

Texas City Business Unit

Business Strategy

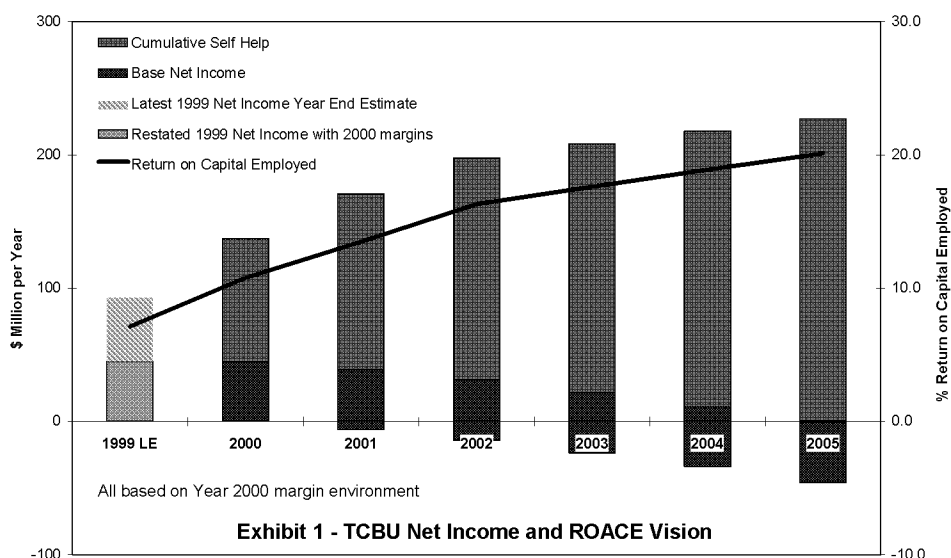
Having delivered a successful transition to BP Amoco after the merger and an effective \$60 million cash cost reduction program in 1999, the leadership team turned their focus to address the long-term strategic direction and performance of the Texas City Business Unit (TCBU). During the summer 1999, the leadership team completed a four-month journey to develop a business strategy that sets a bold new direction for the TCBU to achieve aggressive financial and HSE performance targets aligned with the BP Amoco Group's strategic intent for Downstream businesses.

In July 1999, Sir John Browne and his senior management team communicated the strategy and goals for the new BP Amoco Group to all employees and the financial investment community. The TCBU leadership team adopted the key Downstream strategies as the basis for the TCBU direction. These key Downstream strategies and goals are:

- achieve 0.05 Days Away From Work rate in year 2001, which is a 60% reduction from 1999 target
- achieve a minimum business unit return-on-average-capital-employed (ROACE) of 10% at the bottom-of-cycle refining margins and 15% at mid-cycle refining margins;
- reduce business unit cash costs for the year 2001 by at least 25% from year 1998 levels;
- analyze the business unit portfolio for potential asset disposals contributing toward the Downstream goal of divesting \$3 billion of assets by year-end 2001;
- continually improve refining capability to provide unique "clean" fuel products to support Retail Marketing's goal of leading the market place with "clean" fuels;
- leverage refining integration -- where it creates distinctive BP Amoco advantage --through increased petrochemical feedstock production for the Chemicals Stream and through mutually advantaged crude oil supply arrangements with Upstream;
- reduce CO₂ emissions by 10% from a 1990 base by year 2010; and
- meet BP Amoco Group policy commitments to employees, which emphasizes developing and recognizing employees for performance.

TCBU Alignment and Performance Goals

Aligned with the Downstream strategy, the TCBU aspiration is to deliver impressive HSE and financial performance. This is in spite of a harsh refining business environment.



As shown in Exhibit 1, we expect a margin environment decline in 2000 and continued gradual deterioration in margins over time, in line with the refining crack spread trend since 1992. In 1999, the TCBU delivered approximately \$100 million of self help resulting in \$90 million of net income. TCBU will continue to overcome the negative margin environment and grow net income through considerable self help to improve net income to about \$200 million in year 2005. The ROACE would increase from 7% in 1999 to about 20% in 2005.

