

THE COMPETITION TRIBUNAL

IN THE MATTER OF THE *COMPETITION ACT*, R.S. 1985, c.C-34, as amended, and the *Competition Tribunal Rules*, SOR/94-290, as amended (the “*Rules*”);

AND IN THE MATTER OF an inquiry pursuant to subsection 10(1)(b) of the *Competition Act* relating to the proposed acquisition of ICG Propane Inc. by Superior Propane Inc.;

AND IN THE MATTER OF an Application by the Director of Investigation and Research for an interim order pursuant to section 100 of the *Competition Act*.

B E T W E E N:

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

- and -

SUPERIOR PROPANE INC., PETRO-CANADA INC., THE CHANCELLOR HOLDINGS CORPORATION and ICG PROPANE INC.

Respondents

NOTICE OF APPLICATION

TAKE NOTICE that the Director of Investigation and Research (the “Director”) will make an application, as outlined in the Statement of Grounds and Material Facts attached, on a day and place to be determined by the Competition Tribunal, pursuant to s 92 of the

Competition Act (the “Act”) for:

- (a) an Order or orders against the Respondents pursuant to s. 92 of the *Competition Act* dissolving the acquisition of ICG Propane Inc. (“ICG”) by Superior Propane Inc. (“Superior”) (the “Merger”) or such other remedial orders as may appear just including the disposition of assets or shares under s 92 as the circumstances may appear. And in particular:
 - i) pursuant to s 92 (1)(e)(i) of the Act and order directing the Respondents to dissolve the Merger in such manner as the Tribunal may direct;
 - ii) pursuant to s 92 (1)(e) (ii) of the Act, an order directing Superior to dispose of all of the shares and assets of ICG and the merged entity or as designated by the Tribunal and in a manner as the Tribunal may direct;
 - iii) pursuant to s 92(1)(e)(iii) and s 105 of the Act any other order that the Tribunal considers appropriate;
 - iv) such further order as the Tribunal deems advisable under s 92 and in particular s 92 (1) (f) and s 99 of the Act;
 - v) such further or other interim orders as may be appropriate.

AND TAKE NOTICE that if you do not file a response with the registrar of this Tribunal within thirty days of the date upon which this application is served upon you, the Tribunal may, upon ex parte application of the Director, make such order as it may consider just.

The addresses for service of the respondents are:

Superior Propane Inc.
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All other Respondents

c/o Petro-Canada Inc.
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DATED at Ottawa, Ontario, this 7th day of December, 1998.

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Statement of Grounds and Material Facts

1. This application is brought pursuant to s 92 of the Competition Act (“Act”) to dissolve or otherwise remedy the undue lessening or prevention of competition in the market for propane in Canada that will ensue upon the implementation of the acquisition of ICG by Superior on Monday December 7, 1998.

2. On July 14, 1998, Superior submitted a short-form prenotification filing pursuant to section 121 of the Act to the Bureau regarding its proposed acquisition of all of the shares of The Chancellor Holdings Corporation (“CHC”), a wholly owned subsidiary of Petro-Canada. CHC, in turn, owned ICG. The prenotification filing included documents setting forth information about the Merger:

- (i) Superior is a corporation constituted under the laws of Canada and is engaged primarily in the retailing and wholesaling of propane, and the sale of propane consuming appliances and equipment and related services in all 10 provinces and territories. All of the outstanding shares of Superior are owned by the Superior Propane Income Fund (“the Fund”), a limited purpose trust established for the purpose of holding the debt and equity of Superior. The fund has issued trust units which are listed on the Toronto Stock Exchange.
- (ii) ICG is a corporation constituted under the laws of Canada and is engaged in selling and distributing propane and providing related services to customers in all Canadian provinces and territories except Prince Edward Island, Newfoundland and to a lesser extent Nova Scotia. ICG operates through a network of company-owned distribution outlets and independent dealers

located throughout its sales and distribution area. In 1990, Petro-Canada indirectly acquired ICG and combined Petro-Canada's retail propane operations with ICG's business.

THE MERGER

3. The Merger was scheduled to close on October 30, 1998 and, failing closing, the parties' Definitive Share Purchase agreement stipulates that the parties may terminate their respective obligations to proceed with the Merger by December 15, 1998. The parties had agreed to give the Bureau 21 days notice of their intention to close pending the Director's inquiry. Such a notice was provided to the Director on October 9, 1998, signifying the parties' intention to close on October 31, 1998. The notice was conditioned upon the Director providing an undertaking to provide his preliminary views by October 30, 1998, which accorded with the previously announced schedule by which the Director would provide preliminary views at that date and final views at November 30 1998. It was additionally conditioned upon the Director entering into discussions leading to a final resolution of any outstanding issues, or an interim arrangement that would permit the closing of the transaction subject to whatever terms could be agreed upon. On October 14, 1998, the Director rejected the proposal, given the seriousness of the competition concerns raised by market checks and by the Director's inquiries to date. On October 16, 1998, the parties withdrew their notice to close.

