CT-00/

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Commissioner of Competition for a consent order pursuant to sections 92 and 105 of the *Competition Act,* R.S.C. 1985, c. C-34;

AND IN THE MATTER OF the proposed acquisition by Ultramar Ltd. of a petroleum product terminal facility and wholesale supply business located in Ottawa currently owned by Coastal Canada Petroleum Inc.;

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

ULTRAMAR LTD.

Respondent

CONSENT ORDER IMPACT STATEMENT

---

1. This Statement is filed by the Commissioner of Competition (the "Commissioner") pursuant to paragraph 77 of the *Competition Tribunal Rules*. It describes the circumstances surrounding the Draft Consent Order ("DCO") and its anticipated effect on competition. The DCO is submitted by the Commissioner, with the consent of the respondent.

NATURE AND PURPOSE OF THE PROCEEDING

2. The DCO is designed to eliminate the substantial lessening or prevention of competition that, in the absence of the DCO, would be likely to arise in the wholesale supply and terminal markets for refined petroleum product in the Ottawa region, as described in paragraph 1 of the Statement of Grounds and Material

Facts ("SGMF"). The Commissioner requests the Competition Tribunal's approval of the DCO pursuant to sections 92 and 105 of the *Competition Act* ("Act"), in order to require that Ultramar Ltd. ("Ultramar"), (1) continue to offer wholesale supply of refined petroleum product to the independent marketers, during the period of the DCO, (all as defined in paragraph 2 of the SGMF) at commercially reasonable wholesale prices, (2) maintain the use of the facility (as defined in the DCO) thereby keeping it in the market, and (3) ensure suitable terminal capacity and loading facilities are available for the supply of product to independent marketers.

EVENTS GIVING RISE TO THE POTENTIAL IMPACT ON COMPETITION

3. On July 29, 1999, Ultramar publicly announced that it had signed an agreement with Coastal Canada Petroleum, Inc. ("Coastal") pursuant to which Ultramar would acquire Coastal's petroleum product terminal facility (the "Coastal facility" or "facility") and Coastal's refined petroleum product wholesale supply business in the Ottawa region (the "proposed transaction"), all as defined in the SGMF.

4. Included in the assets to be purchased are the land, the terminal facility, the customer list and the refined petroleum product inventories on hand at the closing of the proposed transaction.

5. On closing, Ultramar would assume all of the environmental liabilities associated with the terminal as well as the existing supply agreement between **#**, as more fully set out in the SGMF, and Coastal would exit the market.

6. Ultramar is a subsidiary of Ultramar Diamond Shamrock Corporation ("UDS"). UDS is a refiner, wholesaler and retailer of refined petroleum product in the United States and Canada.

7. Ultramar currently owns and operates, in Canada, a refinery in St-Romuald, Quebec, which has a current capacity of 160,000 barrels (25.5 ML) per day, which Ultramar plans to increase. It also owns various petroleum product storage and distribution facilities and a network of approximately 1,280 outlets for gasoline and

diesel fuel as well as operations providing home heating oil direct to households. Ultramar also has a wholesale, commercial and industrial business. Ultramar's operations are located in Quebec, the Atlantic provinces and Ontario.

8. In the Ottawa region, Ultramar owns a refined petroleum product terminal, located adjacent to the Coastal facility, which has been inactive since 1995. Ultramar's inactive facility has a storage capacity of approximately 232,000 barrels (36.9 ML).

9. In the Ottawa region, Ultramar also owns, operates or acts as principal supplier to, approximately 63 retail outlets and sells refined petroleum product to industrial, commercial and residential accounts by shipping refined petroleum product principally through an Ottawa region terminal owned and operated by Imperial.

10. Coastal is incorporated under the laws of the province of New Brunswick and is a wholly owned subsidiary of Cosbel Petroleum Corporation, which is a wholly owned subsidiary of The Coastal Corporation. These latter two companies are incorporated in the state of Delaware, United States.

