Competition Tribunal Tribunal de la Concurrence

**CT-1989-003 – Doc # 390**

IN THE MATTER OF an application by the Director on 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.

BETWEEN:

The Director of Investigation and Research
Applicant

and

Imperial Oil Limited
Respondent

and

Attorney General of Quebec
Beacon Hill Service (2000) Ltd.
Atlantic Refining and Marketing Employees Association
and Atlantic Oilworkers Union Local 1
Consumers' Association of Canada
Pioneer Petroleums
Claude Harnois Inc.
Barron Hunter Hargrave Strategic Resources Inc.
Attorney General of Newfoundland and Labrador
Petroles Ronoco Inc.
The City of Victoria
Lyn-Den Distributors
Banff Bulk Fuels Ltd.
Texaco Retail Council, Halifax-Dartmouth Metropolitan Area
Cook's Oil Company Limited

Intervenors

## REASONS AND DECISION

**Dates of Hearing:**

October 16 - November 10, and December 7, 1989

**Presiding Judicial Member:**

The Honourable Madame Justice Barbara J. Reed

**Lay Members:**

Dr. Frank Roseman
Madame Marie-Helene Sarrazin

**Counsel for the Applicant:**

**The Director of Investigation and Research**

George N. Addy
Janet Johnston

**Counsel for the Respondent:**

**Imperial Oil Limited**

John F . Howard, Q.C.
John J. Quinn
Mitchell Wigdor
Alain Lortie

**Counsel for the Intervenors:**

**(a) Attorney General of Quebec**

Yves Bériault
Madeleine Renaud

**(b) Atlantic Refining and Marketing Employees Association and Atlantic Oilworkers Union Local I**

Ronald A. Pink

**(c) Consumers' Association of Canada**
M. James O'Grady, Q.C.
Katherine Young

(d) **Pioneer Petroleums**

Sandra J. Simpson

(e) **Claude Harnois Inc.**

Jean-Robert Laporte

(f) **Barron Hunter Hargrave Strategic Resources Ltd.**

J. Spence Stewart, Q.C.

(g) **Attorney General for Newfoundland and Labrador**

B. Gale Welsh

(h) **Petroles Ronoco Inc.**

Jean Lemoine

(i) **Lyn-Den Distributors**

David G. Newman
Thomas W. Turner

(j) **Banff Bulk Fuels Ltd.**

Philip G. Lister

(k) **Texaco Retail Council, Halifax-Dartmouth Metropolitan Area**

Ronald A. Pink

(I) **Cook's Oil Company Limited**

Ronald A. Pink

**Representatives for the Intervenors:**

(a) **Beacon Hill Service (2000) Ltd.**

E.F. Anthony Merchant

(b) **The City of Victoria**

John Brewin, M.P.

# COMPETITION TRIBUNAL
# REASONS AND DECISION

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***The Director of Investigation and Research***

***v.***

***Imperial Oil Limited***

## SUMMARY

The Tribunal is prepared to approve parts of the order sought but not all of it. A summary of the Tribunal's conclusions appears below together with an index of its reasons.

### Summary of Conclusions

1. The Tribunal is prepared to approve the RDCO filed on November 28, 1989 insofar as the following provisions are concerned:

   (i) divestiture or debranding of the retail outlets identified m confidential schedules 6, 7 and 8, being 346 in number;

   (ii) divestiture or debranding of a further 68 retail outlets in the Province of Quebec which 68 shall be identified by Imperial and notice thereof provided to the Director within 12 months from the issuance of the order.

The terms and conditions on which such divestiture or debranding are to occur are set out in the RDCO and include a requirement that the debranded stations be offered unbranded supply for five years;

(iii) divestiture of the nine terminals listed in schedule 5, i.e. terminals at Baie Comeau, Rimouski, Ottawa, Sault Ste Marie, Thunder Bay, Sudbury, Calgary, Victoria and Prince George, on the terms set out in the RDCO.

As the Tribunal notes in its reasons, while the general criteria respecting retail markets were determinated by the Director the specific stations chosen for divestiture were chosen by Imperial. It is clear that many of the stations would have been closed or debranded by Imperial, as a result of the merger, in any event. This is equally true with respect to most of the terminaling facilities which are required to be divested.

