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CT-89/3

THE COMPETITION TRIBUNAL

IN THE MATTER OF an Application by the Director of Investigation and Research under sections 92 and 105 of the Competition Act, R.S.C. 1985, c.C-34, as amended;

AND IN THE MATTER OF the acquisition by Imperial Oil Limited of the shares of Texaco Canada Inc.

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE
FILED / PRODUIT
JUIN / JUNE 29 1989
REGISTRAR — REGISTRAIRE
OTTAWA, ONT. #1

B E T W E E N

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

- and -

IMPERIAL OIL LIMITED

Respondent

NOTICE OF APPLICATION

Director of Investigation
and Research
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Hull, Quebec

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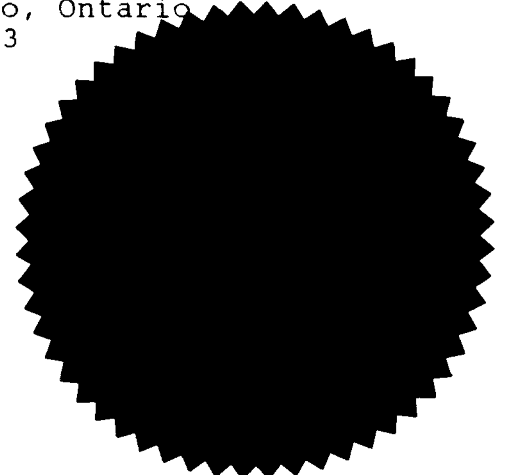

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IMPERIAL OIL LIMITED

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NOTICE OF APPLICATION

TAKE NOTICE that the Applicant, the Director of Investigation and Research (the "Director"), will make an application to the Competition Tribunal ("the Tribunal") for

1) an order pursuant to section 105 of the Competition Act in the form of a Draft Consent Order attached hereto as Appendix "1"; and

2) such further or other order as the Applicant may advise and the Tribunal consider appropriate.

AND TAKE NOTICE that in support of this Application the Director will rely upon this Notice of Application, the Draft Consent Order, the Consent Order Impact Statement, affidavit evidence and such other material as may be filed or the Director may advise.

Dated at the City of Hull in the Province of Quebec this 29th day of June, 1989.

Calvin S. Goldman, Q.C.
Director of Investigation
and Research

TO: Imperial Oil Limited
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AND TO: The Registrar
Competition Tribunal
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Appendix 1 - Draft Consent Order

Appendix 2 - Overview of the Industry

STATEMENT OF THE GROUNDS FOR THE APPLICATION UNDER S. 92 AND THE MATERIAL FACTS ON WHICH THE DIRECTOR RELIES

I - GROUNDS FOR THE APPLICATION

1. The Director of Investigation and Research (hereinafter "Director") states that the Respondent Imperial Oil Limited (hereinafter "Imperial") has effected a merger, through the acquisition of shares of Texaco Canada Inc. (hereinafter "Texaco"), which merger is likely to prevent or lessen competition substantially in refined petroleum product markets in Canada within the meaning of section 92 of the Competition Act (the "Act").

2. The Director alleges that the merger is likely to prevent or lessen competition substantially in certain markets of Canada in the wholesale and retail supply of refined petroleum products and in particular, gasoline. The Director alleges that competition is likely to be substantially lessened or prevented as a result of:

(i) the elimination of a major refiner-marketer in the Atlantic Canada region;

(ii) the elimination of a significant supply alternative for non-integrated gasoline marketers in Quebec and Ontario;

(iii) the reduction in the availability of terminaling facilities for the storage and distribution of refined petroleum products across Canada;

(iv) the elimination of an effective competitor from the branded sector of the retail gasoline markets across Canada; and

(v) an increase in the opportunity for inter-dependent market behaviour among refiner-marketers.

3. An order of the Tribunal in the form of the draft Consent Order attached hereto is therefore required to ensure that competition is not likely to be prevented or lessened substantially as a result of the merger.

II - MATERIAL FACTS

A. DEFINITIONS

4. In this Application

- **"Divestiture"** means in the case of:

  (i) a company owned service station, the sale of the site;

  (ii) a dealer owned service station, the early termination, at the operator's option, on 3 months notice, of all contractual arrangements between the service station owner and Imperial or Texaco or, failing early termination, the non-renewal by Imperial and Texaco of all such contractual arrangements at the end of the initial term thereof;

  (iii) a terminal owned by Imperial or Texaco, the sale thereof;

  (iv) the Eastern Passage refinery, the sale thereof, save and except that Imperial, in accordance with the terms of the Draft Consent Order, may continue the reciprocal supply agreement based at the Eastern Passage refinery.

- **"Downstream"** means activities related to the manufacturing, distribution and sale of petroleum products, namely: refining, transportation, terminaling and marketing (wholesale and retail).

- **"Eastern Passage refinery"** means the Texaco refinery in Dartmouth, Nova Scotia and the adjoining marine terminal.

- **"Imperial"** means Imperial Oil Limited and its subsidiaries and affiliates operating in Canada.

- **"Independent Marketer"** means a person or firm engaged in the marketing or distribution of refined petroleum products but who is not affiliated with a refiner other than by means of an arm's-length supply contract. An independent marketer may also be known as an independent reseller, unbranded marketer, private brand distributor, private brand reseller or private brand dealer.

- **"Majors"** or **"Major Oil Companies"** means the largest integrated petroleum companies operating in Canada. They are Imperial, Petro-Canada, Shell and Texaco.

- **"Regional Major"** means an integrated petroleum company that confines its activities to certain regions of Canada only. Irving, Suncor, Husky, Ultramar and Chevron Canada are referred to as regional majors.

- **"Service Station"** means a site where branded or unbranded gasoline is offered for sale to the general public. The sale of gasoline may be combined with other offerings to the public.

- **"Terminal Operator"** means a firm that provides storage facilities and wholesales the product generally to independent marketers.

- **"Texaco"** means Texaco Canada Inc. and its subsidiaries or affiliates operating in Canada.

- **"Tribunal"** means the Competition Tribunal.

- **"Upstream"** means activities related to the exploration, development, and production of crude oil and natural gas.

- **"Wholesale Price"** means the price, typically set at a terminal or refinery rack, to independent marketers.

B. THE PARTIES

5. The **Director** is the officer appointed under section 7 of the Competition Act, R.S.C. 1985, c.C-34 as amended.

6. **Imperial** is one of Canada's largest integrated oil companies. Imperial is active in all phases of the petroleum industry in Canada, including the exploration for and production of crude oil and natural gas. In Canada, it is the largest producer of crude oil, is one of the largest refiners and marketers of petroleum products and is a significant supplier of natural gas. It is also engaged in the exploration, development and production of coal and in the manufacture and sale of chemicals and fertilizers. Imperial is owned 69.9% by Exxon, a U.S. based company.

7. Imperial's operations are conducted in three main segments: natural resources, petroleum products and chemicals. Petroleum products operations consist of the transportation, refining and the distribution and marketing of refined products. These operations are carried on by Esso Petroleum Canada, a division of Imperial.

8. **Texaco** with its subsidiaries, is an integrated oil producer which operates in two primary sectors: energy resources,

which encompasses crude oil and natural gas activities; and petroleum products, which include the refining, distribution and marketing of refined petroleum products. Texaco Inc., a U.S. based company held approximately 78% of the outstanding common shares of Texaco.

C. THE TRANSACTION

9. Imperial entered into a confidentiality agreement in November, 1988, with Texaco Inc, and was provided with certain information with respect to Texaco and its operations. Imperial entered into negotiations which led to a Controlling Shareholders' Agreement under which Texaco Inc. agreed on January 20, 1989, among other things, to sell Imperial all of the shares which it and its subsidiaries owned in Alberta Texaco, a corporation which owned approximately 78% of the outstanding shares of Texaco.

10. Imperial, pursuant to various agreements and the provisions of the Canadian Business Corporations Act, acquired all the shares of Texaco at a cost of approximately $4.96 billion.

D. IMPERIAL UNDERTAKINGS

11. Following discussions with representatives of the Director with respect to the proposed acquisition, Imperial agreed that, until the Director's examination was completed and an application was filed with the Tribunal, Imperial would hold separate, maintain and, subject to the Director's consent, not dispose of any of the downstream assets of Texaco acquired in the transaction. In this regard, on January 20, 1989, Imperial provided certain formal undertakings which were subsequently amended on February 24, 1989 (hereinafter "Undertakings"). The Undertakings provide, in part, that Imperial:

> "shall divest any or all of the following assets or interests of Texaco Canada as the Director, in his absolute discretion, may require."

The Undertakings further provide that:

> "until the Director has identified the Assets to be divested pursuant to paragraph 1, Imperial will hold separate the [downstream] operations...and not take any action towards combining the [downstream] operations of [Texaco] with its own operations."

The Undertakings also provide:

> "Imperial agrees that the terms of the Divestiture and Trustee Sale as set out above may, if the Director so decides after having identified the Assets to be Divested, be made part of a consent order of the Competition Tribunal under Section 105 of the Competition Act."

Finally the Undertakings provide that:

> "the Director retains all his rights under the Competition Act including, without limitation, the right to bring an application under section 92 of the Act at any time within three (3) years of the closing date with respect to any aspect of the Proposed Acquisition."

12. The Undertakings expire on June 30, 1989. In order to preserve the effectiveness of any remedy which the Tribunal may consider appropriate the Director will seek an Interim Order. Imperial will consent to the granting of an Interim Order.

III - COMPETITIVE ANALYSIS

13. The Director believes that a description of the downstream sector of the Canadian petroleum industry is necessary in order to fully appreciate the nature of the application and the remedies being sought. Appendix 2 contains a detailed overview of the downstream sectors of the industry, namely: refining, import supply, terminals and retail gasoline marketing.

14. The Director does not allege that there is, or is likely to be, a substantial prevention or lessening of competition in the upstream sectors of the petroleum industry as a result of the acquisition. In addition, the Director does not allege that there is likely to be a substantial prevention or lessening of competition in the lubricants and specialty chemicals sector. Accordingly, this Application and the Draft Consent Order are limited to the downstream sector of the industry where the merger has removed Texaco as an effective major competitor across Canada.

A - GENERAL COMPETITION CONCERNS

15. The petroleum industry in Canada has been the subject of concern and extensive examination by all levels of government. The concern exists in large part because there are no acceptable substitutes for gasoline and it is used by almost

every consumer. All gasoline brands have virtually identical properties (homogeneous) and expenditures for the purchase of gasoline are largely unavoidable (inelastic demand). In addition, in any particular region, the major petroleum companies supplying gasoline are relatively few in number and are generally vertically integrated from exploring for crude oil, to refining, to distribution and on to marketing gasoline. Finally, there is a long history of involvement by various goverments relating to the supply, trade and consumption of crude oil and refined petroleum products.

16. Where until recently there were four major Canadian refiners - Imperial, Shell, Petro-Canada and Texaco -, as a result of this merger there now are three - Petro-Canada, Imperial Oil and Shell.

17. Increasing concentration at the refinery level raises a special concern about competition in the downstream petroleum industry due to the extent to which all the refiners are vertically integrated into marketing. Vertical integration in potentially anti-competitive in the petroleum industry because it affords greater opportunity for horizontal interdependent behaviour among refiners by making it easier for each party to monitor the behaviour of its rivals. As the number of independent marketers decreases the opportunities for a refiner-marketer to grant private discounts at the wholesale level

decreases because gasoline sales are made at posted prices that are known to all the refiners.

18. The integrated system of distribution gives each refiner confidence that their rivals will support a higher and more stable price at the retail pump. The Restrictive Trade Practices Commission (hereinafter "RTPC") in its 1986 report, Competition in the Canadian Petroleum Industry recognized that,

> "There are, however, other aspects of the refiners' participation in retailing. There is an interaction of wholesale and retail markets that goes beyond a simple displacement forward of wholesale prices plus a retail markup. Downward pressure on retail prices can feed back to wholesale prices. If forward vertical integration leads to a more stable retail market, this can lead to higher average retail prices. (RTPC,p.282)"

and that

> "The important questions and criticisms raised in this inquiry regarding the actions of the oil companies virtually all relate to vertical integration,...in combination with high concentration. A critical element is the nature and extent of vertical relationships that are entered into with competitors, thereby increasing horizontal integration or concentration of control over key market variables such as price....(p.271)"

19. Price transparency is a vital facilitator of oligopolistic inter-dependent behaviour between refiners. Accordingly, the increased concentration brought about by this merger provides the basis for one of the Director's primary

competition concerns about the merger: the increased potential for anti-competitive use of market power.

20. The RTPC, expressed similar concerns:

> "When two of five firms in an oligopoly merge, serious questions arise about the extent to which independent competitive initiative will be inhibited. The concerns are magnified when the firms are vertically integrated and the principal product is as homogeneous as gasoline. The risk is as much from competitive interdependence as it is from tacit understandings arising. There is less chance of discord developing from differing strategies among firms or from imbalances in supply and demand within firms. (RTPC, p.337)."

21. The Director's concerns are similar today given that two of four major national refiners are combining.

22. The implications of present concentration levels for competition are important because the current level of surplus refining capacity in Canada and abroad makes it highly unlikely that additional refineries will be built in Canada for supply to the domestic market.

23. The Director examined the increased concentration of the refining segment of the downstream petroleum industry and its effect on the conduct of refiner-marketers. The Director, like the RTPC before him, has focussed his examination not only on the presence of a high refinery concentration level, unavoidable in

light of economies of scale, but also on those factors that constrain or modify the domestic refiners use of market power. In particular, the Director has examined current capacity utilization levels and the likely availability of supply for independent marketers because it is here that competition is more vulnerable, and it is here also that viable remedies are at hand.

24. The Director's findings parallel those of the RTPC, which concluded as follows:

> "In the Commission's view the preferred focus of public policy in this critical area of concern over supply is to seek to avoid unreasonable anti-competitive effects resulting from the way or the terms upon which the owners of scarce facilities, notably refineries and large terminals, make their capacity available to others. If the market power and vertical integration are to be left in place, in order to facilitate possible economies, care must be taken to ensure that the power is not misused. In the Commission's view it is therefore important that the scope of the duty to supply on the part of someone possessing a high degree of market power be defined as precisely as possible, and that a mechanism exist by which the principles can be applied in a fair but timely way." (RTPC, p.448-9)

The RTPC further noted:

> "The Commission's rejection of the more costly and disruptive structural remedies urged upon it in these proceedings followed from its conviction that effective assurance of supply to efficient independents and to potential entrants would be sufficient. Keeping the import option as free and open as possible is part of the answer, but by itself is not enough. The Commission considers that it would also be desirable, in cases where a supplier holds a high degree of market power, to require that supplier to supply others unless sufficient reason for not doing so is established. In other words, as the market power over supply increases there would be less need to prove that failure to supply injured someone or that it substantially

> there would be less need to prove that failure to supply injured someone or that it substantially injured competition, and greater focus would be placed on the adequacy of the supplier's reasons for refusing supply." (RTPC, p.453)

In addition the RTPC stated:

> "The unavoidably high concentration in petroleum refining, together with pervasive vertical integration and dual distribution, makes it very important to take all reasonable steps to maximize the assurance of supply to un-integrated marketers. One avenue is to clarify the scope of the duty of domestic refiners to supply product to others. Secondly, it makes the import option an extremely important competitive factor in the areas of the country open to imports." (RTPC, p.467)

25. Given that this merger has increased concentration in the domestic refinery industry it is important to maintain a viable import option to prevent the likely substantial lessening or prevention of competition. For imported gasoline to prevent refiners from restricting supplies and raising prices, import facilities must be in place, products must be available to unintegrated marketers and the independent marketers need outlets to market imported product.

26. The actual volume of gasoline being imported today is low, but it is not solely the volume of imports that measures the import option's impact on domestic gasoline prices. Rather, it is the option to switch to imported gasoline that safeguards the unintegrated marketers' access to competitively priced supply from domestic refineries. The Restrictive Trade Practices

Commission recognized the importance of unobstructed imports as follows:

> "While import competition can be expected to work only imperfectly, it is nevertheless very desirable that it not be obstructed (RTPC, p.269)".

27. In Ontario, Quebec and British Columbia, gasoline imports are available. However the ability to import gasoline is linked to the availability of well located marine terminal storage capacity. One important deterrent to entry into the marine terminal business is the terminal operator's uncertainty about assured throughput levels needed to make his investment in terminal facilities profitable. The import option thus depends upon the economics of marine terminal operations, which in turn depends upon the volume of independent gasoline retail business. In areas relatively close to U.S. supply points, for imports by truck it is the availability of U.S. supply and the cost of transportation which defines the import option.

28. In Atlantic Canada, provincial regulations in two provinces raise barriers to de novo entry at the retail level. These regulations together with the existence of large and entrenched branded service station networks reduce the likelihood that a sufficiently viable independent sector will develop in this market. In this context, the merger would likely entrench a more highly concentrated refinery industry where power to set

price and restrict supply at the retail pump is unconstrained by imports by non-refiners for sale to independent marketers.