4. More recently, on November 16, 1998, the parties provided a further notice stating their intention to close the transaction on December 7, 1998. The Director provided his final views to the parties on November 30, 1998. On Sunday December 6 1998 the Tribunal made an order dismissing the Director's application under s 100 of the Act seeking an order forbidding the closing for a period of 21 days pursuant to the Act. It is expected that the parties will proceed to the closing of the Merger on Monday December 7 1998 as forecast.

THE INQUIRY

5. An inquiry into this Merger was commenced by the Director on August 14, 1998, pursuant to section 10 of the Act. On the same day Bureau staff met with counsel for the parties and reiterated that the Merger raised serious competition concerns.

6. The Merger would combine the only two national propane companies in Canada, resulting in a national market share of over 70%. The Inquiry was commenced following an initial review which indicated substantial competition concerns. In a number of geographic markets the transaction will result in the merged entity attaining a monopoly. In many of the remaining markets, the parties will have a very high market share, frequently in excess of 65%. Barriers to entry and exit include, *inter alia*, the mature nature of the market, long-term customer supply and equipment rental contracts, reputation, access to supply and equipment and significant sunk capital cost and time involved in building the business.

7. The preliminary examination and the Inquiry into the Merger has included the following:
 - (i) a review of the prenotification filing and Competition Analysis from the parties to the Merger and their recommendations regarding interim hold separate and non-dissolution structures;

 - (ii) industry contacts by telephone, in-person interviews with, and written responses to questionnaires from customers, competitors, industry associations, provincial and territorial governments and others related to the industry;

- (iii) meetings with counsel and senior officials of the parties, by telephone conference or in-person, to provide and obtain information about the Merger and to discuss emerging issues;
- (iv) a review of information returns and documents from the parties compelled by formal powers under s. 11 of the Act;
- (v) a review of examinations of representatives of the parties pursuant to orders obtained under s. 11 of the Act;
- (vi) a review of the parties' supplementary economic and legal submissions;
- (vii) a review of the over 90 unsolicited complaints received from the public regarding the Merger (a figure rarely, if ever, before reached in past transactions reviewed by the Bureau);
- (viii) a review of analyses and reports from experts retained by the Bureau; and
- (ix) analysis of in-house economists.

8. Concerns expressed in the Director's market checks regarding the Merger include:

- (i) The likelihood of substantial price increases and service deterioration in the supply of propane in markets with a high degree of overlap, especially in rural and remote areas, including markets where the merging parties are the sole suppliers;
- (ii) The amassing of market power post-merger which will make competitive entry increasingly difficult;

- (iii) Because of the high cost of switching to alternative fuels, substantial likelihood of becoming captive to a supplier with substantial market power;
- (iv) The reinforcement of practices designed to make switching of suppliers costly including charges to terminate supply contracts;
- (v) The concentration of national accounts and many local markets into the hands of one entity.

MARKET DEFINITION

9. The relevant product market is the supply and delivery of bulk propane; the supply and delivery of propane equipment (or accessories); and service and maintenance of propane equipment (or accessories) to retail and wholesale customers. Product markets may be further broken down into the following categories: residential, commercial, industrial, agricultural, automotive, wholesale, and national and major accounts. National accounts are those national buyers who require delivery of propane across large geographic areas. There appear to be administrative economies to large, multi-location customers in contracting with one supplier for the supply of propane.

Alternative fuels do not appear to be a reasonable alternative for some end-uses. In local geographic markets where natural gas is not present or has a limited presence the best alternative to propane is heating oil or electricity. For both alternatives there are substantial switching costs and qualitative attributes which make propane a preferred product for certain customers.

10. The relevant geographic markets are considered to be local markets centred around branches/satellites, with the exception of national accounts where the relevant geographic market includes the supply and delivery of propane and auxiliary products to retail and

wholesale customers throughout Canada or in several provinces.

COMPETITIVE EFFECTS OF THE MERGER

11. The Merger will create a dominant national and, in many markets, local propane marketer.

12. The propane market in Canada is valued at approximately \$1 billion. It is difficult for customers to switch easily and cost effectively to an alternative type of fuel, in the event of a substantial price increase. Customers in many areas are captive to propane. Thus in some local markets, customers are likely to tolerate a 5% price increase in light of the switching costs to alternative fuels.

13. Alternatively, in many local markets where Superior and ICG have a dominant position (i.e. a large share of installed customer base), there is evidence that propane prices are constrained more by the switching cost of alternative fuels than by prices of other propane retailers. The constraint of propane prices by the switching costs to alternative fuels is more a consequence of inter-dependent pricing behaviour of Superior and ICG than of the relative substitutability of propane to alternative fuels.

