Phillips 66 Limited
7th Floor
200-202 Aldersgate Street
London
EC1A 4HD
O: 020 7822 4400

PROVIDING ENERGY. IMPROVING LIVES.

Director of Markets
Competition & Markets Authority
The Cabot
25 Cabot Square
London
E14 4QZ

Via Email: RoadFuels@cma.gov.uk

1 August 2022

Road Fuel Market Study: Invitation to Comment

I refer to your letter dated 11th July 2022 inviting Phillips 66 Limited ("**P66L**") to submit its observations on the CMA's Invitation to Comment concerning the CMA Road Fuel Market Study launched on 8th July 2022 ("**Market Study**"). In this letter, P66L sets out its preliminary observations on the matters identified by the CMA in its Invitation to Comment and its *Road Fuel Review*, published on 8th July 2022. These observations are provided in relation to each of the three specific segments of the road fuel supply chain that the CMA intends to consider in its Market Study, i.e. refining, wholesale and retail.

P66L is a member of the UK Petroleum Industry Association ("**UKPIA**") and has seen both UKPIA's earlier submission to the CMA (dated 20th June 2022) and a draft of its response to the Invitation to Comment. We do not repeat in detail points made by UKPIA in those responses, to which we refer the CMA, in particular as regards the matters on which the CMA should focus (at each of the refining, wholesale and retail levels), the different factors that influence the pump price of road fuels (including the impact of international commodity market prices, exchange rates, transport and logistics costs and tax) and its description of the factors that are relevant to an assessment of refinery profitability.

Phillips 66 operations in the United Kingdom

Phillips 66 is an integrated downstream petroleum and chemicals group, headquartered in Houston, United States of America. It is not active in the upstream activities of exploration and production of crude oil and natural gas: it purchases crude oil for its refining operations on the global markets for crude oil. It owns and operates 12 refineries globally, 11 of which are in the United States and one, Humber Refinery, is in the United Kingdom; it also has an 18.75% interest in the MiRO refinery, in Germany. It markets its products globally, including in Europe and has retail operations in a number of countries, including the United Kingdom. Its chemicals operations are carried out in a joint venture with Chevron, as Chevron Phillips Chemical.

In the United Kingdom, Phillips 66 is active through P66L and its subsidiary companies. Its UK head office is in London, where its commercial trading and marketing teams are located. P66L is active at all levels of the downstream sector in the UK, i.e. refining, wholesale supply and retail.

P66L owns and operates the Humber Refinery in North Lincolnshire, which has a crude oil processing capacity of 221,000 barrels per day. Crude oil feedstocks are purchased on global markets and imported by ship. The products manufactured at the Humber Refinery include petrol (gasoline), diesel, aviation (jet) fuel, petrochemical feedstocks, fuel oils, heating oil and petroleum coke. It can produce up to 95,000 barrels per day of gasoline and 115,000 barrels per day of distillates (including diesel). The Humber Refinery operates in a global market and the products it makes are both exported globally and sold into the UK market (which is also referred to as the 'inland' market). Inland distribution of road fuels nationwide in the UK is undertaken by road, rail, pipeline, and sea, with the core customer area of P66L being in the regions located near the Humber Refinery.

P66L supplies road fuels into the inland UK market via its own, joint venture and third-party terminals, including its own distribution terminals adjacent to the Humber Refinery (some terminal assets of which are shared with the adjacent Lindsey Refinery operated by Prax), current exclusive use of a third party terminal at Bramhall (near Stockport) and a joint venture terminal at Kingsbury (near Tamworth). It also has agreements to use third party terminals throughout the UK.