29. Because the merger does not increase refinery concentration appreciably in Western Canada, and refinery concentration is lower in Western Canada than in Quebec/Ontario, the vertical link between refining and marketing is not a competition issue in the context of this region. The Director's concern in Western Canada is therefore with high market share by a single firm in each separate urban market.

30. In summary, where the import option operates freely, and domestic refiners have excess capacity, domestic prices track off-shore wholesale gasoline prices. This ensures a viable independent marketing presence. The merger, which fundamentally alters the structure of the refining industry, is of concern because excess refining capacity and the import option may disappear. Gasoline demand forecasts indicate that the excess domestic refinery capacity will likely disappear in a few years. New refinery investment for domestic supply is not likely at this time by domestic refiners. If excess capacity disappears and if the import option becomes ineffective there is likely to be a substantial lessening or prevention of competition.

B - COMPETITIVE ANALYSIS: ATLANTIC CANADA

The Market

31. The Atlantic region (Nova Scotia, New Brunswick, Prince Edward Island and Newfoundland/Labrador) is a distinct market area for refined petroleum products. Interregional transfers by all four Atlantic refiners excluding exchanges pursuant to reciprocal supply agreements, have accounted for between 4% and 6% of the region's total supply of refined products over the period 1985 to 1988. Virtually all of these transfers (86% of which consist of gasoline and diesel fuel) come from Quebec by marine transport. Atlantic Canada also differs from other regions because two provinces, Nova Scotia and Prince Edward Island, regulate in detail the distribution of refined products. Finally, in Atlantic Canada there are no independent terminal operators importing gasoline for distribution to independent resellers.

Overview

32. The industry is highly concentrated and is subject to high entry barriers. The merger is likely to lead to a substantial lessening or prevention of competition for refined petroleum products in this vertically integrated industry.

33. The barriers to entry include economies of scale, entry limiting provincial regulations in two provinces, excess capacity at all levels of the industry, and the existence of large sunk costs. After the merger the three remaining refiners in the region would be supplying the five largest gasoline retailers who together have about 96% of the market. Further, with the exception of the distribution of fuel oil for heating, independent resellers are virtually non-existent in the Atlantic. Finally, with the exception of heavy fuel oil and light fuel oil, imports are not an important source of supply. In any event, only the refiners would have the terminals necessary to handle imports of gasoline, diesel fuel and light fuel oil.

ATLANTIC REFINING

Concentration

34. Prior to the merger there were four refiners in the region: Imperial, Texaco, Irving and Newfoundland Processing. After the merger, but for the Consent Order, there would be three.

35. The Newfoundland Processing refinery at Come By Chance (105,000 b/cd capacity) is subject to a 25-year restrictive covenant limiting its rights to sell refined products in Canada outside of Newfoundland. Irving Oil has a long standing policy

of not supplying independent resellers. Thus, without the Consent Order, in three provinces, independents would have only one refinery available to supply them, Imperial. This industry structure does not invite potential retail entrants because of their uncertain access to supply.

Barriers to Entry

36. There are high barriers to entry, de novo, into refining because:

(a) the region's demand is growing slowly, if at all;

(b) all four refineries have excess capacity;

(c) there are substantial economies of scale in refining such that the addition of a single refinery of minimum efficient scale would add between one-third and one-half of the present capacity;

(d) a refinery embodies a huge amount of sunk costs, i.e., the equipment has no other uses;

(e) environmental regulations are growing in stringency so building a new refinery (even if a site could be found) would be more costly than expanding an existing facility; and

(f) given the choice between investing in a new refinery or importing refined products, the latter is the more profitable option.

ATLANTIC DISTRIBUTION (TERMINALS)

Concentration

37. All of the majors operating in the Atlantic region have at least one terminal. Ultramar has sixteen while Imperial has nine, Texaco has five, Petro-Canada has two terminals and Shell has one. Irving has a number of terminals in the region which are generally not available to serve independent marketers. With the exception of heating oil, very little of the imported refined products get to the few independent wholesalers and retailers in the region.

38. In all five locations where Texaco operates marine terminals in Atlantic Canada: Halifax/Dartmouth, N.S.; Charlottetown, P.E.I.; Chatham/Newcastle, N.B.; Saint John, N.B.; and Long Ponds, Nfld., Imperial also operates terminals. The acquisition of Texaco's terminals by Imperial would significantly increase concentration of terminal capacity in these areas.

39. Only one independent terminal operator, Olco, operates terminals in the region; one in Nova Scotia and one in New Brunswick. Both terminals are leased. However, Olco's terminals are currently used to handle heavy fuel oil (i.e., bunker fuel),

and do not handle such "clean" refined products as diesel, heating oil or gasoline.

Barriers to Entry

40. Barriers to de novo entry (new facilities) into terminal operations are high due to:

(a) substantial excess capacity among existing terminals;

(b) suitable deepwater sites in the core Halifax/Dartmouth area are limited;

(c) environmental regulations restrict the number of sites available and increase capital and operating costs relative to existing terminals;

(d) the absence of independent marketers to generate demand; and

(e) a small and fragmented market.

41. Purchasing existing terminal facilities does not necessarily remove much of the cost of building new facilities. Many older terminals are now being recognized as environmentally unsound requiring significant investments in areas of pollution control. Furthermore, the legal liability of environmentally unsound facilities can be large.

MARKETING

Concentration

42. Pre-merger, there were only six significant retailers of gasoline; post-merger five sellers would have 96% of the region's gasoline sales were it not for the Consent Order.

43. The significant retailers are Irving, Ultramar and the majors. Only three of the six pre-merger companies had a refinery in the region. The rest obtained their supplies through reciprocal supply agreements with Imperial, Texaco or Irving.

44. Not only is the retail gasoline industry highly concentrated, there is only a small "competitive fringe." Independents operate only 50 of about 2700 service stations and there are only two small chains: Olco and Co-op which account for most of these stations. There are few independent marketers in the Atlantic region. This is atypical of every other region of Canada. The import option is ineffective given the few independent marketers and high transportation costs.

Imports

45. In the Atlantic region imports do not provide an alternative source of supplies of refined petroleum products for potential independent wholesalers and retailers.

46. No independents import refined products into the Atlantic provinces due to lack of access to marine terminals owned by non-majors, and the high cost of trucking from Maine. Olco, leases two heavy fuel oil terminals in the region. It entered the market in 1985. Imports of refined products by truck into the Atlantic area is only a viable option for communities near the New Brunswick/Maine border. In most parts of the Maritimes, the costs of trucking product from Maine are excessive.

Barriers to Entry

47. There are barriers facing entry into retail gasoline distribution. There are few wholesale suppliers of gasoline and independent marketers cannot use, or threaten to use, the import option as it does not exist. Further, Irving Oil does not supply independents and Newfoundland Processing only sells in Newfoundland. Nova Scotia and PEI regulate entry and increase the cost of building a new station because of facility requirements. Both provinces also control the transfer of

wholesaling and retailing licences. Independents who want to acquire a number of retail sites to form an efficiently sized network of stations must therefore approach one of the refiner marketers who account for 98% of the outlets. There is also a great deal of excess capacity in gasoline retailing as indicated by the number of low volume stations.

48. Nova Scotia and PEI engage in extensive direct regulation of both wholesale and retail petroleum distribution. Entry into gasoline retailing requires a demonstration that the "public convenience and necessity" justifies new service stations. Gasoline marketing is also controlled, e.g., in Nova Scotia a service station is required to have two service bays and provide attendants to dispense gasoline. This prevented the introduction of self-serve gas bar method of operation. Most importantly prospective entrants cannot experiment with new methods of retailing that the public might well find beneficial.

Effective Competition Remaining

49. Independents operate only 50 of the approximately 2700 retail service stations and two firms account for 44 stations. Their share of the market, for the Atlantic region as a whole, is under 2% of the outlets.

51. In Atlantic Canada, outside of Newfoundland, after the merger there would be only one firm with a refinery in the region with a history of supplying gasoline, diesel and light fuel oil to independents. Since independents have no direct access to imports or access through an independent terminal operator, they are deprived of the gasoline import option when negotiating supply contracts with the few refineries in Atlantic Canada with a record of supplying independents.

Removal of a Vigorous and Effective Competitor

52. The merger has removed Texaco as an effective and vigorous competitor in the Atlantic. Between 1983 and 1987 Texaco market share increased in St. John's and Halifax by 18%. By increasing sales through fewer outlets, Texaco has sharply cut its retail costs per litre sold. Furthermore Texaco has a reputation for successful advertising and promotion which adds to its effectiveness as a competitor in the branded segment of the market.

C - COMPETITIVE ANALYSIS: QUEBEC/ONTARIO

The Market

53. Quebec and Ontario form a distinct geographic market for gasoline refining and gasoline supply to retail markets because gasoline moves easily between these two provinces by truck, by marine, and by pipeline. Conversely transportation costs prevent gasoline from moving easily into the Quebec/Ontario region from other parts of Canada. Reciprocal supply agreements between refineries in Ontario and Quebec cover large volumes with terms as long as fifteen years.

54. For the purpose of analyzing the influence of vertical integration between the refining and marketing stages of the industry on retail gasoline markets, the relevant market is both provinces. For the purpose of analyzing the influence of service station locations and local levels of concentration on retail markets, the relevant market is each urban area.

REFINERIES AND TERMINALS IN THE QUEBEC/ONTARIO MARKET

Concentration

55. Before the merger, the three firm concentration ratio based on crude oil refining capacity market shares, was about 65%. After the merger the three firm concentration ratio is 80% and the four firm concentration ratio increases to about 90%.

56. Refinery capacity is also measured in terms of outputs. Imperial's share of gasoline and distillate refining capacity (outputs) in Quebec/Ontario is 33%. Imperial's true share of post-merger gasoline and distillate (primarily diesel and fuel oil) is higher than 33% because the capacity of the combined Nanticoke and Sarnia complex is higher than the sum of the two refineries' rated capacities. Pre-merger in 1988 Imperial and Texaco combined, accounted for 47% in Ontario of gasoline supplies to independent marketers and 31% in Quebec.

57. In six important locations - Baie Comeau, Rimouski, Sault-Ste. Marie, Ottawa, Sudbury and Thunder Bay - the merger leaves Imperial with a substantial share of storage capacity.

Imports

58. In the Quebec/Ontario market imports accounted for about 7% of gasoline sales. In Ontario, imports in 1988 accounted for just over 3% of the gasoline market in 1988. In Quebec, imports accounted for just over 12% of the gasoline market in 1988. Two independent terminal operators in Quebec and Ontario (Norco and Olco) imported, for distribution to independent marketers, 28% of all gasoline imports into Quebec in 1988. Most imported gasoline is used by refiners to optimize their refinery runs rather than as a primary source of supply.

59. The availability of imports causes domestic wholesale prices to track off-shore prices with a short lag in Ontario and a longer lag in Quebec. The import option is limited by the following factors:

(a) Trucking costs limit the access of trucked gasoline to centres close to U.S. refinery bulk plants that are located on a major pipeline or at a marine terminal. The trucking cost for the short haul from Buffalo to Toronto is about 1.5 cents per litre.

(b) Marine cargo transport is cheaper, but in Ontario a need for smaller sized cargo shipments, and the shorter

navigation season makes imports less attractive than in Quebec.

(c) The availability of independently owned marine terminal facilities.

(d) Barriers to entry into the marine terminal business.

(e) For independent resellers, transaction costs for imports are higher than for purchases of domestic gasoline, due to exchange rate risk, credit terms, quality variations and large delivery schedules.

(f) A shortage of backhaul shipments raises the cost of marine cargoes for Ontario distributors.

(g) The import option may be interrupted by international events beyond the control of the Canadian government, or by Canadian public policy considerations that transcend competition policy.

Other Factors - Excess Refinery Capacity

60. Surplus refinery capacity is, after the import option, the second most important influence on wholesale gasoline prices. The economics of refinery operations causes the refiner to maximize its returns by increasing the utilization rate of the refinery.

61. In 1988, the Quebec/Ontario refinery utilization rate was 87%. Utilization rates have climbed from the low point in 1982 when the rates were 78.4% and 70.7% in Quebec and Ontario, respectively. Utilization rates will continue to climb as gasoline demand grows. The regulatory requirement that leaded gasoline be phased out by 1990 increases the demand for natural octane gasoline components which in turn places a strain on gasoline capacity.

62. De novo construction of a refinery designed to supply the domestic market is unlikely in the foreseeable future. Demand for gasoline and heating oil fell continuously between 1980 and 1986 and motor gasoline demand is forecast by the National Energy Board to rise by just 0.6% per annum to 2005.

63. New entry into Canadian refining for the domestic market is also unlikely in part because low world refinery utilization rates continue.

64. An investment in a petroleum refinery is largely a sunk cost that causes both exit and entry barriers to be high. The least expensive way to add refinery capacity to the system is for an existing refiner to make additional investments to modify an established refinery.

Removal of Vigorous and Effective Competitor

65. The merger removes a vigorous and effective competitor from the market. Texaco owned Nanticoke, one of the newest and most efficient refineries in Canada. Texaco used the facility to supply independents directly in Ontario and indirectly in Quebec through a reciprocal supply agreement with Petro-Canada through its refinery in Montreal.

Efficiencies

66. The merger leads to significant efficiencies, particularly by bringing the Nanticoke and Sarnia refineries under common ownership resulting in substantially larger volumes of gasoline supply in the market.

MARKETING

Concentration

67. In Ontario and Quebec, the merger substantially raises the level of concentration both in refining throughout the region and in marketing in many urban locations. The link between refinery and marketing concentration concerns the Director.

68. Imperial's post-merger market share of retail gasoline would exceed 30% in seventeen cities, and in eighteen additional cities, including metro Toronto and Montreal, it would exceed 25%. Its share of outlets will be 24% in Ontario and 20% in Quebec. The merger raises the four firm concentration ratio in many urban areas to the 65-80% range. In many of these areas independent marketers account for less than 20% of gasoline sales.

69. Absent the import option and excess domestic refinery capacity, the Director alleges that the refiner/marketer group's control over supply is strengthened sufficiently to permit inter-refiner/marketer rivalry to proceed with reduced competitive discipline from independent marketers.

70. The Director alleges that because the Quebec/Ontario refinery industry is concentrated, the stability of a refiner oligopoly is facilitated by refiners vertically integrating into marketing.

Barriers to Entry

71. Increased regulatory standards for under ground gasoline tanks and stricter environmental liabilities associated with those tanks raises the ratio of "sunk" costs (specific location and use costs that are not recoverable when a station is converted to an alternative use) to the total investment in a service station. When sunk costs increase, an entry/exit barrier is raised because present operators will continue to use inefficient facilities longer than otherwise, and because the new entrant must accept greater risks.

72. An independent marketer's chief concern when considering entry or expansion through new or improved service stations is the assurance of supply at competitive prices. As reviewed above, excess refinery capacity and the import option cannot be guaranteed indefinitely. Without these two safeguards for supply, independent resellers face a significant entry barrier: they face a requirement for two level entry.

73. At the retail stage, the quality of a location largely determines the station's volume. Good service station locations are limited. If a single company owns or controls a large share of the service stations in a particular urban market, that firm is likely to control a large share of the better service station locations.

Removal of a Vigorous and Effective Competitor

74. Texaco was removed as an effective and vigorous competitor in gasoline marketing industry across Canada. In 1984-85, Texaco embarked upon a major program of rationalization ("System 2000") to improve the productivity of its service station network. From January, 1985 to date, Texaco reduced its network from 2341 stations to 2023, a decrease of 14% or 318 stations. Texaco consolidated its network among fewer high volume "state-of-the-art" System 2000 outlets.

75. Between 1983 and 1987, Texaco increased its share of gasoline sales in many urban markets examined. For example, Texaco's Hamilton share rose by 35%, its Montreal share by 21%, its Quebec City share by 27% and its Metro Toronto share by 14%. By increasing sales through fewer outlets, Texaco has sharply cut its retail costs per litre sold, and has thus become a more vigorous and effective competitor. Moreover Texaco has a reputation for successful advertising and promotion which adds to

its effectiveness as a competitor in the branded segment of the market.

Other Factors - Refiner/Marketer Concentration (Vertical Integration)

76. The Director believes the independent marketer segment plays a special role in the petroleum industry. That role is to remove the option for the concentrated refiner/marketer group to seek a stable joint profit maximizing equilibrium. It follows, that ensuring that competitively priced gasoline supply be available to independent marketers is vital to a competition policy that addresses this vertically integrated industry.

77. The RTPC made precisely the same points:

> "In the Commission's view the preferred focus of public policy in this critical area of concern over supply is to seek to avoid unreasonable anticompetitive effects resulting from the way or the terms upon which the owners of scarce facilities, notably refineries and large terminals, make their capacity available to others. If the market power and vertical integration are to be left in place, in order to facilitate possible economies, care must be taken to ensure that the power is not misused. (RTPC, P.448)"

D - COMPETITIVE ANALYSIS: WESTERN CANADA

The Market

78. Western Canada forms a single geographic market area for the refining and supply of gasoline. Product moves between the Prairies and British Columbia through the Trans-Mountain Pipe Line joining Edmonton to Kamloops.