In the light of the evidence concerning the competitive situation which exists in the retail market, there seems little doubt that the divestitures of retail stations, which are being required, are sufficient to meet any competition concerns which may exist with respect to those markets. The Director should undertake to inform the public, in his future annual reports, as to what changes in the structure of the industry result from the divestitures which, pursuant to his request, have been ordered.

2. The supply assurance provisions will be approved providing the following alterations are incorporated therein:

(i) removal of the qualification from paragraph 27 which allows Imperial to refuse supply to any independent who is in default of payment with any gasoline supplier (this does not preclude Imperial requiring normal credit security from independents but prevents Imperial from refusing to contract with an independent merely because that independent has a dispute with another supplier);

(ii) addition of a clause making it clear that shortfalls in volume, which Imperial is to be allowed pursuant to paragraph 21(4), are only permissible when Imperial can demonstrate to the Director that the shortfall occurs as a result of unexpected underliftings by independents (the reason Imperial gave for requiring the 10% latitude);

(iii) deletion of the volumes supplied to debranded Texaco and Esso stations so that those volumes are not counted as part of the sales to independents (they had not been so counted m earlier versions of the supply provisions because those stations were not previously part of the independent market and the volumes sold to them, therefore, were not included in calculating the volume required to be provided to independents).

The supply assurance provisions are designed to guarantee that a supply of gasoline continues to be available to independent gas stations (i.e. those that are not affiliated with one of the "majors"). On November 10, 1989, the Tribunal expressed concerns with the provisions as they were then proposed on two grounds: requiring Imperial to "offer" such supply to the independents, with no provision respecting price, was not sufficiently enforceable to constitute a real obligation; the volume to be supplied from year to year was to vary in such a way as to discourage the independents from importing gasoline, which importing is said to discipline domestic prices.

The Director and Imperial filed a revised draft order curing both defects which the Tribunal had identified. That revised draft, however, had three new aspects to it which two members of the Tribunal find troublesome. They are of the view that those three alterations, two of which lower the volumes to be provided to the independents, should be removed.

3. With respect to the Atlantic region, the provisions relating thereto will only be approved if either:

(i) all assets in the region are divested; or

(ii) additional evidence respecting the financial resources, expertise, experience and plans of the purchaser are presented to the Tribunal sufficient to demonstrate that the purchaser of

the Texaco Atlantic assets will in fact be a vigorous competitor in the Atlantic region comparable to Texaco, the competitor it is replacing.

The division of the Atlantic assets between Imperial and an as yet unknown third party purchaser raises questions which would not have arisen had all the assets in the region been ordered divested. Two members of the Tribunal have not been persuaded, on the basis of the evidence as it stands, that the degree of divestiture required by the RDCO is such as to in all likelihood, eliminate the substantial lessening of competition, arising as a result of the merger, in the Atlantic region.

4. Paragraph 21(5) should be removed. It is completely ambiguous and potentially a source of protracted legal wrangling, in the future, over its proper interpretation. The Tribunal is not prepared to approve such a provision.

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# I Introduction

On June 29, 1989, the Director of Investigation and Research filed a notice of application under sections 92 and 105 of the *Competition Act,* R.S.C. 1985, c. C-34. In the notice of application, the Director alleges that the acquisition by Imperial Oil Limited ("Imperial") of the shares of Texaco Canada Inc. ("Texaco") is likely to prevent or lessen competition substantially. It is alleged that this will occur in certain wholesale and retail markets for refined petroleum products, particularly gasoline.

Imperial, which is controlled by the U.S.-based Exxon Corporation, is one of Canada's largest integrated oil companies.[1] Imperial is the largest domestic producer of crude oil. Even before acquiring Texaco, Imperial was a significant player in both refining and retailing. Post-merger it continues to have the largest share of Canadian refining capacity and it will be the largest gasoline retailer in all areas of Canada except Ontario and the Atlantic. In those regions it will be a close second to Petro-Canada and Irving Oil, respectively.

Texaco was, prior to the acquisition by Imperial, also a major integrated oil company. Although smaller than Imperial, it participated actively in crude oil exploration as well as m refining,

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[1] A vertically integrated oil company is one which operates in more than one sector of the petroleum industry, from the exploration for crude oil to the marketing of refined petroleum products.

distributing and marketing petroleum products in Canada. The U.S.- based Texaco Inc. held approximately 78% of the shares of Texaco. It is common knowledge that Texaco Inc. decided to sell its Canadian subsidiary as part of an extensive restructuring undertaken to resolve certain financial difficulties. These arose in large measure from its protracted and unsuccessful legal battle with Pennzoil Co.