14. The conditions in the propane industry are conducive to the likelihood of inter-dependent behaviour. These conditions include: small number of local competitors, barriers to entry, homogeneous product, relatively stable demand, good information in the market about who has which customer and about prices (transparency of prices) and participation in multiple markets. Moreover, in this industry there is a history of explicit coordination. These conditions facilitate successful forms of collusion as well as less formal forms of cooperation such as conscious parallelism. This merger will entrench this inter-dependent behaviour.

15. Propane is a byproduct of natural gas and crude oil production. It is a niche fuel, having unique energy and physical properties. It is transportable in bulk as well as by pipeline. In many applications it is subject to displacement by natural gas, where natural gas pipeline networks are available. It is cheaper in most provinces and more reliable than electricity. It is cleaner and generally more expensive than fuel oil. Certain uses are essentially unique to propane: agricultural and other drying uses in those areas where natural gas is not easily available, heating in remote confined areas (such as construction sites, mines, oil wells and forestry operations), portable home use (BBQ) and non polluting fleet automotive use. It is also a mature market with a stable sales and distribution pattern.

16. Fringe and regional competition exists in some local markets. But where significant overall, sustained, competition exists, it is primarily between the merging parties. Both parties operate dual distribution systems, wholesaling product to agents and also competing against them in the same geographic and product markets.

17. While the supply of propane is plentiful, there are peak periods where the merging parties are better able to deal with demand. The scale of the merging parties' operations, and their organizational advantages in the transportation, distribution and storage of propane, give them a competitive edge. They are also able to secure discounts and preferential supply through "keep dry" (akin to take or pay) arrangements with certain refiners, and in the case of ICG, vertical arrangements with Petro-Canada. The benchmark price of propane at the supply point is governed initially by North American postings. There is, accordingly, outside of the supply arrangements available to the merging parties, a fundamental transparency to propane supply pricing at its source.

18. The necessary tank, haulage and distribution equipment is purchased in bulk by the parties. Unused or outmoded equipment is generally scrapped or sold out of market. The parties qualify for private contract rates with national railways for the transport of propane

by tanker car.

19. National accounts, such as gasoline retailers, national forestry, mining or manufacturing concerns are frequently captive to the merging parties. Their ability to provide multi-market billing and monitoring services and consistent supply with central sales, places them in a unique position to capture this “core” business. Many major accounts are similarly dependent upon the parties.

20. The Director has concluded the Merger would likely lessen or prevent competition substantially in the supply of bulk propane, equipment and service maintenance of propane equipment and accessories to retail customers, due in part to the merged entity's extremely high post-merger market share, and the ability to exercise market share; the high barriers to entry and the fact that remaining competitors cannot, in many markets, be relied upon to constrain or reduce prices given the above factors and the frequency of interdependent behaviour of the propane industry in Canada.

MARKET SHARES

21. Superior operates in approximately 120 local markets . ICG operates in approximately 110 markets.

22. The Director has determined from all sources, that of 80 markets (as defined by Superior’s branch boundaries) analysed to date, 58 markets will result in market shares of the merged entity of over 35 % market share; of that 47 are over 65%; 26 over 80%; and 17 over 90%. There are also 8 markets in which there is a monopoly. ICG operates in approximately 14 markets where Superior presently does not operate.

23. National, major and direct accounts represent about 22% of total sales of the parties, which is about 16% of the total Canadian volume of propane sales. The merged

entity would virtually be the only practical source of supply for national accounts.

24. There are a significant number of local markets where the merged entity would be the dominant source of supply at wholesale and retail of propane and related equipment and services.

ENTRY CONDITIONS

25. There are a variety of entry barriers to this industry which, in combination, make effective entry unlikely. Significant entry considerations include the long-term restrictive contracts which provide the holder with exclusivity over the refilling of their own tanks. There must be switching costs associated with going to an alternative provider of propane because it is necessary to have one firm's tanks removed and replaced with another firm's tank. The industry is mature and has experienced slowly declining demand in certain markets in the recent past; time would be required to obtain the necessary permits to install storage capacity; time and resources would be required to enlist customers in a business where participants agree that a reputation for reliable service is a significant competitive asset. To the extent that contractual restrictions related to equipment rental limit the ability of many customers to switch suppliers in the short-run, this causes further delay in substantial entry. Even short-term contracts could indirectly discourage entry, since it implies that new entrants may have to operate for a period of time at well below minimum efficient scale while they wait for additional potential customers to come "on line".

26. There are significant contractual barriers, with restrictive terms including lengthy initial terms (a minimum of one year, with the bulk of the contracts having a duration of 3 to 5 years) automatic renewal, liquidated damages, right of first refusal and right to compete clauses, equipment removal costs and exclusivity clauses. Customers are less likely to switch suppliers. Both parties have a large contracted base of customers; an

estimated 95% of Superior's customers are under contract, and ICG strives to place all of its customers under such restraints.