11. The Coastal facility currently has a product storage capacity of 240,000 barrels (38.2 ML) as well as support marketing operations and a “cardlock operation”, which is a card-activated fuelling facility for commercial trucking fleets. At the Coastal facility, refined petroleum product is loaded for shipment by tank truck via three top loading arms for distillates, ten bottom loading arms for gasoline and distillates, and two bottom loading arms dedicated to the blending of fuel ethanol and gasoline. Top loading arms are important for some independent marketers which currently operate tank trucks designed to receive distillates at the top.

12. Due to its age and current condition, the facility requires investment. Additionally, new safety and environmental standards will come into force December 31, 2000 under the *Gasoline Handling Code*, O. Reg. 521/93. Therefore, significant capital expenditure will be required in order to keep the facility operational, in a condition of complete compliance.

13. In 1998, Coastal sold approximately **#** of refined petroleum product to purchasers in the Ottawa region. In the Ottawa region, Coastal is the only non-integrated terminal operator and the largest wholesale supplier to independent marketers. Coastal accounts for approximately **#** of the gasoline sales and **#** of the total refined petroleum product sales to the independent marketers. Almost all of Coastal's sales were to independent marketers.

14. Almost all of Coastal's product, except for fuel ethanol and low vapour pressure gasoline blendstock, is purchased from **#** pursuant to a long-term supply contract which will expire on or about **#** The product is delivered to Coastal's terminal via the Trans-Northern Pipeline ("TNPL").

15. The remainder of Coastal's product is offshore refined petroleum product obtained via tank truck from **#**. In 1998, Coastal purchased approximately **#** of low vapour pressure blendstock and premium grade gasoline as well as distillate from **#**. This represents **#** of Coastal's annual requirement.

16. Coastal is the only supplier, based in the Ottawa region, of the equipment and blendstock necessary to blend fuel ethanol with gasoline. Coastal sold approximately **#** of fuel ethanol in 1998 in the Ottawa region.

17. Coastal does not own a refinery in Canada nor does it operate refined petroleum product retail outlets in Canada.

18. The wholesale supply of refined petroleum product to independent third-party purchasers and the provision of terminal facilities for refined petroleum product in the Ottawa region constitute the relevant product markets for the purpose of determining the likely effects of the proposed transaction on competition.

19. All of the major wholesale suppliers in the Ottawa region use terminal facilities. Imperial, Petro-Canada, Shell and Coastal all own and operate terminals in the Ottawa region. Ultramar and Sunoco use the Imperial and Shell terminals,

respectively, for their wholesale operations pursuant to throughput agreements. As previously indicated, Ultramar's terminal is currently inactive.

20. The independent marketers are the only purchasers at the wholesale level which are not vertically integrated or affiliated with a refinery and therefore they are the only non-captive purchasers of refined petroleum product in that market. Integrated marketers receive product either from their own refinery or from a terminal operator designated by their refinery and hence do not purchase in the open market. For these reasons, the non-captive, independent marketers are the relevant market purchasers of refined petroleum product at the wholesale level.

21. The presence, generally, of the following characteristics in the Ottawa region wholesale supply market would provide an opportunity for the exercise of market power by the wholesale suppliers: a) homogeneity of refined petroleum product; b) repeated and frequent interaction among suppliers; c) a small number of firms engaged in wholesale supply; d) posted price transparency; e) multi-market contact among integrated wholesalers; and f) common vertically integrated structure.

22. Other characteristics present in the wholesale supply market which currently limit the extent to which the Ottawa region wholesalers are able to exercise market power are: a) the excess terminal capacity; b) the high fixed costs involved in refinery and wholesale operations, which provide an incentive for high throughput of product; and c) the presence of a vigorous non-integrated competitor. These factors limit the ability of integrated wholesale suppliers to take advantage of the factors described in paragraph 21.

23. Refined petroleum product in the Ottawa region comes mostly from Montreal. Ottawa region wholesalers are somewhat constrained by Montreal area wholesalers with respect to the price they can charge independent marketers, but only to the extent to which the independent marketers can competitively acquire product from other refiners or terminal operators in Montreal and transport it

themselves to Ottawa. Trucking is currently the only alternative mode of transportation available to the independent marketers and involves a significantly higher cost than the pipeline.