Cost reduction is an important component of self help especially over the next two years, but cost reduction alone will not deliver the level of self help needed to grow the business. In order to achieve this level of growth, the self help will be heavily weighted towards innovation and operating gap closure. Major tactics toward achieving these goals have been identified and will be pursued across the organization. Major highlights of our strategy implementation include:

- safety leader in refining industry as measured by site OSHA rate of 0.8 by year 2001;
- moving all non-branded fuels from the Colonial Pipeline to more profitable light oils markets and into chemical feedstocks by year-end 2001;
- being uniquely positioned to take advantage of crude sourcing shifts due to new crude finds, especially in the deep-water Gulf of Mexico and Angola;
- producing clean fuels to fully support Retail Marketing's goal of brand-marketing clean fuels in 15 US cities by year-end 2000;
- reducing fixed cash costs from \$285 million in 1999 to about \$250 million for year 2001;
- increasing the supply of chemical feedstocks to the Chemicals Stream;
- improving energy usage efficiency \$12 million by year-end 2001;
- increasing on-stream availability from Solomon 4th to 1st quartile performance;
- achieving hydrocarbon loss of 0.4 weight percent by year 2001 resulting in \$ 8 million savings;

- reducing CO₂ emissions by 10% from 1998 levels by year 2001; and
- hosting a major power cogeneration facility for startup in 2002.

The TCBU will meet these targets with restricted resources –roughly 15% fewer employees and approximately \$100-150 million of additional capital for clean fuels beyond the \$20-\$30 million per year of sustaining capital plus about \$30-\$40 million per year of turnaround capital.

Refining Industry Structure and Attractiveness

Overall the refining industry is extremely competitive, resulting in low profitability for the average refiner. Top performing refiners can earn an acceptable return by effectively executing a strategy that captures several potential sources of industry advantage. To understand where advantage can be captured, a thorough analysis of the refining industry structure and its implication for the future was conducted and summarized below.

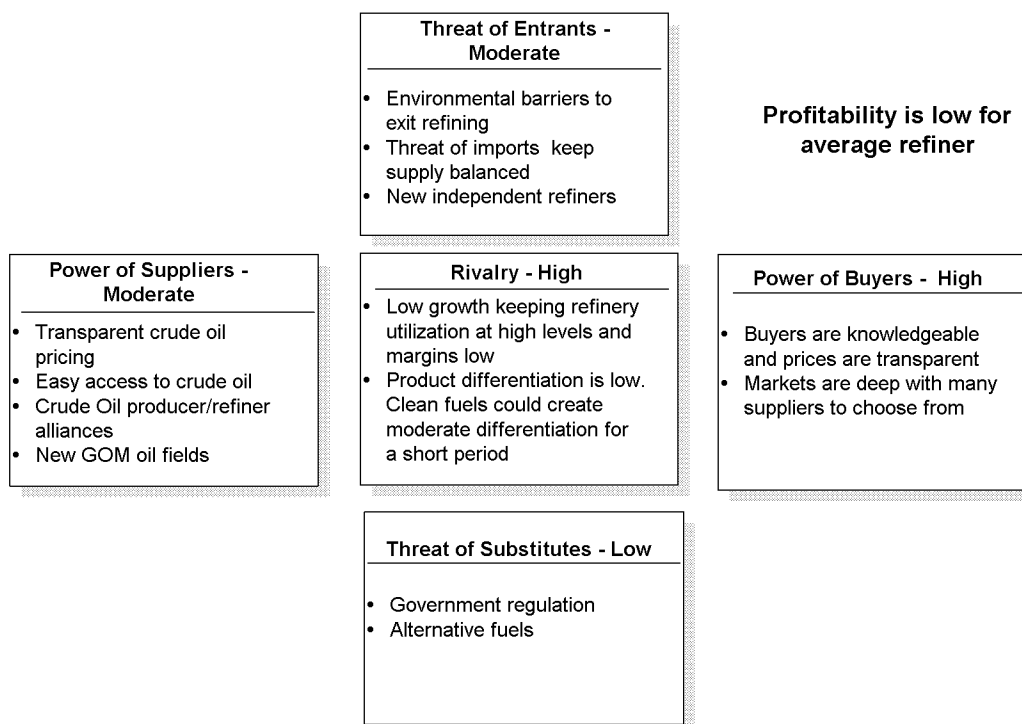


Exhibit 2 -- Refining Industry Competitive Factors

From the supply side, refiners along the US Gulf Coast (USGC) have found it difficult to gain an advantaged crude oil supply arrangement, because crude oil market pricing is transparent and all refiners essentially have easy access to crude oil supplies at similar in-bound logistics costs. Only a few Gulf Coast refiners (i.e., Louisiana) have abundant crude supplies from sources in close proximity to their refineries resulting in low in-bound logistics costs and thereby capturing a favorable landed crude price. To maintain a secure outlet for crude supplies, heavy crude oil producers such as Mexico, Venezuela, and Saudi Arabia have increased their forward integration into refining. Roughly 70% of the USGC refining capacity is integrated for heavy crude oil