79. Because the merger does not increase refinery concentration appreciably in Western Canada, and refinery concentration is lower in Western Canada than in Quebec/Ontario, the vertical link between refining and marketing is not a competition issue in the context of this region. The Director's concern in Western Canada is with high concentration by a single firm in each separate urban market.

80. In Western Canada retail service station competition is not linked to refinery concentration as was the case in Ontario/Quebec. Therefore, the relevant market for analysis of gasoline retailing in Western Canada is not the region, it is each urban market.

REFINING

Concentration

81. Texaco has access to refined products through a processing agreement. Through the agreement, Imperial gains access to between 1.4 and 2.0 million m3 per year at Edmonton from the Petro-Canada refinery, and this raises Imperial's effective refinery capacity and increases refinery concentration. Imperial is gaining about 6% of the refining capacity in Western Canada through acquisition of the processing agreement.

Imports

82. Refined product imports are insignificant in the Prairies. Though imports have access to B.C., just 112 thousand of cubic metres were imported in 1988, a total of 3% of B.C. gasoline sales. The Trans-Mountain Pipe Line links Edmonton and B.C., which effectively could allow imports into B.C. to displace Edmonton refined gasoline from B.C. markets into the Prairies.

Barriers to Entry

83. Surplus capacity in Western Canada, (utilization rates are 86% in the Prairies and 82% in B.C.) the legacy of the boom that ended in 1982, makes it unlikely de novo entry into refining will occur in Western Canada.

MARKETING

84. Urban markets are distinct markets for the analysis of competition at the retail service station stage of the industry. In Western Canada, the Director's principal concern is at the retail stage, and is not, as in Quebec/Ontario and Atlantic Canada linked to vertical integration between the concentrated refinery and the marketing stage of the industry.

85. In three western locations - Calgary, Victoria and Prince George - the merger leaves Imperial with a substantial share of storage capacities.

86. At the retail stage, the quality of a location largely determines the station's volume. Good service station locations are limited. If a single company owns or controls a large share of the service station sites in a particular urban market, that firm is likely to control a large share of the better service

station sites. The merger would in addition remove Texaco as an effective major competitor in Western Canada.

87. In Selkirk, Regina, Yorkton, Leduc and Moose Jaw, Imperial's post merger market share exceeds 30%. In twelve other Western urban centres, Imperial's post merger share would exceed 25%. In virtually all Western cities examined, the combined market share of independent marketers and would exceed 20%.

IV - CONCLUSION

88. The acquisition of control by Imperial of Texaco is likely to prevent or lessen competition substantially as a result of:

(i) the elimination of a major refiner-marketer in the Atlantic Canada region;

(ii) the elimination of a significant supply alternative to non-integrated gasoline marketers in Quebec and Ontario;

(iii) the reduction in the availability of terminaling facilities for the storage and distribution of refined petroleum product across Canada;

(iv) the elimination of an effective competitor from the branded sector of the retail gasoline markets across Canada; and

(v) an increase in the opportunity for inter-dependent market behaviour among refiner-marketers.

89. The Director's position is that with the Draft Consent Order there will not likely be any substantial lessening or

prevention of competition in Canada arising from the merger. The import option has been strengthened by virtue of the substantial increase in the volume of storage available to independent marketers and terminal operators. Independent marketers are guaranteed access to more gasoline from Imperial's Nanticoke and Sarnia refineries than was being supplied before the merger. Independent marketers will also have access to a share of the additional volumes that Imperial expects to produce because of the efficiencies associated with combining the operations of the two refineries. The divested service stations will become available to independent marketers in those markets where Imperial's share is high, and where the independents' combined share is modest. The Draft Consent Order will create opportunities for independent marketers to compete more effectively through the acquisition of divested retail outlets and terminals. Finally, in Atlantic Canada, the Draft Consent Order effectively re-establishes the market structure that existed pre-merger and creates a unique opportunity for new entry.

V - RELIEF SOUGHT

90. The Director pursuant to s.105 of the Act requests the issuance of an Order for divestiture and supply in the form of a Draft Consent Order attached hereto.

APPENDIX 1

CT 89/

THE COMPETITION TRIBUNAL

IN THE MATTER OF an Application by the Director of Investigation and Research under sections 92 and 105 of the Competition Act, R.S.C. 1985, c.C-34, as amended;

AND IN THE MATTER OF the acquisition by Imperial Oil Limited of the shares of Texaco Canada Inc.

B E T W E E N

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

- and -

IMPERIAL OIL LIMITED

Respondent

DRAFT CONSENT ORDER

UPON the application of the Director of Investigation and Research (the "Applicant") pursuant to sections 92 and 105 of the Competition Act, R.S.C. 1985, c. C-34, as amended (the "Act") and pursuant to a Notice of Application dated the 29 day of June 1989, for a Consent Order directing the divestiture of assets including certain assets acquired by Imperial Oil Limited ("Imperial") by virtue of its acquisition of all of the

outstanding shares of Texaco Canada Inc. ("Texaco") and other remedies specified in the draft Consent Order.

AND UPON considering the Notice of Application, the Affidavits filed herein, the Consent Order Impact Statement and Consent of the Parties filed herein,

AND IT BEING UNDERSTOOD BY THE PARTIES HERETO THAT nothing in this Order shall be taken as an admission by the respondent of any facts or law which would support the allegation that the acquisition prevents or lessens, or is likely to prevent or lessen, competition substantially.

IT IS HEREBY ORDERED THAT:

PURPOSE:

1. The purpose of this Order is to maintain the continued competitive presence of viable petroleum refining, wholesaling and retailing assets such that the acquisition, direct or indirect, by Imperial, by purchase of shares, of control over the business of Texaco will not prevent or lessen, or be likely to prevent or lessen competition substantially in the downstream sector of the Canadian petroleum industry.

DEFINITIONS:

2. For purposes of this Order the following terms will have the indicated meaning:

- **"Atlantic Region"** means the Provinces of Nova Scotia, New Brunswick, Prince Edward Island, and Newfoundland and Labrador.

- **"Company owned service station"** means a retail service station outlet owned or leased by Imperial or Texaco which may be leased to a dealer who operates the business with whom either Imperial or Texaco has contractual relations with respect to the supply of gasoline and the use of proprietary trademarks.

- **"Eastern Passage Refinery"** means the Texaco refinery in Dartmouth and the Dartmouth marine terminal.

- **"Dealer owned service station"** means a retail service station owned by a party other than Imperial or Texaco with whom either Imperial or Texaco has contractual relations with respect to the supply of gasoline and the use of proprietary trademarks.

- "Director" means the officer appointed under section 7 of the Competition Act, R.S.C. 1985, c. C-34 as amended.

- "Gasoline" means a volatile refined petroleum liquid hydrocarbon which, by its composition, is suitable for use as a fuel in internal combustion engines to power motor vehicles which is generally available in three grades of motor gasoline generally recognized as: regular leaded, regular unleaded, and premium unleaded.

- "Imperial" means Imperial Oil Limited and all subsidiaries and affiliates operating in Canada, including its downstream division Esso Petroleum Canada.

- "Service station" means a site where branded or unbranded gasoline is offered for sale to the general public which offering is frequently combined with other offerings to the public.

- "Terminal" means an intermediate storage and product distribution facility serving large customers and secondary bulk plants which normally has large storage capacity for marine, rail or pipeline receipts of refined petroleum products.

- "Tribunal" means the Competition Tribunal.

- "Texaco" means Texaco Canada Inc. and any of its subsidiaries.

- "Reciprocal Supply Agreement" means an arrangement whereby refiners exchange petroleum products in different geographic locations on a volume for volume basis.

GENERAL CONDITIONS:

3. Where pursuant to the terms of this Order, Imperial is required to divest assets it shall, in the case of:

(i) a company owned service station, sell the site or make lease arrangements in accordance with paragraph 33 hereof;

(ii) a dealer owned service station, provide for the early termination, at the operator's option on 3 months notice, of all contractual arrangements between the service station owner and Imperial or Texaco or failing early termination, Imperial or Texaco shall not renew such contractual arrangements at the end of the initial term thereof;

(iii) a terminal owned by Imperial or Texaco, sell such terminal;

(iv) the Eastern Passage refinery, sell it save and except that Imperial, in accordance with paragraph 13 hereof, may continue any reciprocal supply agreement based at the Eastern Passage refinery.

4. All assets to be divested pursuant to the terms of this Order will be offered for sale on a going-concern basis.

5. All divestitures provided for herein are subject to the prior approval of the Director who shall advise Imperial whether he approves of the divestiture not more than twenty-one (21) days following his being advised in writing by Imperial of all material information concerning the proposed divestiture including the identity of the proposed purchaser. For greater certainty, the Director's approval includes the method of divestiture.

6. The Director's approval may include, but is not limited to, a determination of the eligibility of prospective purchasers relative to the competitive impact of their acquiring any of the assets identified for divestiture in this Order.

7. Imperial may, subject to the Director's approval, stipulate as conditions of sale of the assets to be divested

pursuant to this Order conditions including the financial viability of prospective purchasers, environmental undertakings or post-divestiture employment undertakings.

8. Where the Director, having considered a proposed divestiture transaction and the stated purpose of this Order, does not approve a divestiture transaction, Imperial may apply to the Tribunal for final determination which determination may include a variation to the lists of assets identified for divestiture in the Schedules annexed hereto.

9. Imperial shall, for a period of ten (10) years from the date of this Order, provide notice to the Director prior to acquiring, directly or indirectly, other than in the ordinary course of business, any assets in Canada which are being used in the refining, wholesaling or retailing of petroleum products.

10. (a) Except where provided otherwise in this Order, all divestitures which involve a sale or lease shall be completed within twelve (12) months from the date of the Order; however, on consent of the Director, such period may be extended for such period as the Director considers appropriate in the circumstances. It is the general intention of the parties that divestitures are to be completed within the 12 month period and that extensions will be sought only on a limited basis, including but not limited to, instances where more time is required to

remedy environmental requirements prior to the completion of the divestiture transaction.

(b) If any of the divestitures required by this Order are not completed within the periods required under this Order, except for the divestiture of terminals as provided for in paragraph 18, Imperial shall forthwith transfer the authority to dispose of the assets to a trustee to be appointed with the approval of the Director ("Trustee") for the sale of the assets on the following terms ("Trustee Sale"):

(i) the assets shall be divested by the Trustee within six (6) months of the Trustee's appointment at the most favorable price and on the most favorable terms and conditions available;

(ii) the Trustee Sale shall be accomplished on terms acceptable to the Director;

(iii) the Trustee Sale shall be considered to have been completed when the purchaser has signed a binding agreement that has been approved by the Director pursuant to subparagraph (vii);

(iv) the Trustee shall have the full power and authority to effect the Trustee Sale and shall use all reasonable efforts to accomplish it;

(v) Imperial shall use its best efforts to assist the Trustee in accomplishing the Trustee Sale. The Trustee shall have full and complete access to the personnel, books, records and facilities of the assets to be divested, and Imperial shall provide to the Trustee such financial or other information relevant to the assets as the Trustee may request. Imperial shall take no action to interfere with or impede the Trustee's accomplishment of the Trustee Sale;

(vi) after appointment, the Trustee shall file monthly reports with the Director and Imperial setting forth the Trustee's efforts to accomplish the Trustee Sale;

(vii) no Trustee Sale shall be made without the Director's approval, who shall advise the Trustee and Imperial whether he approves of any proposed Trustee Sale not later than twenty-one (21) days following his being advised in writing by the Trustee of full information concerning the proposed Trustee Sale including the identity of the proposed purchaser; and

(viii) the Trustee Sale shall be conducted at Imperial's expense and the proceeds paid to Imperial.

(c) Where any assets remain unsold after the periods provided for in this Order, the Director or Imperial, subject to any other provisions of this Order, may apply to the Tribunal for a variation of the Schedules annexed hereto.

11. Except as provided in paragraphs 28 to 31, nothing in this Order shall limit the rights available to the Director or any person under section 106 of the Act.

ATLANTIC:

12. In the Atlantic Region Imperial shall divest all of the following assets (which are more fully described in Schedules 1, 2, 3, and 4):

(a) the Eastern Passage refinery together with the Ultramar/Texaco reciprocal supply agreement identified in Schedule 1;

(b) terminals located at Saint John (New Brunswick), Chatham/Newcastle (New Brunswick), Charlottetown, (Prince Edward Island) and Long Ponds (Newfoundland) identified in Schedule 2;

(c) 74 company owned service stations identified in Confidential Schedule 3;

(d) 123 dealer-owned service station agreements identified in Confidential Schedule 4; and

(e) all bulk plants, vehicles, equipment and all contracts or customer lists which may be associated with any of the assets detailed in (a), (b), (c), or (d) above, other than those which are proprietary to Great Eastern Oil Limited.

13. In the event that the purchaser of the Eastern Passage refinery approved by the Director does not wish to assume the obligations of the Ultramar/Texaco reciprocal supply agreement, Imperial may assume and fulfill Texaco's obligations as provided therein using its facilities at the existing Imperial refinery in Dartmouth, Nova Scotia.

14. The divestiture of the Eastern Passage refinery shall, to the extent reasonable and possible, be to a purchaser who, in the Director's opinion, is likely to ensure the continued operation of the Eastern Passage refinery as a viable concern and supply the domestic downstream petroleum products market.

<u>TERMINALS</u>:

15. In addition to the terminals identified in paragraph 12(b) Imperial shall divest all terminals identified in Schedule 5.

16. Imperial may, as a condition of sale of the terminals located in Charlottetown (Prince Edward Island), Sault Ste. Marie (Ontario) and Victoria (British Columbia) arrange with the purchasers to lease storage space (terminaling rights) at the divested terminals. The requirement by Imperial for storage as a condition of sale shall not exceed 25% of the throughput capacity of the terminal being divested and shall not be for a period exceeding 3 years from the date of sale. It is understood that the purpose of this provision is to provide Imperial sufficient time to expand or construct new terminal storage facilities at these locations. In Sudbury (Ontario), Imperial may elect to divest either of the Imperial or Texaco terminal facilities and such election and divestiture shall be made no later than 18 months from the date of this Order or such longer period as the Director considers appropriate.

17. All divestitures of terminals identified in Schedules 2 and 5 shall, to the extent reasonable and possible, and subject to the Director's approval, be made to a purchaser who is likely to ensure the continued operation of the facility including the import of refined petroleum products into Canada.

18. (a) If after the expiry of a reasonable period of time, no purchaser has expressed an interest to purchase any of the terminals identified in Schedules 2 and 5, Imperial, on consent of the Director, may close or dismantle any such terminal.

(b) For purposes of subparagraph (a), a "reasonable period of time" means a maximum of 18 months for the terminal to be divested in Sudbury and, for the remaining terminals to be divested, a maximum of 12 months from the date of this Order.

(c) Where in the Director's opinion Imperial has not exercised due diligence in relation to the divestiture of any terminals identified in Schedules 2 or 5, the Director may direct Imperial to place any unsold terminals in the hands of a trustee who will offer them for sale and if any such terminal remains unsold it may be closed or dismantled.

SUPPLY - ONTARIO/QUEBEC:

19. For purposes of paragraphs 20 to 31 of this Order

(a) "independent marketers" shall mean wholesalers, wholesaler-retailers and retailers who are in the business of reselling gasoline in Ontario and Quebec, who neither own nor are affiliated (as defined in the Act) with any person who owns a refinery and who agree

to purchase a minimum annual quantity of 20 million litres; and

(b) "supply year" shall mean each successive twelve (12) month period commencing with the first calendar month after the date of this Order.

20. Imperial shall, for a period of seven (7) years from the first day of the calendar month following the date of this Order make available to independent marketers, wholesale supply of gasoline, directly or indirectly, from its Sarnia and Nanticoke refineries at Imperial wholesale supply points in Ontario and Quebec. For greater certainty the obligation provided for herein may be satisfied, in whole or in part, by reciprocal supply agreements with refiners in Quebec.

21. The volume of gasoline to be made available under the terms of paragraph 20 (hereinafter "allocated volume") shall be determined as follows:

(1) The allocated volume in the first supply year is 1511 million litres plus the percentage increase in the previous year in industry demand in Ontario and Quebec for gasoline as determined from publicly available data acceptable to Imperial and the Director. 1511 million litres is the 1988 volume of supply of gasoline to

independent marketers in Ontario and Quebec from Imperial's Nanticoke and Sarnia refineries.

(2) (a) The allocated volume in a supply year shall be increased by one-half (1/2) the amount, if any, by which the actual purchases from Imperial by independent marketers in the previous supply year exceeded the allocated volume in that supply year, except that there shall be no such increase in any supply year where the allocated volume exceeds the allocated volume in the first supply year. The resulting allocated volume shall be increased by the percentage increase in the previous year in industry demand in Ontario and Quebec for gasoline as determined from publicly available data acceptable to Imperial and the Director.