24. The current most cost efficient means of transporting refined petroleum product into the Ottawa region terminals from Montreal is through the TNPL, at a cost of 0.35 cents per litre (“cpl”).

25. For an Ottawa region purchaser at the wholesale level, the Ottawa region gasoline rack prices have historically been 0.57 cpl higher than those in Montreal, based on a monthly average between January 1992 and July 1999. In addition, there is an average cost of delivery to a retail station from an Ottawa region terminal of 0.25 cpl. As a result, the total average delivered cost of obtaining gasoline via an Ottawa region terminal operator, which has access to the TNPL, to retail stations in the Ottawa region is 0.82 cpl above the Montreal rack price, based on the same historical average. This compares to a cost of between 0.80 and 1.1 cpl above the Montreal rack price when the trucking option is exercised.

26. Therefore, the available wholesale pricing information indicates that the Ottawa region wholesale suppliers are pricing close to the lowest cost of obtaining refined petroleum product from Montreal terminals by truck. The more efficient pipeline transportation option is not similarly constraining wholesale prices. This indicates, in the Commissioner's view, that the total cost savings of the most efficient mode of transportation (net of any additional terminalling costs) are not being passed on to the independent marketers. As such, the Montreal area wholesalers are only constraining Ottawa region wholesalers' prices to the extent that the Montreal supply is able to enter the Ottawa region by truck, and not by pipeline. Thus, the Montreal supply option has had a limited constraining effect on the Ottawa region wholesale supply market.

27. In addition, transporting refined petroleum product by truck from Montreal area wholesalers is generally less profitable for the independent marketers because of

the additional costs they must incur for the multiple and low-volume delivery stops which characterize their activities in the Ottawa region. This limits the substitutability of the Montreal area wholesalers for Ottawa region wholesalers.

28. As a result of the wholesale pricing information and the transportation inefficiencies described in paragraphs 25 to 27, the Commissioner is of the view that Montreal does not form part of the relevant geographic market for the wholesale supply of refined petroleum product.

THE ALLEGED EFFECTS OF THE PROPOSED TRANSACTION ON COMPETITION

29. Because the independent marketers purchased **#** of their product from Coastal, the combined share of the sales of the integrated wholesalers to the independent marketers would rise from **#** to **#** as measured by sales in the Ottawa region to the independent marketers in 1998. After the proposed transaction, the independent marketers would only have integrated refiners as possible sources of supply in the Ottawa region. Furthermore, after the transaction, each wholesaler would have, to a greater or lesser extent, their own captive network market, diminishing the incentive to supply to independent marketers.

30. Coastal has proven itself to be a vigorous competitor by offering expansive credit terms, stable supply, storage capacity and personalized service to independent marketers. In 1998, virtually all of Coastal's wholesale sales in the Ottawa region (excluding cardlock sales) were to independent marketers.

31. Ultramar has an incentive to reduce its average cost. Because the costs of operating a terminal are largely fixed, Ultramar could do this by reducing its capacity. After the proposed transaction, and once Ultramar has refurbished its own facility, Ultramar would have an incentive to close Coastal’s terminal because of its current condition and maximize throughput at its own terminal. Ultramar could also close both terminals and enter into a throughput agreement with another terminal operator in the Ottawa region. Either strategy would enable Ultramar to

reach the same level of average cost while throughputting less product. The most efficient course of action for Ultramar would be to close both terminals and operate in the Ottawa market via a throughput agreement with a third party. The next most efficient course of action would be for Ultramar to close the Coastal facility, due to its age and condition, once Ultramar has refurbished its own facility. Either of those options would reduce the negotiating leverage and security of supply for the independent marketers.

