

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 for an interim order pursuant to s. 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

AFFIDAVIT OF JOHN PECMAN

I, John Pecman, of the City of Nepean, in the Regional Municipality of Ottawa-Carleton, in the Province of Ontario, MAKE OATH AND SAY:

1. I am employed as a senior commerce officer with the Competition Bureau (the "Bureau") in the Department of Industry Canada, and I am the officer responsible for an inquiry (the "Inquiry") into the proposed acquisition (the "Merger") of ICG Propane Inc. ("ICG") by Superior Propane Inc. ("Superior") made under the authority of the Director of Investigation and Research (the "Director") and pursuant to the provisions of paragraph

10(1)(b) of the *Competition Act* (the "Act"), and as such have personal knowledge of the matters deposed to in this Affidavit. Where such knowledge is based on information that I have received from others, I have indicated the source of this information and verily believe such information to be true.

2. I am a senior commerce officer employed in the Bureau. I hold a degree of Master of Arts in economics from McMaster University, received in 1983. I joined the Bureau in 1984 and have been responsible for a number of inquiries in the criminal, civil, and latterly the merger branches of the Bureau. I was responsible for the Laidlaw Waste inquiry which resulted in orders of the Tribunal in 1992 pursuant to s 79 of the Act. I was also responsible for the ADM/Maple Leaf Mills merger which was the subject of a consent order before the Tribunal in 1996, and the CWS/WMI merger inquiry which resulted in a consent order in 1998. I have received several merit awards from the Director for recognized achievement in the conduct of inquiries. In many of the above applications I have given evidence by affidavit or orally which has been accepted by this Tribunal.

THE PRELIMINARY EXAMINATION

3. The Director was first formally advised of the Merger on or about June 26, 1998, when representatives of Superior sought an indication from the Bureau that the Director would confine himself to non-dissolution remedies in the event that he found that the Merger was problematic.

4. Thereafter, Bureau staff and counsel for the Director held discussions and meetings with the parties and their counsel with respect to the parties' request for an agreement to waive dissolution as a remedy, thereby, enabling Petro-Canada Inc. ("Petro-Canada") (the vendor of ICG) to extricate itself from the Bureau review of the Merger by completing the sale pending the review.

5. On June 29, 1998, the Bureau representatives informed counsel for Petro-Canada that the Bureau would not permit an agreement of dissolution as a potential remedy given the severity of the competition issues and the principle that the Bureau would not approve the sale of ICG prior to the Bureau's analysis in that this would have limited the remedies available to the Director. Counsel for Superior continued to make various proposals to enable the sale to be completed.

6. On July 20, 1998, Superior and Petro-Canada signed a definitive share purchase agreement in which Superior was to acquire all of the outstanding shares of ICG from Petro-Canada for **[COMMERCIAL CONFIDENTIAL INFORMATION]**. Until July 1, 1998, Petro-Canada was attempting to sell its interest in ICG to the public through the ICG Income Propane Fund.

7. 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 owns ICG. Superior also filed a Competition Analysis regarding the Merger. The prenotification filing included documents setting forth information about the Merger. I have reviewed these documents, and based upon this review, state, and do believe, that:

- (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 one territory (Yukon). Documents received during the s. 11 hearing indicated that on October 30, 1998, Superior acquired a propane marketer in the Northwest 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.

8. Counsel for the parties were informed on August 14, 1998 that the Bureau would be in a position to give its preliminary views on the proposed transaction by October 31, 1998, and final views by November 30, 1998.

THE MERGER

9. 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, and to enter promptly thereafter into "good faith" 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, and s. 11 examinations of the parties took place the following week in Calgary. More recently, on November 16, 1998, the parties provided a further notice stating their intention to close the transaction on December 7, 1998. Attached hereto and marked Exhibit A-1 to A-4 are true copies of correspondence communicating the foregoing.

THE INQUIRY

10. 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. Attached hereto and marked Exhibit B to this affidavit is a true copy of a chronology of events in the Inquiry.

11. Due to the complexity and the significance of the Merger to the Canadian propane market, an investigative team of commerce officers, Bureau economists, counsel and experts has been engaged in the analysis of the proposed transaction. The Merger would combine the only two national propane companies in Canada, resulting in a national market share of over 70%. The prompt and thorough analysis of the Merger has been given a high priority by the Bureau.

12. 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.

13. 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) preliminary analysis of in-house economists.

14. As part of the inquiry process the Bureau has interviewed numerous persons including the governments of British Columbia, Alberta, Yukon Territory, Saskatchewan, Northwest Territories, Manitoba, Ontario and Quebec. In particular, serious concern has been raised by the Yukon and Quebec governments. Attached hereto as Exhibit C is a true copy of the submission from the government of the Yukon Territory. In addition, the Director received complaints, comments and inquiries from other organizations against the Merger such as the National Farmers Union. Concerns expressed in such sources regarding the Merger include:

- (i) The fear of 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, fear 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.