(b) Where the allocated volume in a supply year is greater than the allocated volume in the first supply year, the allocated volume shall be increased by the percentage increase in the previous year in industry demand in Ontario and Quebec for gasoline as determined from publicly available data acceptable to Imperial and the Director.

(3) The allocated volume in a supply year shall be decreased by one-half (1/2) the amount, if any, by which the allocated volume in the previous supply year exceeded the actual purchases from Imperial by independent marketers in that supply year. The resulting allocated volume shall be increased by the percentage increase in the previous year in industry demand in Ontario and Quebec for motor gasoline as determined from publicly available data acceptable to Imperial and the Director.

(4) The maximum allocated volume in a supply year shall not exceed the volume represented by 26.4% of the total gasoline refining capacity which will result from the combined operations of the Imperial Sarnia and Nanticoke refineries excluding increased capacity resulting from investment by Imperial after the date of this Order.

22. All sales by Imperial, whether as part of existing or new agreements in respect of all sales and processing or other supply arrangements with the independent marketers, in any year following the issuance of the Order, shall be added to determine if the allocated volume for that year has been fully purchased.

23. The allocated volume of gasoline shall be of the grade and quality sold by Imperial to independent marketers in the

grade mix that is the same proportion in a twelve month period as the grade mix of all gasoline sales to independent marketers during the previous twelve month period as determined from publicly available data acceptable to Imperial and the Director.

24. The terms governing supply to independent marketers pursuant to the provision of paragraphs 20 to 27 will be reasonable commercial terms as negotiated by Imperial and independent marketers from time to time. For greater certainty the provisions of the Imperial standard form contract attached as Schedule 6 shall fulfill the requirements of this paragraph.

25. The term of supply agreements entered into pursuant to the provisions of this Order may vary from one (1) to five (5) years, or any combination thereof, at the purchaser's option. Imperial is not obliged pursuant to the terms of paragraphs 20 to 27 to enter into supply arrangements after the expiry of seven (7) years from the first day of the calendar month following the date of this Order. Imperial is not obliged to supply, pursuant to the terms of paragraphs 20 to 27, after ten (10) years from the date of this Order.

26. Nothing in paragraphs 20 to 27 shall be deemed to restrict or limit, in any manner, the ability of Imperial and an independent marketer to enter into processing or other supply arrangements not provided for therein, save and except that

Imperial shall remain bound by the prohibitions provided for in paragraph 35 for the periods specified therein.

27. Nothing in paragraphs 20 to 31 shall be deemed to require Imperial to supply an independent marketer who is in default as a result of non-payment under any existing processing or other supply arrangement with Imperial or Texaco.

28. For a period of up to three (3) years from the date of this Order, the Director may apply to the Tribunal for a variation of the terms of paragraphs 20 to 27 where there has been a material change in circumstances such that, in his opinion, the supply assurance of gasoline to independent marketers has been rendered ineffective, or, where the Director determines that such a variation would not restore the effectiveness of the supply assurance provided for in paragraphs 20 to 27, he may apply to the Tribunal for any other remedy under the Act including those provided for in section 92.

29. The Director, after the third year from the date of this Order, may, where there has been a material change in circumstances such that, in his opinion, the supply assurance of gasoline to independent marketers provided for in paragraphs 20 to 27 has been rendered ineffective, apply to the Tribunal for a variation of the terms of the said paragraphs. The Director's rights to seek variation under the terms of this paragraph shall

be limited to seeking a variation of the terms of paragraphs 20 to 27 other than the 7 and 10 year terms provided for therein.

30. No application may be brought pursuant to paragraphs 28 or 29 unless the adverse impact on the effectiveness of the provisions of paragraphs 20 to 27, given the material change in circumstances, is attributable, in whole or in part, to the effects of the acquisition of Texaco by Imperial.

31. For purposes of paragraphs 28, 29 and 30, "material change in circumstances" shall include, but is not limited to, the restriction, by law or otherwise, of imports of gasoline into Ontario and Quebec, or a significant reduction of gasoline refining capacity in Ontario and Quebec.

RETAIL:

32. Imperial shall divest 346 retail outlets identified in Confidential Schedules 7, 8, and 9.

33. Imperial shall provide, by sale or lease, for the continued operation of at least half (1/2) of the retail outlets listed in Schedule 9. Any lease entered into by Imperial pursuant to the terms of this paragraph shall be for a period of at least ten (10) years at lease rates prevailing in the market at the time. Where any retail outlets are leased pursuant to

this provision Imperial shall, at the option of the tenant, offer unbranded gasoline supply for the duration of the lease.

34. The lessees of company owned service stations identified for divestiture in Schedule 7 and the dealers at dealer owned service stations identified for divestiture in Schedule 8 may, at their option, elect to continue or terminate on three (3) months notice their existing contractual arrangements with Imperial or Texaco for branded supply. In the latter case, Imperial shall offer unbranded gasoline supply to the owner of any such station for a maximum period of five (5) years from the date of divestiture or the date of this Order, whichever period is later.

35. Imperial is prohibited from offering or entering into a branded supply agreement for gasoline with, and from re-acquiring any retail outlet identified in Schedules 7, 8 and 9 for a period of five (5) years from the date of divestiture or the date of this Order whichever is later.

NOTICE:

36. When notice is required to be given pursuant to any of the terms of this Order, it shall be considered given if dispatched by registered letter

TO Director of Investigation and Research
Bureau of Competition Policy
21st floor
Place du Portage
Phase I
50 Victoria Street
Hull, Quebec
K1A 0C9

AND TO Imperial Oil Limited
111 St. Clair Ave. West
Toronto, Ontario
M5W 2J8

Attention: Corporate Secretary

JURISDICTION:

37. The Tribunal shall retain jurisdiction in this matter for purposes of addressing any matters in this Order where specific reference is made to the Tribunal, for purposes of variation and for any other purposes provided for in the Act.

Dated at Ottawa this __________ day of ___________ 1989.

____

TO: The Director of Investigation and Research
Bureau of Competition Policy
21st floor,
Place du Portage,
50 Victoria St.
Hull, Quebec

TO: Imperial Oil Limited
111 St. Clair Ave. West
Toronto, Ontario

Schedule 1	-	Description of Eastern Passage Refinery
Schedule 2	-	Description of Atlantic terminals to be divested
Schedule 3	-	Description of Atlantic company owned service stations to be divested (CONFIDENTIAL)
Schedule 4	-	Description of Atlantic dealer owned service stations to be divested (CONFIDENTIAL)
Schedule 5	-	Description of Ontario/Quebec/Western Canada terminals to be divested
Schedule 6	-	Imperial standard form independent marketer supply agreement
Schedule 7	-	Description of Ontario/Quebec/Western Canada company owned service station outlets to be divested (CONFIDENTIAL)
Schedule 8	-	Description of Ontario/Quebec/Western Canada dealer owned service station outlets to be divested (CONFIDENTIAL)
Schedule 9	-	Description of company owned service station outlets subject to 10 year lease provision (CONFIDENTIAL)

SCHEDULE 1

EASTERN PASSAGE REFINERY

The refinery is located 4.5 miles south of Halifax, Nova Scotia on Halifax Harbour. It is situated on 454 acres of owned land plus a 29 acre water lot.

The refinery, which can process 20,000 barrels per calendar day of crude oil, comes complete with a 2 berth dock for the marine receipt of crude oil and petroleum products as well as a sales terminal for the shipping of petroleum products by tank truck and tank car.

Tankage at the refinery enables it to store up to 1.1 million barrels of crude oil, 0.3 million barrels of heavy fuel oil, and 1.4 million barrels of gasoline, heating oil and diesel fuel. The refinery is equipped with its own waste water treatment plant, compressed air facilities, steam generators, electrical distribution system, firewater and cooling water circuits, and laboratory. In addition there are numerous other auxiliary pieces of equipment for the treating, handling, movement, and storage of various intermediate streams, additives and products.

There is one major, long term purchase/sale agreement of equivalent volumes entered into with Ultramar Canada which expires on December 31, 1998. The agreement is assignable under certain conditions. It provides for the sale and delivery of 370,000 cubic meters per year of petroleum products by Texaco to Ultramar at Eastern Passage refinery in exchange for the sale and delivery of equivalent volumes by Ultramar to Texaco at Ultramar's Montreal, Quebec facilities. In addition, there are numerous other small, short term purchase/sale, throughput, and exchange agreements in place with various parties to facilitate the movement of refinery products.

SCHEDULE 2

ATLANTIC CANADA TERMINALS

There are 4 terminals in the Atlantic provinces in addition to the terminal operation at Eastern Passage refinery. They are:

Saint John, New Brunswick - 2294 Bay Side Drive

The terminal is situated on approximately 5 acres of land leased from Canada Ports Corporation. It is located on the east side of Courtenay Bay, Saint John Harbour.

A pipeline connection to the Irving Oil Company dock allows the marine receipt of petroleum products. Products are loaded for shipment by tank truck at 2 top loading racks equipped with 5 arms for gasoline and 5 arms for distillates. There are 6 storage tanks, one of which is out of service. Tankage permits storage of up to 140,000 barrels of product. The site also contains an office/warehouse building (120' x 50'), plus the necessary pipelines, pumps, instrumentation, and other auxiliary equipment.

Chatham, New Brunswick - 152 Upper Water

The terminal is situated on approximately 14 acres of owned land. It is located on the south shore of the Miramichi River.

A pipeline connection to a dock jointly owned with Ultramar Canada permits marine receipt of petroleum products. Products are loaded for shipment by tank truck at 1 top loading rack equipped with 3 arms for gasoline and 2 arms for distillates. There are 5 storage tanks which permit storage of up to 220,000 barrels of product. The site also contains an Office/Warehouse building (50' x 60'), plus the necessary pipelines, pumps, instrumentation, and other auxiliary equipment.

Charlottetown, Prince Edward Island - 1176 Lower Great George

The terminal is situated on approximately 7.8 acres of owned land. It is located on Charlottetown Harbour with road access to Great George Street and Prince Street.

A pipeline connection to the 1 berth Texaco dock permits marine receipt of petroleum products. Products are loaded for shipment by tank truck at 1 top loading rack equipped with 3 arms for gasoline and 3 arms for distillates. There are 7 storage tanks which permit storage of up to 160,000 barrels of product. The site also contains an office/warehouse building (30' x 75'), plus the necessary pipelines, pumps, instrumentation, and other auxiliary equipment.

Long Pond, Newfoundland - 103 South Side Road

The terminal is situated on approximately 4.8 acres of owned land. It is located on the east side of Conception Bay, about 13 miles from the city of St. Johns.

A pipeline connection to a 2 berth dock owned by Canada Ports Corporation permits the marine receipt of petroleum products. Products are loaded for shipment by tank truck at 2 top loading racks equipped with 3 arms for motor gasoline, 3 arms for distillates, 1 arm for aviation gasoline, and 1 arm for jet fuel. There are 8 storage tanks which permit the storage of up to 60,000 barrels of motor gasoline, 60,000 barrels of distillates, 6,500 barrels of aviation gasoline and 14,000 barrels of jet fuel. The site also contains an office/warehouse building (50' x 60'), plus the necessary pipelines, pumps, instrumentation and other auxiliary equipment.

The terminal is currently operated under contract by Great Eastern Oil.

SCHEDULE 3

DESCRIPTION OF

ATLANTIC COMPANY OWNED SERVICE STATIONS

TO BE DIVESTED

(CONFIDENTIAL)

SCHEDULE 4

DESCRIPTION OF

ATLANTIC DEALER OWNED SERVICE STATIONS

TO BE DIVESTED

(CONFIDENTIAL)

SCHEDULE 5

DESCRIPTION OF

ONTARIO/QUEBEC/WESTERN CANADA

TERMINALS TO BE DIVESTED

There are 9 product storage facilities west of the Atlantic provinces that will be divested. The Baie Comeau facility that will be divested is the Imperial Oil Limited facility. At Sudbury, either the Texaco terminal or the Imperial Oil agency plant will be divested. The facilities are:

Baie Comeau, Quebec (E) - 9 R. Maritime

The terminal is situated on approximately 2 acres of land leased from the Quebec and Ontario Paper Company. It is located on the west side of English Bay.

A pipeline connection to the dock owned by Transport Canada permits marine receipts of petroleum products. The pipeline section is leased from the owner, Ultramar Canada. Products are loaded for shipment by tank truck at 1 top loading rack equipped with 2 arms for gasoline and 2 arms for distillates. There are 7 storage tanks which permit the storage of up to 80,000 barrels of product. The site also contains an office/warehouse building (60' x 100') plus the necessary piping, pumps, instrumentation, and other auxiliary equipment.

Rimouski, Quebec - 15 Rue Goulet

The terminal is situated on approximately 6.3 acres of owned land. It is located close to the St. Lawrence River and has road access onto Goulet Street.

A pipeline connection to a 2 berth dock owned by Transport Canada permits marine receipt of petroleum products. Products are loaded for shipment by tank truck at 1 top loading rack equipped with 4 arms for gasoline and 6 arms for distillates. There are 8 storage tanks which permit storage of up to 150,000 barrels of product. The site also contains an office/warehouse building (30' x 80'), a rail spur for tank cars, plus the necessary pipelines, pumps, and instrumentation.

Ottawa, Ontario - Merivale Road, Nepean

The terminal is situated on approximately 18.7 acres of owned land. It is located on the Hunt Club Road extension which joins the Merivale Highway.

Products are received by pipeline via a lateral which is connected to Trans-Northern Pipeline. Products are loaded for shipment by tank truck at 2 top loading and 1 bottom loading racks equipped with 8 arms for gasoline and 9 arms for distillates. There are 9 storage tanks which permit the storage of up to 230,000 of products. The site also contains an office/warehouse (88' x 131'), a rail spur for tank cars, plus the necessary piping, pumps, and instrumentation.

<u>Sault Ste. Marie, Ontario</u> - 1010 McNabb Street

The terminal is situated on approximately 13.3 acres of owned land. It is located on the north shore of St. Mary's River with road access onto McNabb Street.

A pipeline connection to a dock owned by Ports Canada Corporation permits seasonal marine receipts of petroleum products. The section of pipeline from the dock to Imperial Oil Limited terminal is owned by Imperial. The section from the Imperial terminal to the Texaco terminal is owned by Texaco on a right of way. Products are loaded for shipment by tank truck at 1 top loading rack equipped with 3 arms for gasoline and 6 arms for distillates. There are 6 storage tanks which permit the storage of up to 290,000 barrels of products. The site also contains an office/warehouse building (102' x 50'), a rail spur for tank cars, plus the necessary piping, pumps, and instrumentation.

<u>Thunder Bay, Ontario</u> - McKellar Island No. 2

The terminal is situated on approximately 14 acres of owned land. It is located on the Lakehead Harbour with road access onto Arthur Street.

A pipeline connection to the Texaco dock permits the marine receipt of petroleum products. Products can also be received and unloaded via tank car. Products are loaded for shipment by tank truck at 1 top loading rack with 3 arms for gasoline and 3 arms for distillates, as well as by tank car at 1 top loading rack equipped with 8 arms for gasoline and 8 arms for distillates. There are 7 storage tanks which permit the storage of up to 190,000 barrels of products. The site also contains an office/warehouse (60' x 102') plus the necessary piping, pumps, instrumentation, and other auxiliary equipment.

<u>Sudbury, Ontario (Texaco)</u> - 1160 Kelly Lake Road

The terminal is situated on approximately 2.6 acres of owned land.

Products are received by tank car and unloaded at a tank car unloading rack. Products are loaded for shipment by tank truck at 1 top loading and 1 bottom loading rack. There are 6 arms for gasoline and 6 arms for distillates. There are 9 storage tanks which permit the storage of up to 25,000 barrels of products. The site also contains an office/warehouse (50' x 140') plus the necessary pipelines, pumps, instrumentation, and other auxiliary equipment.

Sudbury, Ontario (Imperial Oil) - 202 Douglas Street

The facility is situated on approximately 3 acres of owned land.

Products are received by tank car and unloaded at a tank car unloading rack. Products are loaded for shipment by tank truck at 2 top loading racks equipped with 3 arms for motor gasoline, 6 arms for distillates, and 2 arms for aviation gasoline. There are 8 storage tanks which permit the storage of up to 24,000 barrels of products. The site also contains an office/warehouse building (9600 sq. ft.) plus the necessary pipelines, pumps, instrumentation, and other auxiliary equipment.

The facility is operated by an Esso sales agent under contract.

Calgary, Alberta - 10326 Barlow Trail S.E.

This terminal is situated on approximately 27 acres of owned land.

Products are received by pipeline from the Alberta Products Pipe Line. Products are loaded for shipment by tank truck at 2 top loading racks and 4 bottom loading racks equipped with 19 arms for gasoline and 10 arms for distillates. Products are also loaded for shipment by tank car at 2 top loading tank car racks equipped with 4 arms for gasoline and 4 arms for distillates. There are 11 storage tanks which permit the storage of up to 500,000 barrels of products. The site also contains an office building plus the necessary pipelines, pumps, instrumentation, and other auxiliary equipment.