32. In the Commissioner's view, prices would be likely to increase by up to 0.28 cpl, which is the difference between the maximum cost of transporting refined petroleum product by truck from Montreal (1.1 cpl) and the historical average of the wholesale price differential between the Ottawa and the Montreal rack (0.57 cpl) plus the average cost of local transportation from the terminal to the retail station in the Ottawa region (0.25 cpl). The Commissioner considers that a 0.28 cpl increase is substantial for wholesale prices of refined petroleum product.

33. Additionally, the three top loading arms currently present at the Coastal facility would be removed. Independent marketers require top loading arms for distillates. Removal of these arms would limit the ability of the independent marketers to obtain adequate supply without investment.

34. Coastal is the sole supplier of fuel ethanol to the independent marketers from a terminal in the Ottawa region. Ultramar and other integrated suppliers may have little or no incentive to supply fuel ethanol. If Ultramar stopped supplying fuel ethanol, this could remove ethanol blend gasoline from the range of products offered by the independent marketers and would therefore affect their niche and reduce the diversity of products available to consumers. Therefore, on the basis of the factors enunciated in paragraphs 29 to 33 and in this paragraph, there will likely be a substantial lessening of competition in the wholesale supply market.

35. As a result of the proposed transaction, the only alternative to obtaining refined petroleum product from an integrated supplier in the Ottawa region would be to

truck supply in from Montreal at a cost disadvantage. By removing the possibility of independent marketers obtaining direct access, or access through a non-integrated terminal operator, to competitively priced product from Montreal via the TNPL, the acquisition would prevent a potential price decrease in the Ottawa region wholesale market. Therefore, there will likely be a substantial prevention of competition in the wholesale supply market.

36. With respect to the terminal facilities market, after the proposed transaction, all four terminal operators would be integrated refiners, with similar business incentives and disincentives relative to Coastal. Ultramar, an integrated refiner, would control the currently non-integrated Coastal facility which represents the storage facility currently utilized by the independent marketers.

37. The proposed transaction would also foreclose the last access to non-integrated terminal capacity in the Ottawa region for the independent marketers. This would lessen and prevent competition substantially in the terminal facilities and wholesale markets. Currently, as a non-integrated terminal operator, Coastal provides storage to independent marketers. Access to storage in the Ottawa region for the independent marketers is important because it provides independent marketers with an opportunity to store refined petroleum product bought at low prices (e.g. heating fuel bought during the summer months). Furthermore, terminal ownership would improve stability of supply for independent marketers.

38. It is unlikely that the effects of the proposed transaction on competition, as described in paragraphs 29 to 37 above, would be overcome by timely and effective entry into either of the relevant markets.

39. Barriers to timely and effective entry for the terminal facilities business are high due to regulatory requirements, the sunk cost of constructing a new terminal, and the high cost of environmental insurance.

40. Barriers to timely and effective entry for the wholesale business are also high. A wholesaler requires access to a secure and competitive source of supply and effective storage capacity. After the proposed transaction, exclusion of access to the TNPL and to storage would likely result in higher barriers to entry such that independent marketers which might otherwise enter the market by acquisition of a terminal are unlikely to be able to do so even following a significant and non-transitory price increase. Consequently, the proposed transaction would increase the sunk costs necessary for entry into the wholesale business.

41. In summary, the proposed transaction would likely diminish two of the factors described in paragraph 22 which have served to limit the exercise of market power. First, it would eliminate a vigorous non-integrated competitor, and at the same time prevent the entry of a new non-integrated competitor by raising the sunk costs of entry. Second, post transaction, Ultramar would have an incentive to close the Coastal facility and its terminal, which would lead to a reduction of capacity for Ultramar in the terminal facilities market, thereby reducing its incentives to supply the independent marketers. As a result, the proposed transaction is likely to lessen and prevent competition substantially in the relevant markets.

ANTICIPATED IMPACT OF THE DCO

42. The purpose of the DCO is to ensure that the likely substantial lessening and prevention of competition is removed. Specifically, it would impose behavioural obligations that would ensure that Ultramar continues to offer wholesale supply to independent marketers at commercially reasonable wholesale prices, the role that Coastal had played in the relevant markets.