supply through an equity position or processing arrangement. This has constrained many refiners' flexibility for processing opportunity crudes. Local crude oil supplies will become more abundant for USGC refiners, as many new deep-water Gulf of Mexico (GOM) fields come on stream and oil producers aggressively search for local refiners to process the crude. Thus, those USGC refiners having flexibility to process these GOM crude supplies may gain an advantage in the future.

Several factors have led to a moderate threat of new entrants moving into the refining industry. Due to large environmental remediation obligations when refiners permanently shut down operations, many marginal refineries continue to operate, keeping regional refining product supply balances in surplus. In addition to domestic supply, refining product imports have landed in US markets to meet supply needs and have limited product margins. Over the past five years, new independent refiners (Valero, Tosco, Clark) have also entered the refining business when refineries have been sold primarily by either major integrated oil companies seeking to reduce their refining exposure or marginal refiners interested in exiting the business.

From a product substitution perspective, there are no major economical substitutes for refined products today. Some research development has been conducted over the past ten years to substitute alternate fuel sources (compressed natural gas, fuel cells) for refining fuels, but most potential substitutes for displacing large gasoline and distillate volume in the transportation industry are believed to have a time horizon of 20 years or more. Government regulations have supported alternative fuels development and subsidies but have not fostered substantial growth of alternative fuels. Thus, the threat of refining fuels substitution will continue to be low.

From a refining product buyers' perspective, refining products are readily available from many suppliers and markets are deep with transparent pricing. The only major opportunity to capture advantage is by making products with the highest margins. In many cases the highest margin products have been certain petrochemical feedstocks and unique refining fuels before they become undifferentiated over time.

In summary, competitor rivalry among refiners has been intense and resultant product margins have trended lower, making it difficult for the average refiner to earn an acceptable profit.

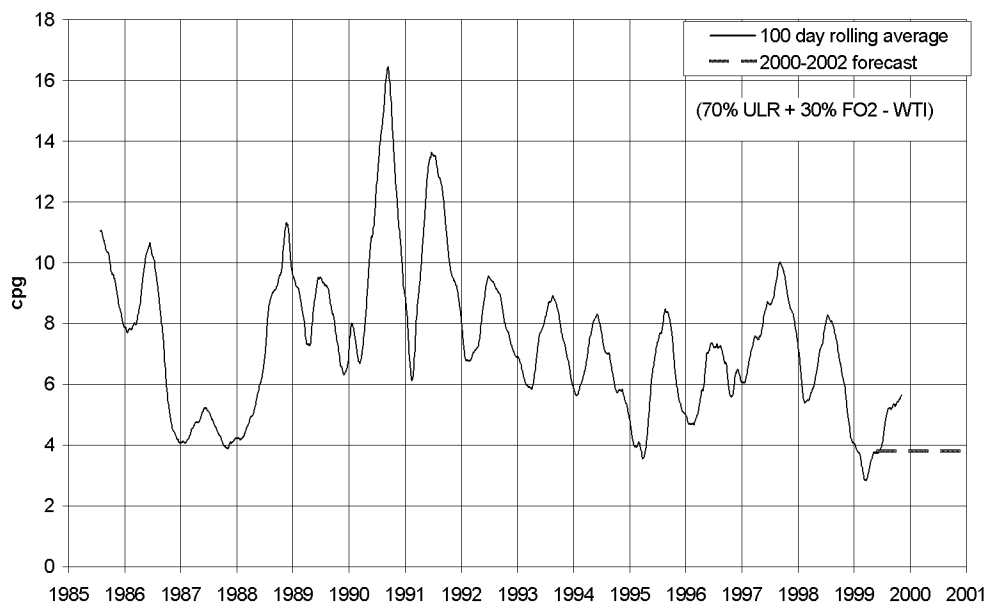


Exhibit 3 -- US Gulf Coast Crack Spread

As shown in Exhibit 3, the USGC crack spread margins for refiners has gradually declined from about 6 - 8 cents per gallon (cpg) in the late 1980's and early-mid 1990's to a new low of about 4 cpg in 1999. Due to the structure of the refining industry, crack spread margins will likely remain in the 4 cpg range at least for the next few years.