27. Competitors are likely to face increased costs through the merged entity's potential control of the supply of propane and equipment.

28. The proposed merger would also increase the likelihood that the dominant firm will exert market discipline which could be manifested by such actions as selective price cutting and targeting competitors in certain markets. In addition, new or existing competitors would likely face economies of scale of the merged entities' route densities and higher relative cost of supplies.

EFFECTIVE REMAINING COMPETITION

29. Remaining competitors in most local markets are small and provide fragmented competition. They have limited market reach and capital restraints and as such have very little scope to bid on either capital intensive or national accounts. A number of competitors only service certain product markets eg. agriculture, rather than servicing, like the parties, a range of end use markets. There are virtually no other competitors to the merging parties for national accounts.

30. Many competitors, particularly in auto propane and cylinder markets, have supply relationships with the parties thereby reducing the vigour of competition through transparency of costs and pricing.

31. Most of Superior and ICG's competitors do not undertake aggressive solicitation of each other's accounts, taking a more passive approach. Additionally, Superior and ICG adhere to a general policy of non-competition, particularly where customers are under contract with competing suppliers. Moreover the parties have acted to jointly to rationalize

their own market dominance and product offerings through swaps and other transactions. This type of inter-dependent behaviour thus extends throughout the industry, resulting in many of the remaining competitors being considerably less effective.

32. In many markets the competitors of the merged entity would more likely act as "followers" of price increases initiated by the merged entity.

REMOVAL OF A VIGOROUS AND EFFECTIVE COMPETITOR

33. The remaining competitors to the merged entity all operate within limited geographic ranges. Many are limited in their marketing and technical capabilities by their size. With the exception of a few markets, the majority of competitors are not providing the same product offering. For example ICG's customer care representatives, automatic fill programs, and fixed price programs are factors which differentiate ICG sufficiently to permit it to be "premium priced" compared to its competitors. Similarly, Superior markets its 7 day/24 hours service, its guarantee that customers never run out of product, and its ability to offer a "service value" to propane customers. This enables Superior to attempt to get "premiums" over most competitors, who generally have a more limited product offering.

34. Both parties recognize that the other is the key "rival". Notwithstanding the existing interdependent behaviour, the parties have, in attempting to rationalize their distribution and marketing networks, sought out the other as the only suitable candidate for a proposed series of swaps of equipment and customer accounts in certain markets. No other candidates were seriously considered. Both parties have a program of vigilant opportunistic acquisitions of smaller competitors.

35. ICG has spent significant sums on restructuring its operations and improving its distribution technology, management and delivery practices.

36. The removal of ICG would mean a virtual monopoly for Superior with respect to national and many major accounts.

37. Large customers have indicated that there has been aggressive price and service competition from ICG in many markets over the past years in the supply of propane. The Merger would remove a vigorous and effective competitor.

CONCLUSION

38. The Director submits that the merger will prevent or lessen, or is likely to prevent or lessen competition substantially in the supply and delivery of bulk propane; supply and delivery of propane equipment (or accessories); and service and maintenance of propane equipment (or accessories) in a number of local markets and in the market for national accounts.

39. Due to the qualitative attributes and switching costs which render propane distinctive from alternative fuels such as electricity, heating oil and wood, and the fact that propane is considered to be in a separate market from natural gas since propane is generally replaced by natural gas upon the latter fuel's entry into a market.

40. The remaining sources of competition are not likely to provide effective competition to the market power of the merged entity in many markets. The merger also removes the only national competitor to Superior, and a vigorous and effective competitor to Superior in local markets throughout the country.

RELIEF SOUGHT

41. In order to remedy the substantial lessening of or prevention of competition in the market brought about by the Merger the Director seeks the following orders pursuant to

section 92 of the Act:

- i) pursuant to s 92 (1)(e)(i) of the Act, an order directing the Respondents to dissolve the Merger in such manner as the Tribunal may direct;
- ii) pursuant to s 92 (1)(e) (ii) of the Act, an order directing Superior to dispose of all of the shares and assets of ICG and the merged entity or as designated by the Tribunal and in a manner as the Tribunal may direct;
- iii) pursuant to s 92(1)(e)(iii) and s 105 of the Act any other order that the Tribunal considers appropriate
- iv) such further order as the Tribunal deems advisable under s 92 and in particular s 92 (1) (f) and s 99 of the Act.

PROCEDURAL

43. The Director requests that the hearing of this application be held in the City of Ottawa , Ontario.

44. The Director requests that these proceedings be conducted in the english language

45. For the purposes of this application service of all documents on the Director can be served on:

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Department of Justice
Counsel to the Director of
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Dated at Hull Quebec this 7th day of December, 1998.

Konrad von Finckenstein
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