43. The DCO, if implemented, would ensure that Ultramar refurbishes and re-opens its terminal and that the Coastal facility is preserved in a viable (as defined in the DCO) condition for three years. Additionally, the DCO would ensure that the land and the TNPL connection are preserved for five years. Finally, the DCO would

ensure that an offer of competitive supply of a minimum volume of product to the independent marketers will be maintained for up to seven years.

44. If, within the five years after the date of the order, Ultramar does not utilize sufficient terminalling capacity at the Coastal facility or if Ultramar does not offer to supply a minimum volume to the independent marketers at commercially reasonable wholesale prices, Ultramar would be required to offer to sell the facility. In the event of a divestiture within the first three years after the issuing of the DCO, Ultramar would be required to have the facility in a viable condition, as at closing. If a divestiture were required during the fourth or fifth year after the issuing of the DCO, Ultramar would be required to offer to sell the facility on an “as-is” basis.

45. The DCO ensures that the independent marketers would not be put at a competitive disadvantage as a result of the proposed transaction, by requiring Ultramar to offer to supply a minimum volume of product at a price no greater than the monthly average of the domestic refiners' posted Montreal rack prices for refined petroleum product plus 0.50 cpl.

46. By requiring Ultramar to refurbish and operate its own terminal and by ensuring the continued operation of the Coastal facility, at least during a transitional period, the DCO would ensure that some excess capacity remains in the relevant markets, thus counterbalancing other elements which could facilitate the exercise of market power. In addition, it ensures that the Coastal facility remains in existence and is therefore available for possible entry by acquisition.

47. By requiring Ultramar to maintain excess capacity, the DCO enhances Ultramar's incentive to increase throughput in order to enjoy scale economies at its terminals, rather than decreasing its costs by closing the Coastal facility and possibly its own terminal. This increased supply would benefit the independent marketers as Ultramar does not currently have a substantial retail network in the Ottawa region and would need to deliver the product to an end user.

48. By obligating Ultramar to provide three top loading arms, the DCO ensures the continuation of meaningful access by the independent marketers to distillates in the Ottawa region.

49. Subsequent to the proposed transaction there would be no direct access by non-integrated suppliers to the TNPL in the Ottawa region and the only alternative independent source of supply would be product from Montreal brought to the Ottawa region by truck at a cost disadvantage of as much as 0.28 cpl. Therefore, the DCO ensures that there will be no interruption of service and requires that Ultramar continue to offer wholesale supply to independent marketers at commercially reasonable prices over an extended period.

50. The DCO would require Ultramar to maintain the site in a viable condition for the next three years. It would therefore maintain storage capacity in the market. Additionally, by preventing the dismantling of the facility, the DCO preserves the Coastal site, including access to the TNPL.

51. If Ultramar failed to comply with the terms of the DCO and was therefore compelled to offer to sell the facility, the facility would then be available for purchase to support a wholesale supply business, which would reduce the sunk costs of entry for a purchaser.

52. Under the DCO, Ultramar would be required to maintain a minimum of two loading arms dedicated to the blending of fuel ethanol and gasoline and to offer to supply fuel ethanol. The independent marketers would therefore be guaranteed a secure competitive source of supply of fuel ethanol for the sale of ethanol blend gasoline. This would ensure that the diversity of products available to the independent marketers, and therefore to consumers, would not be affected by the proposed transaction.

53. With respect to the conditions by which any eventual sale of the facility would take place, the DCO ensures that all interested parties have a fair and equal opportunity

to participate in the process. In the event that Ultramar dismantles the facility or part thereof, the DCO also requires that storage tanks be offered for sale for relocation, making these productive elements of the infrastructure available to independent marketers.

54. The duration of the DCO is sufficiently extensive to ensure that the independent marketers can make long range plans based on competitive supply conditions.

CONCLUSION

55. For the reasons presented herein, the Commissioner recommends the settlement and asks the Competition Tribunal to approve the DCO.