Victoria, British Columbia - 120 Kingston Street

This terminal is situated on approximately 1 acre of owned land. It is located on Victoria Harbour and has road access to Kingston Street and St. Laurence Street.

A pipeline connection to the Texaco dock permits marine receipt of petroleum products. Products are loaded for shipment by tank truck at 1 top loading rack equipped with 6 arms for gasoline and 2 arms for distillates. There are 7 storage tanks which permit storage of up to 35,000 barrels of product. The site also contains an office building (43' x 30'), a warehouse (54' x 51') plus the necessary pipelines, pumps, instrumentation, and other auxiliary equipment.

Prince George, British Columbia - BCR Yards

This facility is leased to a Wholesale Marketer. It is situated on approximately 1 acre of land leased from B.C. Rail. There are 9 tanks which permit storage of up to 3500 barrels. There is a tank truck rack with 6 arms as well as an office building (20' x 20') and a warehouse (40' x 20').

SCHEDULE 6

IMPERIAL STANDARD FORM

INDEPENDENT MARKETER SUPPLY AGREEMENT

petroleum products / wholesale supply agreement

THIS AGREEMENT made this ________ day of ______________________________, 19 ____ between Esso Petroleum

Canada, a division of Imperial Oil Limited ("Esso"), a Canada corporation having an office at ______________________________

____, and

____ ("Customer")

whose address is ____

____

WITNESSES that in consideration of the mutual agreements herein contained and subject to the terms and conditions hereinafter set out, the parties hereto agree as follows:

1. Esso agrees to sell and deliver, and Customer agrees to purchase, accept delivery of and pay for, during the term of this Agreement, the volumes set out below, of the product or products referred to below (the "products"):

Product	Volume Time Period	Method and Place of Delivery	Price per Unit

2. **Duration**

   The term of this Agreement shall be from the _____ day of ______________________, 19 ____, to the _____ day of ______________________, 19 ____.

3. **Volume**

   Customer will give Esso timely notice of its current requirements. Unless otherwise expressly provided herein, the products shall be delivered by instalments and Customer will accept delivery of the products in normal monthly seasonal quantities. Esso may anticipate Customer's requirements and make deliveries at such times and in such quantities as Esso deems convenient. Such action by Esso shall not relieve Customer from its obligation to keep Esso informed of its current requirements. If the volume of any product to be sold hereunder is expressed in terms of the Customer's requirements and a volume is set as Customer's estimated requirements, Esso shall not be obligated to supply the Customer's actual requirements in excess of the volume named as the Customer's estimated requirements but shall have the right at its option to do so on the terms and conditions contained in this Agreement.

4. **Prices**

   (1) The prices shown in Section 1, unless the contrary is indicated, do not include Canada Sales Tax, Excise Tax or any other taxes, duties, charges, levies, fees or royalties of any nature on or in respect of or calculated by reference to the products ("product taxes"). However, if and to the extent that:

   (a) the prices shown in Section 1 do include any product taxes, or

   (b) the Customer is required to pay product taxes to Esso, by reason of any existing law or any law that comes into force after the effective date of this Agreement,

then any increase in any such product taxes or any such new product taxes shall be borne by the Customer and paid to Esso as a price increase effective immediately upon the increase or imposition of the product tax. Furthermore, if and to the extent that there are imposed any new, or any increases in existing, taxes, duties, charges, levies, fees or royalties of any kind on the crude oil or other raw material from which the products are manufactured ("raw material tax"), then any increases in any such raw material taxes or any such new raw material taxes shall be borne by the Customer and paid to Esso as a price increase effective immediately upon the increase or imposition of the raw material tax.

(2) Esso may at any time and from time to time increase or decrease any price or prices mentioned, referred to or provided for in or under this Agreement by giving to the Customer written notice of price change ("Price Change Notice"). The price change will apply to products delivered on and after the seventh (7th) day after the giving of the Price Change Notice, unless the Customer gives to Esso, no later than the fourth (4th) day after the giving of the Price Change Notice, written notice ("Rejection Notice") that it rejects a price increase mentioned in the Price Change Notice. If the Customer gives a Rejection Notice, this Agreement will terminate on the fifteenth (15th) day after the giving of the Price Change Notice, with respect to products mentioned in the Price Change Notice, unless one of the following occurs before termination:

(a) Esso rescinds its Price Change Notice in writing, in which case this Agreement continues with prices unchanged but subject to Esso's continued right to give further Price Change Notices; or

(b) the Customer rescinds its Rejection Notice, in which case prices will change in accordance with Esso's Price Change Notice, or

(c) the parties agree in writing to prices for the products mentioned in the Rejection Notice, for deliveries on and after the said fifteenth (15th) day, in which case this Agreement is thereby amended.

5. **Payment**

Customer shall pay for the products at Esso's office designated on its invoice within thirty (30) days after the date of delivery of the products or within such other period as Esso may from time to time stipulate in writing. Customer shall pay a service charge on the actual daily balance of the amount overdue at the rate of ______________ per cent (________ %) per year, chargeable daily, compounded monthly, or at such other rate as Esso may specify from time to time. Esso may at its option at any time cancel Customer's credit and decline to make deliveries under this Agreement except for cash paid before delivery.

6. **Product Quality**

All products will be supplied under the names shown and shall be at all times up to Esso's specifications or specifications acceptable to Esso for these products.

7. **Trade Names and Trade Marks**

The Customer agrees not to use Esso's trade names or trade marks in any manner in the handling or resale or other disposal of the products purchased hereunder, and if the Customer resells or otherwise disposes of such products to any person for any purpose other than such person's own use and consumption, the Customer shall resell or otherwise dispose of such products only on terms which include the provisions of this sentence.

8. **Validity of Prices**

If any price or change in price provided in this Agreement ceases to be effective or cannot become effective by reason of any law, rule, regulation or order of any governmental authority, Esso may at its option terminate this Agreement as of the date the price ceased to be effective or the price change would have come into effect, as the case may be.

9. **Change in Control**

If the Customer is a corporation, and if at any time during this Agreement:

(a) any shareholder should sell, assign, transfer, give, dispose of or part with any interest in or control of any voting shares in the Customer, or

(b) the Customer should issue voting shares or any interest therein to any person, whether or not previously a shareholder,

with the result that in Esso's opinion the management, ownership or control of the Customer corporation has changed, then Esso may terminate this Agreement upon fifteen (15) days written notice to the Customer.

10. **Taxes**

(1) In this clause "tax" means the amount of any tax, duty, fee, royalty or other charge or sum (whether or not of the same kind) which is payable by any person or persons whomsoever to Canada or another country or to a province, municipality, government or other lawful authority in Canada or another country on or in respect of or calculated by reference to the products or the crude oil or other raw materials from which they are manufactured or the raw petroleum and natural gas rights pursuant to which the crude oil or other raw materials are produced, or on or in respect of or calculated by reference to the production, purchase, sale, ownership, manufacture, storage, delivery, use, transportation, exportation or importation of the products or the crude oil. Tax shall include one which is directed or requested to be paid, whether or not there is any legislative authority therefor at the time of such direction or request or at the time of payment. Income tax other than a tax on net income payable by Esso to Canada or to a province of Canada shall be a "tax" within the meaning of this clause.

(2) Whenever after the date of this Agreement a new tax is imposed or an existing tax is increased Esso may at its option increase the price of any product under this Agreement by the amount which it determines in its sole discretion is the

amount of the new tax or the amount of the increase in the existing tax or the portion thereof to be attributed to a product. Esso shall notify Customer in writing of the increased price and of the date on and after which the increased price is effective.

11. **Government Action**

(1) In this section:

(a) "government" means any country, or a province, state, government or other lawful authority of any country;

(b) "government action" means any action by a government which does not come within the provisions of Section 10 and which in Esso's judgment directly or indirectly increases its cost of performing its obligations under this Agreement, including without limitation:

(i) interference by a government with Esso's supply of a product or the crude oil from which it is manufactured (the "crude oil") from Esso's customary source or sources of supply;

(ii) any change in the laws, rules, regulations, decrees, agreements, concessions or arrangements with any government ("regulations") or if new regulations become effective, whether by law, decree or regulation or by response to the insistence or request of a government;

(iii) expropriation, confiscation, nationalization or participation by a government, or relinquishment of ownership or control to a government, of or in a product, the crude oil, the petroleum and natural gas rights pursuant to which the crude oil is produced, or any operations in respect of the foregoing.

(2) Whenever after the date of this Agreement any government action occurs, Esso may at its option increase the price of any or all the products under this Agreement. Esso shall notify customer in writing of the increased price and of the date on and after which the increased price is effective.

12. **Exchange Rates**

Prices of products imported into Canada or made in Canada from raw materials imported into Canada may be changed at any time by Esso without prior notice to reflect changes in currency exchange rates.

13. **Freight Rates**

In the event of any change in freight rates or other transportation costs affecting the products or the crude oil or other raw materials from which they are manufactured, which occurs after the date of this Agreement, Esso may change the price or prices provided herein to reflect the change in freight rates or other transportation costs. Esso shall notify Customer of the change in price.

14. **Crude Source**

Customer acknowledges and agrees that Esso shall have the right to obtain the products or the crude oil or other raw materials from which they are manufactured, in whole or in part from such source or sources within or outside Canada as it may select. The respective proportions of a product or the raw materials which are obtained from within or outside Canada shall be determined by Esso.

15. **Transportation**

Esso shall have the right to select the means of transportation to the place of delivery. If Esso at Customer's request agrees to use a means of transportation other than that selected by Esso, any additional cost incurred in using the means of transportation requested by Customer shall be paid by Customer. Esso's obligation to deliver the product shall be subject to Esso being able to obtain any permit or certificate required for any vessel or other means used to transport or deliver the product.

16. **Unloading**

Where Customer uses Esso's transportation facilities, Customer will, at its own expense, provide adequate facilities for receiving and unloading products, promptly receive and unload the products and promptly release and return any railway car, vehicle, vessel or other means of transportation ("conveyance") to the transportation company or to Esso in accordance with Esso's instructions. Delivery by the method provided in Section 1 of this Agreement will only be made when Customer has suitable facilities for safely and expeditiously receiving delivery in that manner and in accordance with good oil industry standards and practices. Where a conveyance is detained by Customer beyond the time allowed without charge by the transportation company, Customer will pay all demurrage accruing due and any rentals payable by Esso in respect thereof. If the conveyance is owned, leased or chartered by Esso, an amount in lieu of demurrage will be payable by Customer in accordance with the preceding sentence and such amount shall be determined by Esso in accordance with industry practice.

17. **Safety and Pollution**

Each party shall comply with all laws, regulations and orders applicable to the handling, the delivery and the acceptance of delivery of the products. Customer acknowledges that the oil industry has developed standards and practices relating to the proper handling and storage of petroleum products for the protection of the environment. Such industry standards and practices may in some cases exceed those stipulated by law, and Customer agrees to observe such industry standards and practices. Esso will upon request advise Customer of its standards and practices in respect of the foregoing.

18. **Marine**

In the case of marine deliveries, without limiting the generality of Section 17, each party shall comply with the Canada Shipping Act and the Oil Pollution Prevention Regulations thereunder and, if applicable, the Arctic Waters Pollution

Prevention Act and the Arctic Waters Pollution Prevention Regulations thereunder If a product is at any time to be transported by vessel Esso's obligation to deliver the product shall be subject to Esso being able to obtain any permit or certificate required for any vessel used to transport or deliver the product.

19. **Title**

Title to the products shall pass to Customer upon delivery at the place of delivery mentioned in Section 1

20 **Drums**

Except in the case of drums designated by Esso as non-returnable, Customer shall pay a deposit on steel drums in which any products are delivered in the amount from time to time determined by Esso. Steel drums remain Esso's property and may be returned by Customer at its expense to the place from which they were shipped, in which event Esso will refund the deposit to Customer upon compliance with the following conditions: the drums shall be identifiable as Esso's by embossing or plate, the drums shall be returned within one year from date of shipment; nothing other than the original contents shall have been placed therein at any time, the drums shall be empty, clean, complete with closures, and in a condition acceptable to Esso.

21. **Default**

If Customer fails to make any payment for the products when such payment is due (time being of the essence), or if Customer fails to take delivery of any portion of the products or takes delivery of a greater portion of the products at any time than is provided for herein, or if Customer fails to observe or perform any other of the terms of this Agreement. Esso may, at its option either defer deliveries until such breach is cured by Customer, or treat such breach as a repudiation of the whole Agreement

22. **Non-Performance**

(a) Neither party shall be deemed to be in default of or shall be liable for the non-performance of any covenant, agreement or obligation in this Agreement (except Customer's obligation to pay for product delivered hereunder) if such default or non-performance is caused by or is attributable to fire, storm, flood, war, hostilities, sabotage, blockade, explosion, accident, strike, lockout, work stoppage or slowdown, labour disturbance, riot, rebellion, insurrection, act of God or the Queen's enemies, act of any governmental authority, expropriation of or breakdown of or injury to any facilities used in or for the production, transportation, manufacture, storage, handling or delivery of the product or the crude oil or other materials from which the product is manufactured or derived (the "crude oil"), any occurrence (whether similar or dissimilar to any of the foregoing) which is beyond the reasonable control of the party affected, failure of one or more of Esso's usual suppliers to supply all or any part of the product or the crude oil, shortage of the product or the crude oil for any reason, or compliance with any law, rule, regulation, order, request or recommendation of any governmental authority, domestic or foreign, or person purporting to act therefor.

(b) Whenever for any reason whatsoever, including any reason beyond Esso's control, Esso's supplies of the product which are available for sale or delivery at or from the place or places from which sales or deliveries under the Agreement are normally made or shipped or Esso's supplies of crude oil from its then existing sources of supply are curtailed or cut off or are inadequate to meet Esso's obligations to all its customers and its own needs and those of its affiliated or subsidiary companies, or whenever Esso has reasonable cause to believe that any one or more of such events may occur. Esso may either discontinue deliveries of the product hereunder or may reduce the quantities of the product to be sold under this Agreement by allocating its available supply of product among its customers (whether under written contract or not and whether or not a contract was entered into before or after the date of this Agreement) and itself and its affiliated or subsidiary companies in such manner as it may in its sole and absolute discretion determine, and Esso shall not be obligated to obtain or purchase other supplies of the product or the crude oil.

(c) If for any reason whatsoever Esso shall suffer any loss or reduction of transportation capacity in those facilities by which Esso normally makes deliveries under this Agreement, Esso's obligations under this Agreement to make deliveries shall at its option be reduced in proportion to such loss or reduction in transportation capacity.

(d) Esso shall be under no obligation to make deliveries hereunder at any time when in Esso's sole judgment the making of a delivery might cause strikes to be called against it or cause its properties to be picketed.

(e) Failure to deliver or accept delivery of product which is excused by or results from the operation of any provision of this Agreement shall not extend the term of this Agreement and the quantities of product to be sold and purchased under this Agreement shall be reduced by the quantities affected by such failure.

23. **Notice**

Any notice given under this Agreement shall be given in writing and delivered by hand or sent by telex or mail to the respective parties at their addresses first set forth above or at such other address as either party may designate to the other by notice in writing. If a notice is sent by telex it shall be deemed to have been given and received on the day the telex transmission is actually sent If a notice is mailed it shall be deemed to have been given and received on the fourth (4th) business day following the date of mailing.

24 **Miscellaneous**

Esso shall not be liable for any special or consequential damages arising from any breach of its obligations under this Agreement. It is expressly agreed that the sale of products shall be governed solely by the provisions of this Agreement and not by the provisions of any purchase order Customer may give to Esso either before or after the date of this Agreement whether or not such purchase order is or purports to be accepted by Esso. No waiver by either party of any of the covenants, agreements or obligations contained in this Agreement shall constitute or be construed as a waiver of any

succeeding breach thereof or of any other covenant, agreement or obligation contained in this Agreement, and no delay or omission by either party to exercise any right acquired through the default of the other shall constitute or be construed as a waiver of or an impairment of such right. This Agreement shall be read with such change in number and gender as the context or the reference to the parties hereto may require. The clause headings are inserted for convenience of reference and shall not govern or affect the interpretation of this Agreement. This Agreement shall be binding on and enure to the benefit of the parties hereto, their heirs, executors, administrators, successors and assigns, but shall not be assigned by Customer without Esso's prior written consent.

IN WITNESS WHEREOF the parties hereto have executed this Agreement as of the day and year first written above.

CUSTOMER ______________________________ ESSO PETROLEUM CANADA

BY: ______________________________ BY: ______________________________

SCHEDULE 7

DESCRIPTION OF

ONTARIO/QUEBEC/WESTERN CANADA

COMPANY OWNED SERVICE STATION OUTLETS TO BE DIVESTED

(CONFIDENTIAL)

SCHEDULE 8

DESCRIPTION OF ONTARIO/QUEBEC/WESTERN CANADA

DEALER OWNED SERVICE STATION OUTLETS

TO BE DIVESTED

(CONFIDENTIAL)

SCHEDULE 9

DESCRIPTION OF

COMPANY OWNED SERVICE STATION OUTLETS

SUBJECT TO 10 YEAR LEASE PROVISION

(CONFIDENTIAL)

APPENDIX 2

OVERVIEW OF THE INDUSTRY

1. The Director believes that an understanding of the petroleum industry as a whole is necessary to fully appreciate the merits of the proposed Consent Order.