Sources of Industry Competitive Advantage

To differentiate financial performance from the average competitor, refiners will need to capture as many potential sources of industry competitive advantage as they can to earn superior profitability. Major sources of industry advantage for earning superior financial returns include:

- flexibility to process a wide variety of crude oil feedstocks to capture the most profitable slate as increasingly abundant supplies come on-stream;
- lowering cash costs at an accelerated pace relative to other refiners;
- management vision and leadership coupled with an aligned workforce accepting responsibility and change to improve business performance;
- being first to capture new business opportunities and new markets for product offerings while they are most profitable for market participants;
- low logistics costs for feedstocks and products due to proximity of the refinery to feedstock sources and product markets;
- being innovative in approaches to business development, asset ownership and partnerships for producing improved shareholder value; and

- achieving high refinery on-stream availability for maximum gross margin potential.

Key Elements of the TCBU Business Strategy

To achieve superior performance relative to the average refiner, the TCBU is well positioned to capture several sources of industry advantage through rapid implementation. The strategy elements, will be the lenses that TCBU employees will use to determine what actions to take and not to take when setting business unit direction and driving performance results. The key elements of the business strategy are:

- We commit to being a leader in HSE by having no accidents, no harm to people, and no damage to the environment.
- Employees will work as self-directed teams and will be rewarded for and by their personal development and contribution to team results.
- We will build a culture where everyone views their area with an entrepreneurial spirit to maximize business value.
- We will maximize the value of the TCBU and the integrated BP Amoco chain by:
 - fully supporting the BP Amoco marketers to lead the market place with innovative branded clean fuels;
 - increasing the focus on Chemicals integration with an aim to upgrade remaining non-branded fuels sales to petrochemical feedstocks;
 - utilizing the business unit feedstock flexibility to fully exploit the opportunity of the major new regional crude finds; and
 - continuously and aggressively driving costs out of the system.

The *HSE* strategy has been expanded beyond the conventional context of safety and environmental incidents to include hydrocarbon losses, green house gas emissions and energy usage efficiency. By “no accidents”, the TCBU strives for their elimination and will continue its long-standing refining industry leadership position in Process Safety as measured in terms of casualty loss per barrel. By “no harm to people”, the TCBU is striving for zero employee and contractor injuries and has committed to achieve a refining industry leading site OSHA injury rate of 0.8 by the year 2001 from the performance level of 1.3 through successful deployment of the “Getting HSE Right” processes. By “no damage to the environment”, the TCBU will reduce CO₂ emissions by 25% from 1998 by 2010, and will strive to meet an interim target for reducing CO₂ emissions by 10% of the 1998 levels in year 2001 through better energy efficiency management and increased CO₂ sales from the hydrogen plant to third parties. We will improve energy efficiency from Solomon 3rd to 1st quartile performance by holding teams accountable for day-to-day attention to energy, keeping equipment in energy efficient condition and aggressively pursuing the opportunity to host a third party cogeneration project. Hydrocarbon loss will also be halved over the next two years to 0.4 % weight recovery losses in year 2001.

The TCBU *Employee* strategy requires us to make a major shift from the current hierarchical structure to a flatter organization composed primarily of self-directed teams as the basic building block for delivering business results. Employees will be developed, empowered to

act, and expected to do more in the new team environment. Reward systems will be redesigned to truly reinforce the importance of contribution to team results. The TCBU leadership will transform itself into a board (composed of TCBU managers and other BP Amoco managers external to the TCBU) to set direction for our thriving Fortune 400 size business, to formulate strategy and to foster development and integration of cross-stream opportunities. Process champion positions -- who will also serve on the refining networks sharing improved practices -- will be established to systematically drive consistent core work processes across the business unit and to manage key external relations with other BP Amoco organizations and third parties. Transformation to this flatter structure, coupled with outsourcing refinery services that are not competitive, will deliver the lion's share of the \$30 million cash cost reduction by year 2001.