In the UK P66L supplies road fuels and other products to supermarkets and other large operators of petrol filling stations ("**PFSs**"), transport operators, other oil companies, independently-owned PFSs and other distributors on both an 'unbranded' and 'branded' basis. Branded sales of road fuels are made using the 'JET' brand, which has been used in the UK for over 60 years, including to a network of c.300 independently-owned and operated 'JET' branded dealers who own and operate their own PFSs (under a 'dealer owned, dealer operated' or 'DODO' model). Road fuels are supplied on a delivered or collected (or 'ex-rack') basis. 'JET' dealers are generally located in the North and Midlands areas of England and are the retailers of road fuels to consumers, so they set their own pump prices.

P66L has limited directly-owned retail operations in the UK, with presently only 11 company owned sites owned by a subsidiary company, JET Retail UK Limited. These sites are operated on a 'service station operator' model, under which road fuels are sold by the operator as the agent of JET Retail, which sets the pump prices.

Refining

In its Invitation to Comment, the CMA observes that crude oil prices have risen to record levels, which has (together with exchange rate fluctuations) been a significant factor in the rise in the price of road fuels (paragraph 5(a)). It also observed what it describes as a "growing gap" between the price of crude oil and the wholesale price of road fuels, which it refers to as the "refining spread" (paragraphs 5(b) and 10-12 and Figures 1 and 2). The CMA observes that the rise is the price of road fuels appears to have been due to both demand-side and supply-side factors, which it identifies in its *Road Fuels Review* (at paragraphs 2.18 to 2.25).

P66L considers that these demand-side and supply-side factors, which are international in nature and affect both the crude oil and refined product markets, each of which are transparent and international commodity markets, explain the increase in road fuel prices experienced since June 2021. These are matters over which neither P66L nor other refineries or suppliers in the UK have any control or influence.

The refining of crude oil to manufacture products such as gasoline and diesel is both a capital-intensive and energy-intensive industry. Capital investments are made on a long-term basis and take account of the cyclical nature of refining margins. P66L had made and continues to make very substantial capital investment in its refining assets, including at the Humber Refinery, which is one of Europe's most complex and efficient refineries. It is also noted that the lower carbon projects currently being developed by P66L at the Humber Refinery (which will help realise the UK government's Net Zero strategy) will require very significant capital investment by P66L in the near term.

P66L (and other refiners of crude oil, both in the UK and globally) purchase crude oil, either on the global market or, if vertically integrated, from their own upstream production operations. P66L and other UK refineries are therefore 'price takers' on the global crude oil market, which is a commodity market, with prices for specific crudes established by reference to market price assessments published by price reporting agencies. Refineries must also purchase a range of other inputs for their refining operations, including natural gas, electricity and chemicals, the prices for each of which have increased significantly.

Road fuels are commodity products that are traded internationally. P66L, as with other UK refiners and importers, are 'price takers' in the determination of 'ex-refinery' (or 'ex-import terminal') prices for road fuels, as they are for all other refined products produced or imported by them. Prices for road fuels are therefore established by reference to market price assessments published by price reporting agencies for a particular region. In the case of the UK (and other locations in North West Europe), this is for prices for the Amsterdam-Rotterdam-Antwerp ("ARA") range. We therefore consider that, in its Market Study, the CMA should take account of and consider international prices for refined products, including gasoline and diesel, and the reasons for changes in them.

The "refining spread", as defined by the CMA (*i.e.*, "*the difference between the price of crude oil and the wholesale price of petrol and diesel, whether refined domestically or imported*") does not, in our view, represent an adequate measure of refinery operator margins and profitability, as it does not take into account operating costs (including those of other raw materials, gas and electricity, labour and transport), or the range of other co-products produced by a refinery, each of which are also commodity products sold on international markets, with varying individual margins. We therefore consider that, in its Market Study, the CMA must, if it wishes to assess the profitability of refineries, consider refining margins and not merely a simplistic calculation of the difference between crude oil input prices and the UK refinery (or import terminal) gate prices of each of gasoline and diesel.