2. The industry overview, given the Director's concerns as set out above, will be limited to the downstream sectors of the petroleum industry, namely: import supply, refining, terminals and retail gasoline marketing.

1 - THE CANADIAN REFINING INDUSTRY

Demand for Refined Petroleum Products

3. Imperial's acquisition of Texaco Canada is taking place within a mature industry. Oil consumption as a share of total energy use has been decreasing since the mid-1970s and this decline is projected to continue into the year 2000 and beyond. In 1976 oil accounted for 54% of total Canadian energy consumption. By 1986 this figure had fallen to 40%. A recent National Energy Board (NEB) study projects oil's share will fall to only one-third of total energy consumption over the next 15 years. (Canadian Energy Supply and Demand, 1987-2005, September 1988, p. 69). This reduction in oil's share marks a continued, slow substitution away from petroleum products to alternative forms of energy, particularly for heating by commercial, industrial and residential consumers in Eastern Canada. As a result, refined petroleum products are increasingly being confined to their major captive market -- transportation fuels.

4. Energy use represents 90% of the total Canadian consumption of refined petroleum products. Of total oil end use 62% is for transportation requirements and 28% is for heat generation. The remaining 10% is for non-energy use. (e.g. lubricants, greases, petrochemical feedstock).

5. The demand for refined products has changed over time. In recent years the main trends have been the increasing relative importance of clean products (motor gasoline, aviation gasoline, and diesel) at the expense of fuel oils. Whereas light and heavy fuel comprised 36% of the barrel in 1974, today they represent only 16%. Over this same period clean products increased from 48% to 62%.

Distribution of Primary Oil Demand by Product
(%)

	1974	1981	1988	1990	2005
Motor Gasoline	33	37	37	34	33
Diesel Fuel	11	14	19	21	24
Light Fuel Oil & Kerosene	14	13	8	7	4
Heavy Fuel Oil	22	16	8	9	9
Aviation Fuels (1)	4	5	6	6	6
Petrochemical Feedstock	2	5	4	-	-
Other (asphalt, lubricants)	14	10	18	18(2)	19(2)
Total	100	100	100	100	100

(1) Includes aviation gasoline and turbo fuel - kerosene and naphtha type.

(2) Includes petrochemical feedstocks.

Source: Restrictive Trade Practices Commission, Competition in the Canadian Petroleum Industry, Appendix G, Table G-1: Statistics Canada Catalogue #45-004; NEB, Canadian Energy Supply and Demand, 1987-2005, September 1988, p.70.

6. The NEB forecasts that the growth rate for gasoline demand has stabilized and gasoline will comprise slightly less of the barrel over the next decade. Clean products as a whole,

however, will continue to represent almost two-thirds of refinery output as diesel usage continues to grow.

Demand Trends By Region

7. Atlantic Canada, while exhibiting a steep 16% drop in oil consumption between 1976 and 1986, will continue to be dependent on oil as its main source of energy. Unlike the rest of Canada, the Atlantic region has virtually no access to natural gas. The NEB expects oil's share of energy demand to fall only marginally over the next 15 years from 61% in 1986 to 57%-59% in 2005. Non-transportation use accounts for all of this decline. The share of oil for transportation use is expected to remain stable at 33%. (NEB, p. 64.)

8. In Quebec, oil faces strong competition from electricity. Hydro Quebec continues to pursue incentive programs for certain industrial markets. As a result, the flexibility of fuel choice in industrial plants in this province exceeds that of any other province with many plants able to choose among heavy fuel oil, natural gas, or electricity depending upon relative prices.

9. Like Atlantic Canada, oil's share of end use energy demand in Quebec fell substantially between 1976 and 1986 as petroleum users switched en masse to electricity and natural gas

and away from light and heavy fuel oil. A combination of market forces and government policies led to crude oil prices rising faster than natural gas and electricity prices in the province. These price differentials, the promotion of alternatives to petroleum product use by the Federal Government through incentives, and the eastward extension of the natural gas pipeline in Quebec led to a massive substitution away from oil. To compound the situation, in November 1981 Quebec considerably increased provincial gasoline taxes which further affected gasoline demand. Over the foreseeable future the NEB sees the non-transportation oil share in the province dropping from 17% in 1986 to 13%-14% by 2005 with natural gas and electricity filling the vacuum. Oil used for transportation purposes will maintain close to 25% of the energy market. (NEB, p. 65.).

10. The absence of natural gas in the Atlantic region results in a large share of oil used for non-transportation purposes, and more specifically heating requirements. Today oil in total accounts for just under half of residential heating demand in this region. Since 1973 light heating oil demand has fallen substantially from 88% of residential heating demand to 46% in 1988. While wood, wood waste, and electricity have filled the void, substitutes (natural gas and electricity) have either not been available or economical to the same extent as Ontario or Quebec. For this reason, heating oil is expected to have a continuing important role in the Atlantic market.

11. While the price elasticity of demand for heating oil and heavy fuel oil is relatively inelastic in the short-term, the evidence is quite clear it is substantial in the long-run, as evidenced by the switching to alternative fuels in Ontario and Quebec industry in recent years. The Atlantic Provinces (Nova Scotia, Prince Edward Island, New Brunswick) are the only exception to this trend given the limited opportunities for substitution.

12. In Ontario oil's share of total energy demand declines slightly from 38% in 1986 to 34%-36% by the year 2005. Again, this decline is mostly in non-transportation use as customers continue to convert away from oil and new markets use natural gas and electricity. (NEB, p.66).

13. On the Prairies oil's share of total energy demand declined from 45% in 1976 to 34% in 1986. This figure is expected to fall further to 26%-29% by 2005. In 1986 oil used for non-transportation purposes accounted for only 6% of total end use demand versus 28% for transportation demand. (NEB,p.67). The NEB predicts that transportation energy demand will grow less rapidly in this region thaan in other parts of the country.

14. Oil's share of total energy demand in British Columbia and the Territories has fallen from 44% in 1976 to 36% in 1986

and the NEB projects it will be only 30-31% by 2005. (NEB,p.67). Oil for non-transportation use was 9% of total B.C. demand in 1986 and is expected to decline to 6% by the year 2005. Oil for transportation use is projected to decline marginally from 27% of total energy use in 1986 to 24%-25% in 2005 for similar reasons as discussed for the Prairies.

Transportation Demand

15. Petroleum products account for about 98% of energy demand in the Canadian transportation sector reflecting the fact that there are currently no economically viable or widespread substitutes for propulsion fuels (i.e. motor gasoline, diesel and aviation fuels). As the following table reveals, motor gasoline and diesel are by far the dominant fuels in this sector.

Transportation Demand by Fuel
(%)

Motor gasoline	65
Diesel	22
Aviation turbo	9
Heavy fuel oil, aviation gas, electricity	3
Propane, compressed natural gas (CNG)	1

Source: NEB, Canadian Energy Supply and Demand 1987-2005, September 1988, p.53, p.58.

16. Within the transportation sector road fuels make up over 80% of total transportation energy use compared with only 9%

for air and 4 each for marine and rail. (NEB, p. 59.) Automobiles rely almost entirely on gasoline while trucks are split between gasoline (57%) and diesel (43%) usage.

17. Slow growth in the demand for transportation fuels is anticipated for the next decade. The National Energy Board projects that transportation energy use will grow by about 1% per year over the 1986 to 2005 period with motor gasoline growing only 0.6% annually. (NEB, p.55). The price elasticity of demand for transportation fuels is inelastic in both the short and longer runs.

18. In summary, refined petroleum products used primarily to generate heat (light and heavy fuel oil) face strong competition from readily-available substitutes except for Atlantic Canada where oil continues to dominate. This interfuel competition is expected to continue well into the next century as oil steadily loses ground in the heat energy market. For transportation fuels, which account for two-thirds of Canada's demand for refined petroleum products, petroleum does now and will continue to be the only available choice. Hence, this is a captive sector for suppliers of gasoline, diesel and aviation fuel. Consumers have responded to higher transport fuel prices in the post-1973 period by driving fewer miles, reducing their demand for vehicles, and switching to more fuel efficient

vehicles. These actions have stabilized gasoline demand and this demand is expected to remain flat over the next decade.

Supply of Petroleum Products

19. Refined petroleum products are produced in highly specialized and complex capital-intensive manufacturing facilities requiring a substantial fixed investment and technological expertise. Texaco's Nanticoke refinery, for example, was built in 1978 at a cost of $500 million and to replace it today would cost about $1 billion. Imperial's Edmonton refinery would also cost $1 billion to replace. Shell's Scotford, Alberta refinery cost $1.3 billion to build. (RTPC, pp. 210-211). The magnitude of any particular refinery investment varies depending on the size of the refinery and the sophistication of the conversion and upgrading equipment. In addition to initial investment, refineries require ongoing operating expenses in the tens of millions of dollars per year and occasional upgrading that can cost $100 million or more.

20. The combination of high investment, operating, and upgrading costs, some of which are sunk costs, increases entry/exit barriers in the refining sector and effectively limits the number of firms willing to risk investing capital in refining. The refining sector in all countries is more highly concentrated. The high fixed costs relative to variable costs of

refineries (other than feedstock most costs are fixed) creates pressure on refiners to operate at relatively high levels of capacity utilization to maximize profitability.

The Refining Process

21. Petroleum refining is the process of extracting a variety of marketable products from crude oil. Refineries are capable of processing a range of feedstock including light and heavy crude oils, synthetic crude oil from tar sands, and condensate from natural gas. Refineries are not homogeneous. Each is designed to handle particular types of feedstock in order to produce the desired range and quantities of product. For example, because Imperial's Sarnia refinery has a fluid coker, it is the only Ontario refinery which can run both light and heavier, higher sulphur crude oils. Texaco's Nanticoke refinery, by contrast, is restricted to processing sweet light crudes. Variation of the product slate may be achieved by altering the feedstock inputs, the processing equipment, or the additives.

The World Refining Industry

22. Refined petroleum products are produced on a world-wide basis. In 1988 total world crude oil refining capacity was 73.1 million barrels/day. **Canada** has crude capacity of just under 2 million barrels per day or some 3% of world capacity. This

compares with 15.3 million barrels/day for the United States which has 21% of total world capacity.

23. Presently, world refineries are operating between 75% and 80% of total refining crude oil capacity and it is projected this surplus capacity to persist, particularly in Europe.

World Crude Oil Refining Capacity 1988

Region	Refining Capacity (mm b/d)	Utilization rates* (%)	Share of World Capacity (%)
Centrally Planned Economies	17.6	78	24
North America	17.2	84	23
Western Europe	14.1	69	19
Japan/Asia/Pacific	10.3	73	14
Caribbean/South America	7.2	77	10
Middle East	4.2	72	6
Africa	2.6	83	4
Total World	73.2	78	100

Source: World Oil Trends, Cambridge Energy Research Associates, 1988.

* Utilization rates are for 1987.

The Canadian Refining Industry

24. There are 13 participants in the Canadian refining industry (4 national, 9 regional) comprising a concentrated industry in each region of Canada.

(a) Major (national) fully integrated firms (i.e. market coast to coast and have domestic production): Imperial Oil, Petro-Canada, Shell, Texaco.

(b) Regional integrated firms (i.e. market regionally and have domestic production): Suncor (Ontario, Quebec), Chevron (B.C.), Husky (Western Canada), Irving (Atlantic region), Ultramar (Eastern Canada), Turbo (Western Canada), Parkland (Prairies), Consumers' Co-op (Prairies) and Newfoundland Processing.

25. These 13 companies operate 26 gasoline producing refineries with a total capacity of 1.8 million barrels per day and an average capacity of 72,000 barrels per day. No company has a refinery in the five geographic regions of Canada.

26. The acquisition of Texaco by Imperial will reduce the number of major (national) refiner marketers to three. Imperial, Petro-Canada, and Shell have refineries in four regions, Texaco in two regions, and the remaining nine firms in one region only. Consequently, if a refiner chooses to market products nationally, it must either transport to, or acquire products (usually by reciprocal supply agreement) for resale in, any region in which it does not have a refinery.

Concentration

27. The table below measures Canadian refining concentration on a national basis. Pre-merger Imperial has the largest share of capacity at 22.2% followed closely by Petro-Canada at 21.9%. Texaco is in fifth place with almost 7% of total Canadian capacity. Post-merger Imperial would own approximately 29% of total Canadian refining capacity.

Canadian Refining Capacity by Company

Firm	Number of Refineries	Total Crude Oil Capacity		Pre-Merger Share of Refining Capacity	Post-Merger Share of Refining Capacity
		b/cd	m3/d	(%)	(%)
Imperial	5	417,300	65.7	22.4	29.2
Petro-Canada	6	407,200	64.7	21.9	21.9
Shell	4	271,000	43.1	14.6	14.6
Irving	1	235,000	37.4	12.7	12.6
Texaco	2	126,400	20.3	6.8	-
Newfoundland Processing	1	105,000	16.7	5.6	5.6
Ultramar	1	100,000	15.9	5.3	5.3
Suncor	1	70,000	11.1	3.7	3.7
Federated Co-Op	1	150,000	8.0	2.7	2.7
Chevron	1	35,000	5.6	1.9	1.9
Turbo	1	27,500	4.4	1.5	1.5
Husky	1	9,500	1.5	0.5	0.5
Parkland	1	5,000	0.8	0.1	0.1
Total	26	1,857,900	295.2	100.0	100.0

28. From a regional perspective the merger of Imperial and Texaco increases refinery concentration which has implications for competition in Ontario/Quebec and Atlantic Canada. In

Ontario, Imperial has a refinery at Sarnia while Texaco has one at Nanticoke. In the Atlantic region, both companies have refineries in the Halifax area. Texaco does not have any refineries in Western Canada and supplies its own requirements by processing and supply agreements with other refiners.

Economies of Scale in Refining

29. Economies of scale relative to market size play a significant role in limiting the number of players in the refining industry in all countries. Economies of scale exist in refining because capacity can usually be increased with a less than proportional increase in investment costs. From an engineering standpoint, average capital and operating costs tend to decline as refinery (and crude process unit) size increases. Larger refineries, therefore, tend to have lower investment costs per unit of capacity. Scale economies also exist because labour and maintenance costs rise at a lower rate as refining capacity increases.

30. The RTPC found that with known technology average costs of production reach a minimum at 200,000 b/cd (31,800 cu. metres per day). Using this number as the measure of most efficient economic scale, the Commission found that Canada would require only 9 refineries (rather than the current 26) to efficiently serve market demand without imports.

31. Canadian refinery capacity utilization for 1988 by region is reported with regional refining capacity in the four tables to follow.

Imports, Inter-Regional Transfers, and Refinery Supply Agreements

32. Prior to deregulation in June 1985, imports into Canada were constrained under the Oil Import Compensation program. Trucking from the U.S., for example, did not receive compensation. Since deregulation Atlantic Canada, Ontario/Quebec and the Pacific coast are open to marine cargo shipments from anywhere in the world and Ontario has easy access to product trucked from Buffalo and Detroit.

33. The physical movement of product from other regions and countries indicates that ownership of refining capacity within a province or region is not sufficient, in itself, to measure the opportunities for alternative supplies of refined petroleum products. The possibilities for interregional transfers and imports of refined products (via pipeline, marine vessel, truck) and the existence of reciprocal supply agreements among domestic refiners increase both the quantity of product available to purchasers of refined products and the number of firms they are able to negotiate with.

(a) **Atlantic**: Refining capacities in the Atlantic region are as follows:

Atlantic Region Refining Capacity

Firm	Location	Refining Capacity	Share of Refining Capacity
Imperial	Dartmouth	82,300	18.6
Texaco	Dartmouth	20,500	4.6
Irving	Saint John	235,000	53.1
Nfld.	Come-By-Chance	105,000	23.7
Total		442,800	100

(Atlantic Refinery Utilization Rate, 1988, 60%)

(b) **Ontario/Quebec**: Ontario and Quebec comprise a single geographic market in terms of petroleum refining and distribution within Canada. Product moves between these provinces year-round on the Trans-Northern Pipeline and by marine cargo from April to November when the St.Lawrence Seaway is open. In addition, Quebec and Ontario refiners exchange product via long-term supply agreements.

34. **Inter-provincial movements represent more than 10% of Quebec's total refined product supply and 10% of Ontario's supply. In 1988, motor gasoline and diesel together represented 32% of total product transfers into Quebec and 45% of transfers** into Ontario. (Statistics Canada Catalogue #45004)

35. Product flows between Ontario and Quebec account for a large portion of each province's trade. Of the 1,125,408 m3 of motor gasoline transferred into Ontario in 1988, 956,597 m3 or 85% came from Quebec. In that same year, Quebec brought in 739, 879 m3 of mogas with 325,547 m3 or 44% originating in Ontario. (Statistics Canada Catalogue #45004)

36. Reciprocal supply agreements among refiners also link Ontario and Quebec. For example, Texaco supplies Petro-Canada at Nanticoke and receives product at Petro-Canada's Montreal refinery to supply its Quebec customers.