Building a culture where everyone views their area with an *Entrepreneurial* spirit to maximize business value requires both leadership by example from the top of the organization and engagement of all employees to identify and implement new opportunities that deliver value above and beyond business as usual. Employees will be encouraged to seek and implement new opportunities and to regularly evaluate assets and systems in terms of their net value to the business. A key enabler to achieve this strategy will be to assure that employees have access to business information and that they are recognized for both large and small successes. Several major entrepreneurial actions are already underway to maximize value of the TCBU. A few of the most notable entrepreneurial actions are:

- Capture synergies with local petrochemical facilities and BPA organizations to better utilize the 600 - 800 M barrels of idled refinery tankage.
- Establish an alliance with a third-party energy company to build, own, and operate a large scale power cogeneration facility that economically maximizes TCBU site hosting value, estimated at \$25-30 million of additional annual operating income.
- Cultivate a business arrangement to sell incremental hydrogen unit capacity.

"Clean Fuels" is a BP Amoco hall mark. The TCBU will fully support the BP Amoco marketers to lead the market place with innovative branded clean fuels and will carry on the site's tradition of being among the industry leaders in producing clean gasoline as we were with lead-free and then clear Ultimate gasoline. We will continue to lead the marketplace by producing clean fuels and promoting Ultimate as a valuable, branded product. Challenges will be great as overall demand for premium gasoline in the US declines, future regulations make product differentiation more difficult, and sulfur removal processes and a potential MTBE ban take octane from the refinery's gasoline pool. The public and regulators will not be satisfied with just clean premium gasoline; they also want cleaner regular gasoline and cleaner on-road diesel. There are good opportunities to lead the marketplace with these cleaner fuels and add value to BP Amoco with differentiated products and enhanced Brand image. The challenges will be to make these clean fuels at low cost and minimize production of off-road distillate, which is declining in demand and under increasing pressure from export refineries in Asia. For those light oil products, which cannot be differentiated or branded, the challenge is to move them out of the Colonial Pipeline markets within the next two years and into marine, Midwest and Southwest markets, where they can bring more value to the TCBU.

Through our *Chemicals Integration* strategy, the TCBU aims to upgrade remaining non-branded fuels sales to petrochemical feedstocks having a higher financial return. With 21% of

TCBU products by volume today entering the local petrochemical market place, the refinery supplies double the industry average of petrochemicals on a volume percentage basis and is the center piece of what is an "Ideal Site" with the Global Aromatics BU, Olefins BU-North America, and Lubricants/Additive BU as major local customers. Our challenge going forward is to grow as an industry leader our already large well positioned petrochemical capabilities through innovation, emerging technology, new product offerings, improved logistics, and quality assurance. The refinery's size and complexity means there is potential for more petrochemical feedstocks production through additional stream recovery or process changes. The TCBU will also further develop commercial relationships that align the needs of both the customer and supplier to capture the most promising petrochemical production opportunities for the integrated BP Amoco value chain.

Feedstock Flexibility is critical to success. The TCBU will utilize its feedstock flexibility to fully exploit the opportunity of the major new regional crude finds. As described earlier, the USGC crude sourcing picture is constantly changing and about 70% of the USGC refiners have established long-term supply alliances with Mexico, Venezuela, and Saudi Arabia. These relationships will constrain the refiners' ability to switch to other crudes. We have post audited crude alliance proposals we have been offered in the past by these major heavy oil suppliers. Given the pricing environment over the last few years, those proposals would have been unattractive deals for Texas City. Thus, we will strive to take full advantage of our crude oil processing flexibility to capture exciting new opportunities emerging with significant new regional crude finds in the deep-water Gulf of Mexico and Angola. There are logistics advantages for placing these new found barrels into Texas City versus most other markets. With the anticipated glut of medium sulfur crudes in the region, we will plan for a crude slate that is no heavier than today. Therefore we do not plan to invest in major resid conversion expansions similar to several other major USGC refiners. Instead we will be assigning a "relationship manager" to establish a formal communication link with other BP Amoco groups (OTI, Upstream, Pipeline) -- who manage the marketing and transportation of these new crude finds -- to evaluate and capture future benefits.