In its Invitation to Comment (and in its *Road Fuel Review*, paragraphs 2.5 to 2.8 and 2.18 to 2.28), the CMA has focused its assessment of what it terms the "refining spread" on a very short time period, i.e. by comparing the "spreads" in June 2021 and in June 2022. This is a very short period of time over which to assess the margins and profitability of refiners and importers. Crude oil refining is a capital-intensive, long-term industry that is characterised by significant cyclical variations in prices and refining margins. We therefore consider that refining margins must be assessed on a long-term basis, as these are cyclical in nature and are heavily influenced by government policies, geopolitical events, and international market factors. We note that whilst North West Europe refining margins were above the rolling five year average between March and June 2022 (which followed, in particular, Russia's invasion of Ukraine),

PROVIDING ENERGY. IMPROVING LIVES.

with two specific 'spikes' in May and June, they have since fallen considerably. Accordingly, it is highly misleading to rely on what are no more than 'snapshots' to draw conclusions, particularly in an industry characterized by both significant and long-term capital investments and cyclical margins.

In the period between June 2021 and June 2022 used by the CMA in its *Road Fuels Review*, the price of road fuels was affected globally by the supply-side impacts of a tightening market (especially for diesel) due to refinery closures (primarily in China and the United States), production reductions and the Russian invasion of Ukraine (which has reduced supply from Russia, particularly in Europe), coupled with an increase in demand post COVID-19 lockdowns, which has in turn contributed to the increase in refinery spreads observed by the CMA.[1]

As a result of the COVID-19 pandemic, UK demand for refined oil products fell by 23% in 2020[2] and in March 2021, the UK's overall refinery utilisation rate was only 53% of capacity.[3] This placed enormous financial pressure on UK refineries, including on P66L's Humber Refinery, given the significant fixed costs of operations. However, as requested by the UK Government and in order to ensure the continued supply of road fuels and other products during the pandemic, P66L continued to operate the Humber Refinery and did not stop operations, mothball any production capacity, put any of its employees on furlough or make any redundancies during government mandated lockdowns. However, in doing so, its refining operations in the UK incurred substantial losses.

As the economy recovered following the worst impacts of the COVID-19 pandemic, demand for oil and refined products grew significantly, whilst supply was reduced, in each case both globally and in the UK. Some of the reasons that supply reduced were refinery closures, both in Europe and especially globally, the Russian invasion of Ukraine and responsive measures taken both by governments (i.e. sanctions on Russian businesses) and by businesses to reduce or stop trading with Russia.

Although there has been a reduction in global refining capacity, the capacity of the Humber Refinery has not been reduced and in recent months, in the period covered by the CMA's *Road Fuels Review*, it has been operating at very high levels of capacity utilization, including for gasoline and diesel.

The UK is dependent upon imports to supply 20% of diesel demand, most of which was supplied by Russia in recent years.[4] Since the Russian invasion of Ukraine, the UK and other Western Governments have introduced sanctions, some of which are in effect and others of which are to become effective, to stop the import of crude oil and energy products from Russia and have encouraged earlier compliance with the latter. This has had a major impact on the global market for diesel.[5] Phillips 66 continues to work to ensure security of supply for its

---

[1] S&P Global, "Global diesel supply tightens as buyers turn Russian barrels away", 7 April 2022, available from: https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/oil/040722-global-diesel-supply-tightens-as-buyers-turn-russian-barrels-away

[2] UKPIA, "Statistical Review", 2021, page 8.