37. The Ontario/Quebec market has several important characteristics:

(a) Pre-merger, the refining sector was concentrated. Six firms operated nine refineries in this market with Petro-Canada and Shell operating facilities in both provinces. Imperial has a refinery in Sarnia, Ontario while Texaco refinery is at Nanticoke, Ontario.

(b) There are large numbers of independent marketers, many of which are able to purchase domestic and foreign product. Most of these independents focus their attention on retailing gasoline.

(c) Heating Oil sales have declined dramatically with the rapid growth of natural gas in Ontario and electricity in Quebec. Since 1973 light fuel oil has declined from 52% of Ontario's residential heating demand to 18% in 1988. Over this same time frame Quebec has seen this number drop from 79% to 23%.

(d) The shift in demand away from the heavier end of the barrel has significantly impacted the structure of the refining industry in these provinces. Capacity has been rationalized through the closure of five refineries since 1983 (four in Montreal). In addition, refiners have invested in conversion and upgrading equipment in order to maximize the output of higher valued lighter products, specifically motor gasolines and diesel.

Concentration

38. Pre- and post-merger concentration are measured below.

Ontario/Quebec Region Refining Capacity

Firm	Location	Total Capacity (b/cd)	Pre-merger Share of Refining Capacity (%)	Post-merger Share of Refining Capacity (%)
Petro-Canada	Montreal Mississauga Oakville	230,000	28.0	28.0
Shell	Montreal Sarnia	191,000	23.3	23.3
Imperial	Sarnia	123,500	15.0	28.0
Texaco	Nanticoke	106,400	13.0	-
Ultramar	St.Romauld	100,000	12.2	12.2
Suncor	Sarnia	70,000	8.4	8.4
Total		821,400	100.0	100.0

(Ontario/Quebec Refinery Utilization Rate, 1988, 87%)

39. Petro-Canada has the largest refinery in the market with a 140,000 b/cd facility in Montreal. This company also has the most capacity with a total of 230,000 b/cd at three refineries. Shell is second in total capacity with 123,500 b/cd at two locations. Imperial's Sarnia refinery (123,500 b/cd)is the second largest in the Ontario/Quebec market. Imperial is third overall in total refining capacity. Texaco's Nanticoke refinery (106,400 b/cd) is the fourth largest in the market, Texaco thus is the fourth largest refiner.

40. Texaco's Nanticoke refinery is a modern, efficient plant which came on-stream in the late nineteen-seventies. It is designed to produce a higher range of light oil products, specifically octane-rich gasolines.

41. Imperial's Sarnia refinery is unique in this market as it is the only facility with a coker. This enables it to run both light and heavier, higher sulpher crude oils. Texaco's Nanticoke refinery, by contrast, is restricted to processing sweet, light crudes.

42. Post-merger Imperial will have the largest market share in the Ontario/Quebec market. The three largest refiners (Imperial, Petro-Canada, Shell) will control almost 80% of refining capacity in this market.

43. By focussing exclusively on inputs rather than outputs, crude capacity is not a complete measure of about a refinery's ability to produce clean products. This will depend on the type, size and age of the equipment within the refinery. Because refineries are not homogeneous, a more appropriate measure of concentration in the industry would be to calculate gasoline and distillate capacity market shares since these more accurately reflect each refiner's control over the production of road transport fuels and light fuel oil.

44. Post-merger Imperial jumps from the fourth largest firm in this market to first with one-third of maximum gasoline capacity in the region. This compares with 28% of crude capacity in the region. On a provincial basis, post-merger Imperial would

have 48% of Ontario gasoline capacity compared with 45% of crude capacity.

45. The data also demonstrate the large size of Nanticoke's gasoline capabilities. Texaco has 17% of the market with only one refinery while Shell has 20% with two refineries and Petro-Canada has 24% with three plants.

Sales To Independent Marketers: For the years 1987 and 1988, Imperial and Texaco together account for about 45% of motor gasoline sales to independents in Ontario and a third of sales to Quebec independents. Compared to Imperial, Texaco is a major supplier to independents in Quebec accounting for one-quarter of total sales to this class of trade.

(c) **Western Canada**: Texaco does not have a refinery west of Ontario and thus the merger does not change the structure of the refining industry in Western Canada. Imperial is the largest gasoline and diesel supplier in the Prairie region.

Prairie Region Refining Capacity

Firm	Location	Refining Capacity (b/cd)	Share of Refining Capacity (%)
Imperial Oil	Edmonton	164,900	38.8
Petro-Canada	Edmonton	121,400	28.6
Shell	Scotford	56,000	13.2
Federated Co-Op	Regina	50,000	11.8
Turbo	Calgary	27,500	6.5
Parkland	Bowden	5,000	1.1
Total		424,800	100.0

(Prairie Refinery Utilization Rate, 1988, 86%)

Pacific Region Refining Capacity

Firm	Location	Refining Capacity	Share of Refining Capacity
Petro-Canada	Port Moody, Taylor	55,300	33.2
Imperial Oil	Ioco	42,800	25.7
Chevron	N. Burnaby	35,000	21.0
Shell	Shellburn	24,000	14.4
Husky	Prince George	9,500	5.7
Total		166,000	100.0

(Pacific Refinery Utilization Rate, 1988, 82%)

2 - IMPORTS

46. In the four years since deregulation, motor gasoline import and export activity in Canada has gradually increased. An increasing number of smaller independent terminal operators and independent resellers have turned to imported product as an alternative source of motor gasoline supply. In Ontario, for example, imports rose from 15 thousand cubic metres in 1985 to 410 thousand cubic metres in 1986. Yet Canada continues to be a net exporter of motor gasoline. Statistics provided by the National Energy Board and the International Trade Division of Statistics Canada indicate Canada imported approximately 1.5 million cubic metres of motor gasoline in 1988 while exporting 3.3 million cubic metres.

47. Quebec has consistently imported the largest volume of motor gasoline into Canada, followed by Ontario. In 1988, total imports of motor gasoline into Quebec were in the order of 851 thousand cubic metres while Ontario's total motor gasoline imports totalled approximately 429 thousand cubic metres. Imports of motor gasoline into the Atlantic region were 73 thousand cubic metres in 1988. In British Columbia imports of motor gasoline increased significantly in 1988 from earlier years to total approximately 112 thousand cubic metres. Volumes of imported motor gasoline entering the Prairies have been consistently negligible over the last four years.

48. The U.S. is the major supplier of refined petroleum products to Canada, along with Venezuela. Canada has also received refined products from Algeria, Belgium, France, Italy, Mexico, the Netherlands, Peru, Saudi Arabia, Spain, Trinidad and the United Kingdom.

49. The importance of imports and exports as a component of total product supply varies in each region. Exports are significant in the Atlantic region and to a lesser extent British Columbia. The remaining regions export relatively little of their total motor gasoline supply. Overall, Canada imported 3.65 percent of total domestic product supply and exported 8.30 percent.

50. The level of motor gasoline imports into each region as a component of net regional supply is also a significant indicator of the importance of the import option. Net supply does not incorporate exports or closing stock inventories and hence it may be interpreted as a proxy for demand within each region. However, because net supply includes product volumes found in secondary storage, it exceeds true demand. The Table below reveals that imports as a component of net supply are most important in Quebec.

MOTOR GASOLINE IMPORTS

AS A PERCENTAGE OF NET CANADIAN SUPPLY

	1985	1986	1987	1988
Atlantic	5.31	1.63	3.63	2.52
Quebec	11.51	13.88	16.63	12.21
Ontario*	0.31	3.38	2.59	3.71
Prairies	0.00	0.01	0.09	0.05
British Columbia	0.19	0.04	1.43	3.08
Canada	2.87	4.23	4.78	4.39

* Data adjusted upwards to account for 1986-1988 imports transported by truck reported by the International Trade Division of Statistics Canada.

Sources: National Energy Board
Imperial Oil Limited Submission of February 14, 1989

51. Refiners have accounted for the majority of motor gasoline import activity in Canada due primarily to the fact that petroleum products are jointly produced from crude oil. The RTPC described this situation in their report Competition in the Canadian Petroleum Industry as follows:

> "Output of any product cannot be increased or decreased without affecting the output of other products. Depending on the supply/demand balance of the various product markets, importation of particular types of product as required, may be the economic course for a refiner. Exports allow a similar flexibility, permitting refiners to increase the output of certain products knowing that by-products may be exported at a better price than they could get by unloading the surplus on Canadian markets." (RTPC Report, p. 259)

distillates and other petroeum products. By trading in petroleum products, refiners are able to balance joint products' supply/demand situation while producing an optimal quantity of one particular product.

53. Other large importers of petroleum products include terminal operators and large customers of heavy fuel oil and jet fuel who import for their own use. Such activity, and that of the refiners, typically involves marine shipments of product. Imports may also be made by independent marketers located near the U.S. border by way of truck shipments. Imports transported by road are most significant in the Southern Ontario area. Elsewhere the activity is limited by the high cost of highway transportation.

54. For 1988, the National Energy Board estimated 100 percent of motor gasoline imports into the Atlantic were brought in by refiners. In Quebec, refiners accounted for 71 percent of imported volume while in Ontario refiners imported 25 percent of foreign-sourced motor gasoline. Refiners located in British Columbia imported 40 percent of provincial motor gasoline imports. Quebec independents had access to 240 million litres of motor gasoline in 1988 which represented 3.5 percent of Quebec's net supply. In Ontario, independents were able to purchase 301 million litres of imported motor gasoline in 1988 representing 2.6 percent of Ontario's net supply. Independents based in

British Columbia had access to 67 million litres of motor gasoline in 1988 which accounted for 1.8 percent of net supply.

Barriers to Importing

55. Since June 1, 1985, no trade-related governmental barriers have existed in Canada limiting imports' access to the Canadian market. Non-governmental barriers to trade are not significantly greater than those experienced by other Canadian industries. However, several factors may act as restraints on the demand for imported motor gasoline. These include quality, transport costs, exchange rate patterns, credit terms and security of supply. While quality differences, exchange rates and credit terms may increase the relative cost of imported product somewhat they have not yet acted to exclude imports from the market.

56. The principal difference in quality relates to octane standards even though minimum octane standards set by the governments of Canada and the United States are the same for major grades of motor gasoline. Quality differences that do appear may be explained principally by one of two factors. First, Canadian refiners have voluntarily chosen to produce a higher octane product than is required by the CSGB standards--producing typically an 88-89 octane regular unleaded motor gasoline instead of the 87 octane minimum standard. Second,

certain American refiners make gasoline to meet a lower standard. In the case of large shipments, product can be ordered to fulfill whatever octane standards are sought. Should differences persist, blending in higher octane product has been shown to resolve any significant octane differentials. Blending will, however, increase the cost of obtaining imported product.

57. While Canadian independent resellers would generally prefer to purchase domestically produced product, when price differences expand significantly independent resellers tend to increase their reliance on imports.

58. Exchange rate fluctuations may also increase the already high volatility of foreign-sourced product prices making product obtained via marine shipments more risky than that transported by truck given the longer lag between ordering and delivery of product.

59. Differential credit terms are believed to increase the relative cost of imported product slightly. Marine cargoes are typically paid in full 3-5 days after receipt. U.S.-sourced product must generally be paid for 8-10 days after receipt when picked up by truck. Domestic credit terms are considerably longer, at 30-40 days. Nonetheless, these added costs represent less than one percent of the total cost of the product for both marine cargo and truck shipments.

60. Transportation costs, on the other hand, do limit the presence of imported product in certain regions. Transportation costs per litre of product shipped are highest when trucking. Transport costs per litre are considerably less in the case of marine cargoes. However, access to marine cargoes is limited. Despite the Atlantic region's proximity to international petroleum markets there is currently no marine-based import competition in wholesale motor gasoline markets due to a lack of independently operated terminal facilities. Ontario's access to marine cargoes is also limited by smaller sized cargo shipments and the shorter navigation season. Marine cargoes are not an option in the Prairies and only one large independent is currently importing by marine cargo in British Columbia. The shortage of independently operated terminal storage limits the marine option in British Columbia.

61. A desire to maintain secure supply sources also limits the extent to which some independent marketers engage in importing activity. The degree to which independent marketers are concerned about security of supply will in turn depend upon their belief that motor gasoline is a commodity susceptible to the risk of supply interruptions.

Infrastructure Required to Import by Vessel

62. Access to marine cargo imports is greatest in the coastal regions and Quebec. Importing by marine vessel also occurs in Ontario, although this is limited by the need for smaller sized cargo shipments and the shorter navigation season.

63. Importing petroleum products in general and motor gasoline in particular is a complex process. Marine cargoes are typically 230,000 - 250,000 barrel shipments and therefore require considerable storage capacity. Importers must be financially secure given that cargoes must be paid in full 3-5 days after delivery and shipments of this magnitude typically cost close to $5 million. Long lead times between order and delivery of cargoes further increase risk.

64. The financial burden of owning and operating marine terminal facilities is further increased by the costs associated with the facilities' infrastructure. Investments need to be made in deep water ports, off-loading facilities, pipelines to terminals, loading racks and insurance. There is also only limited waterfront property available in some districts, and often significant municipal and environmental regulatory hurdles must be overcome.

65. Purchasing existing terminal facilities does not necessarily make independent entry problem free. Many older terminals are now being recognized as environmentally unsound, forcing significant investments in areas of pollution control. Furthermore, the legal liability of environmentally unsound facilities can be more costly than the purchase of such facilities.

66. Access to marine cargoes is limited west of Montreal by the need for smaller vessels travelling the St. Lawrence Seaway System. Depending upon the draft of dock facilities, it is possible to bring cargoes of 100,000 barrel capacity into some harbours. However, the majority of Ontario terminal operators have lower drafts and hence can only handle shipments of 50,000 barrel capacity. In addition, Ontario terminal operators typically own less tankage than their counterparts in Quebec and so require more frequent, smaller-sized cargoes. Marine transport within the Great Lakes is further restricted by the navigation season as the Seaway is frozen 3-4 months a year.

67. A further restriction to marine imports into Ontario lies in the shortage of backhaul shipments. The majority of ships used for gasoline haulage into Ontario are parcel carriers which typically bring in chemicals and fertilizers as well as petroleum products to drop off points throughout the St. Lawrence Seaway system. In order to be economically viable, outbound

cargoes must be secured. Furthermore, when travelling between a Canadian origin and destination, shippers are required by law to use Canadian Flag vessels. Rates on these vessels are regarded as considerably more expensive than world shipping rates.

68. In view of the cost of successfully operating terminal facilities and importing, investments in terminals have been found to only be worthwhile when operators have a guarantee of high volume throughout. Large-scale importers generally require their own secure customer base in order to minimize risk.

Infrastructure Required to Import by Truck

69. In contrast to the complexities of large-scale marine imports, Canadian independents in proximity to a U.S. refiner or terminal operator may find importing by truck feasible. Little more than a telephone is required once a supplier who is capable of handling the U.S. tax matters is located. Numerous common carriers exist capable of hauling gasoline on a spot basis. The initial organization time involved in securing a U.S. supply source, arranging for transport, brokerage and border services has been estimated by one independent to be 2-3 weeks. If imported product is obtained through an already established trading system it can be made available in under 24 hours.

70. Investments in trucking assets may be desired if large volumes of product are to be imported on a regular basis. In addition to acquiring the necessary tankers, provincial tax collection permits, provincial and U.S. State vehicle licenses and insurance are also required. Brokerage and customs arrangements must also be made. Nevertheless, imports by truck are relatively easy and independents in Ontario frequently avail themselves of this import option.

71. **Atlantic:** In the Atlantic region Canadian refiners face only minimal competition from imported petroleum products and virtually no competition from motor gasoline imports at the wholesale level. As noted earlier, the National Energy Board estimated 100 percent of the reported 1988 motor gasoline imports into the Atlantic were brought in by refiners. Hence, any wholesale purchase of imported motor gasoline made by an Atlantic independent reseller was made through a Canadian refiner.

72. Independents have not imported motor gasoline by marine cargo in the Atlantic region given the lack of access to independently operated marine terminal or storage space. Only one independent presently operates two marine terminals within the region, both of which are committed to heavy fuel oil. Additional terminal facilities will not likely be built in the future. Construction within the Halifax-Dartmouth area is regarded as prohibitively expensive owing to unavailable land

sites and stringent environmental considerations. Outside this area, populations are too dispersed to support additional terminal capacity.

73. Trucking imports into the area is only a viable option in pockets near the New Brunswick/Maine border. Generally, the costs of trucking product are considered excessive.

74. **Quebec:** Quebec has the greatest access to marine shipments due to the existence of ample independently operated terminal storage, operating on a year-round basis.