Consistent with our **Cost Reduction** strategy, the TCBU will continuously and aggressively drive costs out of the system at an accelerated pace relative to other refiners. The TCBU has already reduced fixed cash costs by 17% (to \$285 million) in 1999 from 1998 spending levels to recapture industry leadership on costs. To hold the cost leadership position, we will simultaneously reduce fixed cash costs another 10% (to about \$250 million) in 2001 and improve refinery onstream availability (from 4th quartile toward 1st quartile performance). These additional cost reductions and on-stream availability improvements will be accomplished by:

- reducing layers and staffing in the organization through a severance program;
- driving core work processes through process champions to improve equipment reliability, reduce expensive unplanned outages, and replace reactive maintenance with proactive planned work;
- driving unnecessary costs from turnaround work lists;
- outsourcing services that are not cost competitive with contractors;

- working with vendors and contractors to lower their cost through enabling business processes such as Risk Sharing, E-Procurement, and Global Contracts; and
- improving use of the Capital Value Process on all capital projects and turnarounds;

Assurance on Strategy Implementation

With the strategy now well defined for setting clear direction, the TCBU leadership team identified major tactics (supporting each Strategy element) and the associated risks for implementing the Strategy. We understand the risks associated with each major tactic and will address these risks as a part of strategy implementation to assure targeted business results are delivered. Throughout strategy development, we sought input from other BPA organizations to ensure that the TCBU strategy was: robust, aligned with the strategic direction of other major BPA organizations, and well supported beyond TCBU boundaries where necessary for implementation. Below are key actions we will take to further assure successful strategy implementation.

- Regularly monitor progress of major tactics against key performance milestones and metrics
- Assign a TCBU lead for major tactics supporting the strategy to assure accountability and follow-up.
- Utilize the TCBU Variable Pay Plan to reward teams for delivering strategy implementation results.
- Continue to actively involve the refinery union leadership in strategy study findings and implementation.
- Make the necessary workforce reductions through voluntary severance wherever possible to maintain employee morale.
- Assign “relationship managers” within the TCBU to manage relationships and coordinate strategy with other BPA organizations critical to TCBU strategy implementation.
- Drive core work processes through Process Champions to ensure that the TCBU systematically improves delivery on all major performance targets.
- Provide strategy deployment support to ensure that major tactics are adequately resourced to implement.

Overarching Goals for TCBU Business Strategy Development

The TCBU SLC and core strategy team developed a set of overarching stretch goals to ensure that the TCBU strategy developed would provide step-out performance results and be aligned with the BPA Downstream strategy/goals. The overarching goals defined below were used to test the TCBU strategy.

1. TCBU Cash Cost

- Fixed cash costs for year 2001 will not exceed approx. \$249 million. Per Downstream ExCo, we must reduce our fixed cash costs by 28% below year 1998. The actual year 1998 fixed cash costs was \$345.8 million, which includes a \$38.2 million downward adjustment to exclude capitalized turnarounds from the original figure of \$384 million.
- Fixed cash costs for year 1999 will not exceed October GFO forecast for TCBU of \$287 million.
- Variable cash costs will continue to be reduced reflecting an EII of 85% for year 1999, with further major reduction on energy and non-energy variable costs in year 2000 and beyond.

2. TCBU must earn a minimum of the cost of capital (10% ROACE) at the bottom of the refining business cycle.

3. TCBU will meet or exceed a 15% ROACE at the mid-cycle of the refining business cycle.

4. TCBU will become a leader on personnel safety (site OSHA rate of 0.8) among the refining industry by the year 2001.

5. TCBU will substantially reduce reportable environmental incidents from 36 incidents in year 1998 with 20% year-over-year improve to approach the limit resulting from current existing hardware constraints. TCBU must also deliver a 10% reduction in CO2 emissions by the year 2010 versus 1990 actual.

6. TCBU will evaluate its refinery assets portfolio against the BPA criteria for divestment opportunities. The criteria are:

- Strong cross business integration, primarily integration with the BPA trading organization and BPA chemicals.
- Market enabling (ability to supply low cost clean fuels for marketing)
- Relative external value to others versus internal value to BPA
- Poor contribution to TCBU site profitability and return on investment

7. Reduce TCBU capital employed from the current \$1.4 billion substantially (\$200-\$300 million minimum) before year-end 2000.