[3] Benedict George, Argus Media, "UK's Grangemouth refinery cuts 130 jobs", 26 April 2026, available from: https://www.argusmedia.com/en/news/2209009-uks-grangemouth-refinery-cuts-130-jobs

[4] Paul Bolton, House of Commons Library, Research Briefing "Imports of energy from Russia", 13 July 2022, page 9, available from: https://researchbriefings.files.parliament.uk/documents/CBP-9523/CBP-9523.pdf

[5] S&P Global, "Global diesel supply tightens as buyers turn Russian barrels away", 7 April 2022, available from: https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/oil/040722-global-diesel-supply-tightens-as-buyers-turn-russian-barrels-away

refineries and customers, all the while abiding by all applicable sanctions levied on Russia including by the United States, European Union and United Kingdom.
In short, the production and supply of road fuels at the refining level in the UK is competitive and the market is functioning efficiently. 'Refinery gate' pricing levels closely follow crude oil prices and changes in the costs of operating refineries and reflect demand and supply on international markets, which in turn have been impacted by a series of micro-economic, macro-economic and geo-political shocks. In this environment, P66L and other UK refineries are price-takers with no ability to influence refinery gate pricing levels. Further, having peaked earlier this year, refinery gate prices are now falling. Accordingly, we see no basis for concern about competition in the production and supply of road fuels at the refining level in the UK market.

Wholesaling
In its Invitation to Comment, the CMA states (at paragraph 16) that long-term exclusive supply agreements between suppliers and independent operators of PFSs may prevent those operators from engaging in more frequent procurement exercises and provide them with less flexibility than supermarkets. It proposes to investigate whether such contracts harm competition and feed through to pump prices (paragraph 18). It is suggested that the length of such contracts should be reduced and/or that break clauses should be introduced (paragraph 17).

As set out above, P66L supplies PFS operators with road fuels on both a 'branded' basis (to independent operators of PFSs under the 'JET' brand) and an 'unbranded' basis (to supermarkets, other large operators of PFSs and independent PFS operators). [✄]. JET dealers have exhibited a high degree of loyalty to the JET brand and many have been wholesale customers for many years.

As the CMA has identified, the UK retail market is highly competitive (*Road Fuels Review*, paragraphs 3.15 and 3.16). Under the recently adopted Vertical Agreements Block Exemption Order (which came into force on 1 June 2022, following the expiry on 31 May of the Vertical Block Exemption Regulation, which was retained in the UK under domestic law post-Brexit), exclusive supply contracts of up to five years' duration benefit from the block exemption, provided the parties' market shares are below 30% and the contracts do not contain any 'hardcore' restrictions. In most cases, agreements of a longer duration are also unlikely have appreciable negative effects on competition.

In our view, there is no basis for the CMA to intervene in wholesale supply contracts with independent PFS operators: the wholesale and retail markets are both competitive and exclusive contracts that have benefits for both the supplier and PFS operator. We consider that reducing the term of supply agreements, preventing exclusive agreements or imposing break clauses to permit a PFS operator to procure road fuels from another supplier are unlikely to lead to lower pump prices, since the lowest prices are typically offered by the supermarkets who operate under their own brands and procure fuel from several suppliers. This would simply make brand owners (such as P66L) less willing to invest in and support dealer-operated networks throughout the energy transition, which in turn would make independent, dealer-operated PFSs *less* competitive in terms of their consumer proposition.

Retail
As set out above, P66L has a very limited direct presence in the market for the retailing of road fuels, with only 11 company-owned PFSs nationally.

As the CMA has identified in its *Road Fuels Review* (paragraphs 3.17 and 3.21) and in its earlier mergers work, competition at the retail level takes place primarily at the local level. We consider that the retail level is competitive, with some of the lowest pre-tax retail prices in Europe (see *Road Fuels Review*, paragraph 3.2) and that UK retail pricing is market-led and depends on local competition (in particular the presence of one or more supermarkets), costs to serve (in particular wholesale fuel prices, but also other costs, including staff, transport and electricity costs, which have increased recently) and volumes supplied by a PFS (given the fixed costs of operation). Prices in rural areas reflect these factors.

Phillips 66 Limited looks forward to working constructively with the CMA on its Market Study and we will provide such evidence as we are able to in response to the CMA's requests for information.

Yours sincerely,

Darren Cunningham
UK Lead Executive and General Manager Humber Refinery
Phillips 66 Limited