely fashion. The State has not borne its burden of proof—and has in fact submitted no evidence—showing that the harm from closing the transaction is irreparable.

C. The Balance of Equities Strongly Favors Denial of An Injunction

In evaluating California's request for a preliminary injunction, the Court "must balance the competing claims of injury and must consider the effect on each party of the granting or withholding of the requested relief." *Amoco Production Co. v. Village of Gambell*, 480 U. S. 531, 542 (1987). The State has the burden of proving that the equities favor an injunction—that "the harm to the parties and to the public that would flow from a preliminary injunction is outweighed by the harm to competition, if any, that would occur in the period between denial of a preliminary injunction and the final adjudication of the merits." *Lab. Corp.*, 2011 WL 3100372, at *21 (citation omitted).

As detailed in the preceding section, the State has not identified any irreparable harm that could even conceivably occur pending trial. On the other hand, Defendants face significant and irreparable harm from a preliminary injunction. Most significantly, a preliminary injunction would [redacted]. Lashway Decl. ¶ 34; Goebel Decl. ¶ 4. This alone weighs against an injunction. *See, e.g., Erickson v. Hutchinson Tech. Inc.*, 158 F. Supp. 3d 751, 762 (D. Minn. 2016) ("[P]otentially delaying or derailing a merger creates a weighty hardship that is difficult to overcome.").

In addition, Plains has spent significant time and money on this transaction, from hiring an investment banker to manage the initial marketing and bidding process to employee time on planning for the transition. Goebel Decl. ¶ 5. VLP has also expanded substantial resources to date. [redacted] means that this time and money has been wasted. Furthermore, Plains will have to start the process over with the serious risk [redacted]. *Id.* ¶¶ 5-6. This type of irreparable harm to Plains weighs heavily against an injunction. *See, e.g., Malon v. Franklin Fin. Corp.*, No. 14-cv-671, 2014 WL 6791611, at *3 (E.D. Va. Dec. 2, 2014) ("There is no assurance in a fluctuating market that the opportunity will remain available on the terms negotiated."); *Minzer v. Keegan*, No. 97-cv-4077, 1997 WL 34842191, at *13 (E.D.N.Y. Sept. 22, 1997) (hardships to defendant of an injunction included "costs expended thus far in preparing the merger" and "diminution of the value of the merger").

Plains marketed these assets as part of a [redacted] Goebel Decl. at ¶ 6.[7] The additional delay and uncertainty created by an injunction—after ten months of investigation by the State and the FTC—will have a negative effect on the employees at the Terminals and may make it difficult for Plains to retain its highly qualified staff. *Id.* ¶ 7. *See, e.g., Gottlieb v. Willis*, No. 12-cv-2637 , 2012 WL 5439274, at *7 (D. Minn. Nov. 7, 2012) ("[E]njoining a large and complex transaction such as this will at a minimum create uncertainty

[7] An injunction would also halt the sale of the Richmond Terminal, even though the State has no real complaint about the sale of that terminal to VLP.

and delay. Such a delay could also impose costs on the participants in the form of the lost time value of money, and ultimately could even jeopardize the transaction.”).

III. A Preliminary Injunction is Not in the Public Interest

On the final factor, the plaintiff has the burden to prove, based on evidence, that the “likely consequences of the injunction” are in the public interest. *Stormans, Inc. v. Selecky*, 586 F.3d 1109, 1139 (9th Cir. 2009). The State claims that its mere belief that it is “trying to protect its citizens and businesses” demonstrates that an injunction would be in the public interest. Mem. at 20. This is hardly sufficient. *Perez. v. Valley Garlic, Inc.*, No. 16-cv-01156, 2017 WL 772147, at *20 (E.D. Cal. Feb. 27, 2017) (a government agency must prove that the injunction is in the public interest, not just that it is pursuing a laudable goal). As explained above, the State cannot prove that there would be any harm to the public, let alone interim harm. On the contrary, the record shows that the transaction would generate tangible near-term benefits to consumers, including capacity expansions that will benefit the public interest. The FTC’s decision, following a thorough investigation, to clear the transaction under the Hart-Scott-Rodino Act reinforces the conclusion that the transaction is consistent with the public interest.

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