15. The Bureau has also conducted a survey of customers through the use of questionnaires. A copy of the customer questionnaire is attached as Exhibit D. The

customer questionnaire was sent to customers drawn from the customer lists supplied by the parties. While there is no suggestion that the questionnaire is scientific, a further explanation of the methodology is contained in a memorandum attached hereto as Exhibit E. The responses of the 705 returned indicated that two of every three respondents had concern about the merger. Another questionnaire was sent to competitors seeking information as to market shares and other commercial information. The competitor questionnaire was sent to the competitors identified by the parties. In total, 76 responses were obtained. Many of the respondents to the latter questionnaire did not view themselves as competitors in Canada of either Superior or ICG.

16. On October 30, 1998, pursuant to the announced timetable of the Director regarding the course of the Inquiry, the preliminary conclusions of the Inquiry were provided during a telephone conference call meeting (which I attended) with counsel for the parties and company officials representing the parties. Mr. James Bocking, Assistant Deputy Director, provided a detailed presentation which reviewed the Inquiry to date. Attached hereto and marked Exhibit F is a true copy of the notes of the said preliminary review as provided to the parties. (The actual oral delivery may have differed slightly from the text). As part of the said timetable the Director had also announced that his final conclusions would be provided on November 30, 1998. Attached hereto as Exhibit G is a true copy of the slidedeck of the final review as delivered to the parties on November 30, 1998. I believe the factual contents of Exhibits F and G to be true as if contained herein and the conclusions and opinions expressed therein accurately reflect those reached by the Bureau in its examination. Portions of Exhibits F and G have been excised for purposes of confidentiality. Unexpurgated versions will be filed herewith at the Tribunal, along with the information in paragraphs 6, 32, Exhibits F and H, and J which are also subject to such request.

MARKET DEFINITION

17. 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.

18. 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

19. The Merger will create a dominant national and local propane marketer.

20. This is a significant transaction. The propane market in Canada is valued at approximately \$1 billion. It appears likely that 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. Thus, the customers in many areas appear to be captive to propane.

21. 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, *in*

extremis, than electricity, and 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 stable or declining market with a mature sales and distribution pattern.

22. 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.

23. The supply of propane is relatively open. However the scale of the merging parties' operations, 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.

24. 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.

25. 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, consistent supply with central sales, billing and monitoring services

places them in a unique position to capture this “core” business. Many major accounts are similarly dependent upon the parties.

26. 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, 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

27. Superior documents drafted prior to the prenotification filing identified 31 out of approximately 120 local markets where the merged entity will have an absolute monopoly. More recently Superior has since identified 40 geographic markets where ICG and Superior have a combined market share of more than 65% of the propane sales. In addition, in seven of those geographic markets the merged entity would have a monopoly on propane sales. In an additional 11 geographic markets the merged entity would have a market share between 50 and 64%, summing to a total of 58 markets with joint market shares in excess of 50%.

28. Based on ICG market share data, the merged entity will have market shares between 90% and 100% in at least 29 local markets. The ICG data also shows the merged entity having market shares between 70% and 89% in 37 additional local markets, and market shares between 51 % and 69% in an additional 21 local markets. There are five markets where the merged entity would have market shares between 35% and 50%. Thus there will likely be post-merger market shares in excess of 35% in 92 markets, out of a total of approximately 110 markets.

29. 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.

30. No matter which party's market share data is used, the fact remains that there are a significant number of local markets where the merged entity would be the dominant source of supply at wholesale and retail supply of propane and related equipment and services. In addition, the merged entity would virtually be the only practical source of supply for national accounts.

ENTRY CONDITIONS

31. There are a variety of entry barriers to this industry which, in combination, make effective entry unlikely. Significant entry considerations are that 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".

32. There are significant contractual barriers, with restrictive terms including lengthy initial terms (a minimum of one year with the bulk of the contracts being between 3 to 5 years) automatic renewal, liquidated damages, right of first refusal and right to compete clauses, equipment removal costs and exclusivity clauses. The "utility" nature of the product promotes the "stickiness" of the customer base. Both parties have a large contracted base of customers; an estimated [**COMMERCIAL CONFIDENTIAL**

INFORMATION] of Superior's customers are under contract.

33. Competitors could face increased costs through the merged entity's potential control of the supply of propane and equipment.

34. The proposed merger would also increase the ability of the dominant firm to 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 Superior route densities and higher relative cost of supplies.