75. Two large independents own marine terminals in the province and import on a regular basis. By having access to marine terminals these independents can credibly threaten to import large volumes of refined petroleum product at the expense of domestic refiners' refinery utilization rates. One of these independents, Les Huiles Norco Lt e. ("Norco") also acts as a wholesaler, supplying a large portion of Quebec independent resellers' volume needs. By giving smaller independents immediate access to imported marine cargoes, Norco's activities have likely forced a reduction in domestic refiners' Montreal rack prices.

76. Both large independent importers are capable of importing significantly more refined products than they do

presently owing to existing under-utilization of storage and throughput capacity. Adequate storage facilities exist should demand for increased amounts of imported product arise. In fact, in the early months of 1989 when Shell's Montreal refinery was experiencing supply difficulties, imports offset any potential market shortage of refined product.

77. Given ready access to affordable marine cargo imports, independent marketers would need to be located quite close to the U.S. border to make trucking product economical. Trucking product from Albany, New York to Montreal appears to be too expensive to be considered a viable alternative.

78. There is no statistically significant difference in rack prices between the U.S. Gulf Coast and Montreal which cannot be accounted for by transport costs. A change in the U.S. Gulf Coast rack price is, in time, fully reflected in the Imperial rack price. Prices do not, however, react immediately. Mean adjustment lags were found to range between 8 and 21 weeks. The considerable amount of time needed to schedule cargo deliveries and the significant inventory financing costs involved in importing compounded by risk aversion are thought to explain most of the adjustment lag.

79. **Ontario:** Storage and transportation facilities for marine shipments are presently more limited in Ontario than in

Quebec. Despite a larger number of independent terminal operators, total accessible marine tankage designated for motor gasoline use is roughly one-third that available in Quebec. Additional limitations on throughput include smaller sized cargoes and the shorter navigation season.

80. Nonetheless, Ontario independent terminal operators could expand their importing activity by utilizing existing excess storage and throughput capacity. Importing by marine cargoes is estimated to be capable of expanding to supply five times what Ontario independent resellers imported in 1988. Importing by truck is extensive in the Southern Ontario region but expansion of this activity depends on the availability of supply within the western New York State market. The existence of a large number of brokers and wholesalers alone does not necessarily guarantee independent marketers access to an alternative source of product supply. Viable alternatives will only be available if sufficient supplies of foreign-sourced product may be accessed by independents either directly or through brokers and wholesalers.

81. Currently, U.S. refined product is only exported to Canadian independent marketers on a spot basis when excess product exists. Hence, sales are sporadic and somewhat seasonal. U.S. refiners and terminal operators are willing to increase export activity to Canada should price differentials make this

desirable. Sufficient excess capacity appears to exist within the present distribution system to satisfy any additional demand for product Canadian independent marketers may seek. Excess capacity exists in two of the main pipelines serving the western New York State area. In addition, adequate quantities of spare terminal capacity exist within the Buffalo area to serve Canadian independent marketers' requirements. Increased liftings by Canadian independent marketers at Buffalo terminal points are unlikely to result in severe border congestion. New York State road weight regulations force tankers to transport only 28,000 litres a trip.

82. Foreign supplies respond to domestic-foreign price differentials. Canadian refiners are effectively signaled that their prices are too high relative to imports when resellers shift their liftings from domestic sources to foreign. Wholesales prices are subsequently reduced, albeit with a time lag, by domestic refiners increasing discounts or lowering rack prices.

83. **Prairies:** Imports are minimal at best. Truck transport would only be feasible for communities located close to the border.

84. **British Columbia:** Importing by marine cargo is conducted on a regular basis by only one large independent

located on Vancouver Island. Additional activity is not expected given a scarcity of independently operated marine terminal space. Trucking refined product from Washington State is feasible into the Vancouver area.

3 - TERMINALS

85. Terminal facilities are an essential part of a petroleum product distribution system whether the product is refined in Canada or imported.

86. Terminal distribution systems are designed to move refined products in the largest quantities that are feasible to a point as close to the various customers as makes economic sense. Shipments move from the refineries to terminals by pipeline, ship or railway tank car. From the terminals shipments go by truck or rail directly to customers, or to local bulk plants. Larger volume customers may also pick-up product in their own trucks at a terminal.

87. Independent terminal operators tend to be located in areas where they can receive shipments by marine cargo. Each refiner-marketer operates its own distribution system. Normally, only product owned by that refiner, whether it is from its own refineries, is obtained through exchange agreements with other refiners or is imported, is stored in its terminals.

88. The key to the profitability of terminals is volume throughput which reduces unit operating inventory carrying costs.

89. The main wholesale buyers from terminals are large independents, other integrated petroleum firms via exchanges, and large commercial enterprises such as trucking firms. The terminalling charge for the use of terminals is normally reflected in the price of the product. Independent wholesalers who buy product from a refiner normally gain access to the refiner's distribution system.

90. Environmental considerations, the availability of suitable locations, particularly waterfront property in urban demand areas, and the need for access to a reliable marketing network are barriers to entry at the terminal distribution level of the industry.

91. Imperial and Texaco have 32 and 21 terminals respectively. The Director has identified 14 locations where the acquisition by Imperial of Texaco's terminals is likely to reduce competition. These locations are Dartmouth, N.S.; Charlottetown, P.E.I.; Chatham and Saint John, N.B; Long Ponds, Newfoundland; Baie Comeau and Rimouski, Quebec; Ottawa, Thunder Bay, Sault St. Marie and Sudbury, Ontario; Calgary, Alberta; Victoria and Prince George, British Columbia. In each of these locations Imperial, as a result of the acquisition, would control a substantial portion of terminal capacity for various refined petroleum products.

92. Imperial has agreed to the divestiture of terminals in all of these locations. In the case of Charlottetown, Sault Ste. Marie, and Victoria the sale is conditional on Imperial being able to negotiate terminalling rights for up to 3 years. In the case of Sudbury, Imperial will sell either the Imperial or Texaco terminal pending a detailed supply study. Texaco's five terminals in Atlantic Canada will be offered for sale with the Eastern Passage refinery.

4 - THE RETAIL GASOLINE MARKETING SECTOR

93. Refined petroleum products and motor gasoline in particular are a vital component of the Canadian economy. Approximately 98% of total energy demand in the Canadian land transportation sector is met by refined petroleum products, for which there are currently no economically viable, widespread substitutes. Motor gasoline is the single most important petroleum product in terms of production (37%) for the petroleum industry. Approximately 85% of domestic motor gasoline sales are to consumers at the retail level. Canadian gasoline demand is approximately 29 billion litres per year.

94. Participants in the retail gasoline marketing sector range from large national marketers such as Imperial and Texaco, to single service station operations. Within this range, participants can broadly be divided into three categories as follows: national integrated, regional integrated, and independent marketers.

95. The independent category generally includes those gasoline retailers who do not have an ownership interest in a refinery and who obtain their gasoline supplies from either the domestic refiners or import sources. Turbo Resources and Parkland Industries are recent examples of two independent gasoline marketers who have integrated backwards into refining in

order to secure a reliable, captive source of gasoline supplies. The independents' marketing strategy usually relies upon low price and high volume. The independents place less emphasis on advertising, promotion, image and credit card services than the integrated oil companies. They compensate for this by cutting prices below those charged by branded marketers for similar offerings. The independent group includes large well known marketers such as Canadian Tire, Mohawk Oil, Sergaz and Sunys which have significant networks in excess of 100 outlets and very small operators with single outlets.

96. The majors have an ownership interest in one or more Canadian refineries and retail gasoline through a combination of company-owned and dealer-owned outlets. The larger firms have developed well recognized brands which they support through extensive advertising, promotion and credit card programs. Imperial retails gasoline in Canada under the Esso brand.

97. There are three main types of retail stations selling branded gasoline:

(i) refiner-owned and <u>operated</u> where the company sets the pump price.

(ii) refiner-owned outlets that are leased to a dealer and where the authority to set pump prices will depend on

the particular contractual arrangements which vary within and among companies.

(iii) independently dealer-owned and operated outlets where there is often a cross-lease arrangement and the authority to set pump prices depends on specific contractual arrangements.

98. The number of company-owned and dealer-owned stations selling gasoline under the brands of the refiners varies by company. For example, Imperial, out of a total network of 3118 outlets has 976 company owned outlets and 2142 (or 69%) independent dealer-owned outlets. Texaco, out of a total network of 2023, had 942 company owned outlets and 1081 (or 53%) dealer-owned outlets.

99. Contracts between the oil companies and dealers who own their own stations are normally for five years duration and require exclusive dealing with respect to motor gasoline. The oil companies frequently offer financial incentives to dealers to sell under their brand. These financial incentives may take many forms including cross lease rental payments or loans for the purposes of upgrading outlets or acquiring equipment. When their contracts expire, dealers are free to seek alternative branded or unbranded suppliers.

100. Company-owned and operated stations tend to be concentrated more in urban areas and have on average higher volume throughputs. Dealer-owned and operated branded stations tend to be more prevalent in rural areas.

101. All Canadian petroleum refiners are to various degrees vertically integrated into gasoline retailing. The development of captive retail networks provides the refiners with an assured outlet for significant portions of their gasoline production. The RTPC noted that vertical integration provides advantages in planning output and investment to the extent that it allows refiners to stabilize demand for their output and better predict their sales.

102. The retail gasoline marketing sector has undergone a major transformation over the past two decades. The number of gasoline outlets in Canada has declined dramatically. In 1970, there were approximately 36,000 retail gasoline outlets in Canada. By 1988, this number was reduced to 19,283, a decline of 47%. This decline in the number of retail outlets results from rationalization programs carried out by virtually all of the integrated marketers. As a trend, older inefficient service stations have been closed and replaced in fewer numbers by high volume stations, particularly self-serve outlets.

103. Reductions in Imperial's and Texaco's networks are representative of what has occurred:

TABLE 1

NUMBER OF TEXACO AND IMPERIAL RETAIL GASOLINE OUTLETS 1970-1988

	1970	1975	1980	1988	Decrease %
Imperial	6,752	5,457	4,386	3,118	54%
Texaco	4,600	4,444	3,538	2,023	56%

(RTPC p.309, company documents)

104. The RTPC in its 1986 report Competition in the Canadian Petroleum Industry noted that the transformation that has taken place in the retail networks of the integrated oil companies, in part, "was goaded by the serious competitive threat of independent marketers which caused the integrated marketers to seek to lower distribution costs to more competitive levels" (RTPC p.319). The importance of the independent sector to competition in retail gasoline marketing is much greater than might be inferred from comparing the market shares of the independents to those of the refiner-marketers.

105. One result of rationalization in the retail gasoline sector has been an increase in the average volume sold per outlet. For example, the RTPC found that average volume

throughputs increased by 54% for the industry between 1970 and 1980 (RTPC p.310). Because retail gasoline outlets have a high percentage of fixed operating costs, average volume throughputs are the key measure of efficiency.

106. Other changes in the retail gasoline marketing sector over the past several years have included widespread acceptance of the self-serve offering, a shift away from combining automobile service with gasoline sales (partly due to changes in automobile service requirements and the emergence of specialized repair outlets), and more cross-merchandizing of gasoline sales with convenience stores, car washes and other offerings.

107. The independent sector has also undergone change. The independent sector as a whole has grown (except in Atlantic Canada) and some firms have expanded their operations into relatively large chains, partly by acquiring directly or by supplying smaller independents. The RTPC observed that independents with fewer than five stations have virtually disappeared in most cities (RTPC p.231).

108. While the oil companies endeavour to differentiate their gasoline through advertising and promotional activities, the RTPC found that in 1985 gasoline produced by Canadian refiners was homogeneous and fungible and that gasoline purchased by independents was exactly the same as that which refiners

supplied to their own marketing departments and to other refiners under exchange, processing and purchase agreements (RTPC, pp.295-8).

109. Competition in retail gasoline marketing is influenced by a number of factors, the most important of which are wholesale supply conditions in terms of excess domestic refining capacity, or the availability of competitively priced imports. Local entry conditions and the relative presence of independent marketers can also affect the competitive situation in retail gasoline markets.

110. Most retail gasoline sub-markets are oligopolistic in that the number of participants is sufficiently small that each must take into account that anything done to affect relative sales, such as direct pump price reductions or the offering of coupons which may also involve a discount at the pump, will likely draw a competitive response.

111. Gasoline purchases by consumers are sensitive even to small changes in the relative prices of gasoline offerings. The knowledge that a price reduction is likely to be matched quickly by close competitors can tend to inhibit pricing initiatives. However, virtually all retail gasoline outlets have the capacity to sell more gasoline and because most operating costs are fixed, marketers have a strong economic incentive to maximize their

sales volumes. A retailer who posted a price above market levels for equivalent offerings would expect to lose sales volume which would, given the economics of gasoline retailing, have a serious negative impact on profitability.

112. The issue of the refiners' control over retail prices was of particular concern to the RTPC which found that such practices tended to lessen competition.

> "Supply relationships between majors and independents which give the majors control over the prices charged at independents' outlets, or which prevent independents from shopping for gasoline because they are bound to a supplier as a condition for gaining access to a site, are a particular source of concern to the Commission." (RTPC, p.321).

113. Within the past three years, Imperial and other firms in the industry, including Shell and Suncor, have moved away from marketing and supply practices by which they obtained control over retail prices charged by their branded dealers and some independents.

114. In 1985 Imperial introduced a wholesale pricing policy for its branded dealer network which involved the elimination of consignment selling and the reduction of commission agency arrangements under which Imperial set pump prices. Imperial also eliminated agency arrangements with independents. These practices have been replaced by buy-sell arrangements under which

the dealers establish pump prices. In 1983 Imperial posted pump prices for 83% of its branded retail volume. In 1988 this volume amount was reduced to 53%. In 1988 Imperial posted pump prices at 28% of Esso outlets.

115. An estimated 70% of typical suburban consumers purchase most of their gasoline within two miles of where a person lives. Since consumers expect prices for particular gasoline offerings to be similar across trading areas, location is the most important factor affecting a consumer's gasoline purchase decision. Trade areas for retail gasoline outlets tend to intersect in most urban areas and, therefore, a pricing initiative in one localized market can quickly be transmitted across a larger area. There can be a domino effect as stations, particularly along well travelled roads, respond to changing prices.

116. A review of 1987 retail gasoline market shares for Canada and by province, except for Atlantic Canada which is treated for purposes of analysis as a region, shows that in all areas of Canada except Ontario and the Atlantic, Imperial will become the largest retail gasoline marketer. In Ontario it will be a close second to Petro-Canada and in Atlantic Canada a close second to Irving Oil. The share occupied by independent marketers varies across the country from a low in Atlantic Canada of 4.5% to a high of 42% in Alberta.

117. In 57 of 122 urban areas where detailed information was examined, Imperial would, by adding Texaco's share, have in excess of 25% of the sales by volume. In 26 of these survey areas, Imperial plus Texaco would account for greater than 30% of retail gasoline sales.

118. Imperial and Texaco have retail gasoline marketing networks with representation in all ten provinces. Imperial also has retail gasoline outlets in the Yukon and the Northwest Territories. There are no Texaco outlets in the Territories. The other national majors, Shell and Petro-Canada also retail gasoline in most parts of Canada.

119. In addition to the national majors, there are at least two regional refiner-marketers operating in each of the provinces along with the independent firms which may have local, provincial or regional representation depending upon the particular chain.

120. The representation and market shares of the national majors, the regional refiner-marketers and the independents varies by and within provinces and local sub-markets.

121. <u>Quebec</u>: In Quebec, Imperial, Texaco, Shell and one regional refiner, Ultramar, have retail gasoline shares ranging between 12 and 18 percent. Irving and Sunoco also market in

parts of the province. There are a significant number of independents operating in Quebec. For example, there are 23 independent brands operating 360 retail outlets in the City of Montreal. The largest and best known independent in Quebec is Sergaz which has chain of over 225 outlets. Overall the independents account for approximately 18% of the Quebec retail gasoline shares.

122. **Ontario**: In Ontario, Petro-Canada has the largest retail gasoline share approximately 25%. Imperial, Texaco and Shell have shares greater than 10%. Sunoco is the only regional refiner marketer with a significant share of the Ontario market at approximately 8%. Ultramar and Husky have representation in a number of local markets. Independent marketers account for approximately 22% of the Ontario market. There are a number of large independent chains operating in Ontario including Sunys, Pioneer, Cango, and Mr. Gas. Canadian Tire also has a significant presence in a number of Ontario communities.

123. **Prairies**: In addition to the four national majors, regional refiner-marketers operating in the Prairie regions include Husky, Turbo, Federated Co-op and Parkland Industries. Across the prairie provinces the independents' collective share is in the 35% to 42% range. Mohawk, Domo and Autotec are independent chains with representation in a number of areas.

124. **British Columbia**: A regional refiner, Chevron, is the largest retail gasoline marketer in British Columbia with approximately 20% of sales. Imperial, Shell and Petro-Canada have shares in excess of 15%, while Texaco's share is approximately 5%. Two other regional refiner marketers, Turbo and Husky have a minor presence in the province. The independents account for approximately 20% of British Columbia's retail gasoline sales. One of the largest independents is Pay Less Gas which is the biggest retail gasoline marketer on Vancouver Island.