EFFECTIVE REMAINING COMPETITION

35. Remaining competitors in most 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 uses.

36. Many competitors, particularly in auto propane and cylinder markets, have supply relationships with the parties.

37. 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 have referred, in both their documents and the hearings, to a general policy of non-competition, particularly where customers are under contract with competing suppliers. A number of smaller competitors also made reference to this practice. This type of inter-dependent behaviour thus extends throughout the industry, resulting in many of the remaining competitors being considerably less effective.

38. 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

39. 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, when examined under oath, the ICG representatives identified their customer care representatives, automatic fill programs, and fixed price programs as factors which differentiate ICG sufficiently to permit it to be "premium priced" compared to its competitors. Similarly, Superior stated during the same hearing that they market their 7 day/24 hours service, their guarantee that customers never run out of product, and their 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.

40. 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.

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

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

43. 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.

EFFICIENCIES

44. Superior has alleged that significant efficiencies will result from the Merger. Many of these remain to be tested and the Director has considerable concern over both the quantum and nature of the said efficiencies. Attached hereto as Exhibit H is the report of Professor Richard Schwindt, which surveys the efficiencies claimed which were first advanced during the week of October 20, 1998. There is further doubt as to whether the said efficiencies will demonstrably be of benefit to consumers given the lack of competition which will prevail in the markets affected by the Merger.

THE POSITION OF THE DIRECTOR

45. On or about November 23, 1998 the Director was advised by representatives of Superior that it intended to make certain changes in the way that it carries on its business in the event that the merger were to proceed, and that these changes would be announced publicly. They are not acceptable to the Director as a resolution of his concerns. While Superior has indicated that its position is flexible, all discussions would have to be on the condition that the Director would lose his prime remedy, through the closing sought to be restrained by the within application.

46. Of the approximately 90 unsolicited complaints received, about 20 dealt with the deterioration of ICG during the period August to October. As part of the due diligence for the Merger, pursuant to an elaborate scheme to safeguard confidential trade information and marketing practices, identified officers of Superior met with their counterparts at ICG under the ultimate supervision of the CEO of Superior and an officer of Petro-Canada.

Nevertheless, significant concerns were raised by certain individuals familiar with the information sharing process over the transfer of ICG information, competitive activity against ICG customers and the perception that the Merger was a foregone conclusion, ending ICG's immediate future as a competitor in the propane business. Articles appeared in the business press reinforcing this with no rebuttal by ICG officials; notices were given to employees which were equivocal as to the seriousness of the Bureau's concerns and silent as to the ICG future other than as part of Superior. Moreover, customers have advised that Superior representatives have flagged the inevitability of the Merger and suggested the fruitlessness of either not continuing with Superior supply or switching to ICG. Attached hereto and marked Exhibit I is a copy of one of the said articles. Separately filed, as Exhibit J, subject to a request for confidential filing, are copies of the complaints and certain notices received regarding the premature integration of ICG into Superior.

47. I fear that if the transaction closes on December 7, 1998 and the status of ICG is reduced at best to that of an entity operating under a hold separate order, ICG will be further diminished in perception and in reality as an independent marketer capable of acting in its own interest (which by definition must embrace competitive activity to the detriment of Superior), and that it will create a perception the Bureau has "blessed" this transaction.

48. While the Director has reached a state of satisfaction regarding the substantial anti-competitive nature of the merger, he is still analyzing the wholesale market, the definition of product submarkets and the precise nature of the substantial lessening or prevention of competition.

49. Other than specific instances where the parties have closed transactions without the knowledge of the Director, or where the Director has consented to a closing pending the approval or realization of an acceptable remedy, or if the Director's competition concerns were minimal, I know of no other instance where the Director has dispensed with his

remedy of dissolution where he has substantial concerns to the level outlined herein. In fact recent history reveals that the Director has vigorously sought the preservation of such remedy before the Tribunal.

50. The preservation of the distinct ICG entity under independent management as a force in the marketplace (and as a possible vehicle for alternate entry) is the only certain path to avoid the anti competitive aspects of the Merger. The Director is prepared to act with all expedition to bring this matter to an early resolution before the Tribunal.

51. There remains disagreement between the Director and counsel to the parties to the Merger with respect to the appropriate remedy. The Director believes that the anti competitive effects of the proposed merger are so pervasive that the entire transaction should not proceed in any form. As such, the Director is convinced that the only suitable remedy is to block the entire transaction.

52. Given that the parties are determined to close the transaction on December 7, 1998, and the obligations of the Director to complete his review of the matter by November 30, there is insufficient time to complete these tasks and file an application under s 92 of the Act. It is the intention of the Director to file an application under s 92 at the earliest possible time, and, if necessary, to bring a motion under s 104 for an interim order pending the hearing and final disposition of this matter.

Sworn before me at the City of Hull)
in the Province of Québec this ____)
day of November, 1998. _____)

John Pecman

A Commissioner of Oaths in
and for Canada