In August 1988, Texaco Inc. sought offers from those interested m buying its share of Texaco. On January 20, 1989 Imperial's offer was accepted. By February 28, 1989, Imperial had taken up and paid for 99.6% of the outstanding shares of Texaco, at a total cost of approximately $4.96 billion (this includes publicly traded shares as well as those previously owned by Texaco Inc.). Proceedings under the *Canada Business Corporations Act* were undertaken in order to convert Texaco, now operating under the name McColl-Frontenac,[2] into a wholly-owned subsidiary of Imperial.

The Director states that competition is likely to be substantially lessened or prevented as a result of this acquisition for five reasons:

> (i) the elimination of an effective competitor from the branded sector of the retail gasoline markets across Canada;
>
> (ii) the elimination of a major refiner-marketer in the Atlantic Canada region;

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[2] Except in the Atlantic region.

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

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

(v) an increase in the opportunity for inter-dependent market behaviour among refiner-marketers.[3]

In order to eliminate the alleged substantial lessening of competition, the Director requests that the Tribunal issue the Revised Draft Consent Order ("RDCO") filed on November 28, 1989. The RDCO is a modification of the Draft Consent Order ("DCO") which had been filed as an appendix to the notice of application of June 29, 1989. The RDCO was filed in response to comments which the Tribunal made on November 10, 1989, expressing concerns about the provisions of the DCO.

The order which the parties now wish the Tribunal to approve, like the earlier version, has four component parts. First, a number of service stations, in Central and Western Canada, must be sold by Imperial or, if dealer-owned, cease to be operated under either the Texaco or Esso brand. Second, Imperial must sell many of the assets of Texaco which it acquired in the Atlantic region, in particular the Eastern Passage refinery and much of the retail network. Third, Imperial must sell a number of terminals located

[3] Notice of application at para. 2.

across the country which are used for the storage of refined product. Fourth, Imperial must supply to independent marketers,[4] in Ontario and Quebec, a certain minimum volume of gasoline. These four components will be considered in further detail below.[5]

## II Applicable Legal Test

As counsel for the Director argued, the burden of proof in a consent order application is on the parties and particularly on the Director. That burden requires the parties to prove that the order which they seek is one which will in all likelihood eliminate the substantial lessening of competition, which they have agreed (by way of presumption) will arise from the merger.[6] In addition, proposals which the Director puts forward are treated with initial deference. There is an initial assumption that they will accomplish what the Director asserts they are designed to do.

The Tribunal enunciated the applicable test for consent orders m the *Air Canada* decision:

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[4]Independent marketers or "independents" are those companies which sell gasoline at retail but do not have an ownership interest in a refinery; cf. the "majors", which have a refinery ownership interest and market from coast to coast and the "regional majors", which have a refinery ownership interest but market only in a particular region.

[5]*Infra* at 24ff.

[6]such presumption does not prevent a respondent from disputing that issue in any contested proceedings should they ensue.

> That test is whether the merger, as conditioned by the terms of the consent order, results in a situation where the substantial lessening of competition, which it is presumed will arise from the merger, has, in all likelihood, been eliminated.[7]

As was also said in the *Air Canada* case:

> The Director is a public officer with a responsibility to craft settlements which serve the public interest. He has the responsibility to ensure that mergers do not lessen or are not likely to lessen competition substantially. He will have access to many facts which are not before the Tribunal. Indeed, in the absence of evidence put forward by an intervenor, the Tribunal will have before it only such evidence as the Director and the respondent, the parties to the consent order, adduce.[8]

The Tribunal recognizes in this case, as it has in others, that there is a range of possible solutions which might be adopted to eliminate a substantial lessening of competition in any given market situation. The Tribunal's role is not to require that the consent order be the optimum solution to the anti-competitive effects of a merger. Its role is only to ensure that the order falls within the range of acceptable solutions. In *Asea Brown Boveri Inc.* the Tribunal stated:

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[7] *Director of Investigation and Research* v. *Air Canada* (July 7, 1989), CT-88/1, Reasons for Consent Order Dated July 7, 1989 at 66 (Competition Trib.).

[8] *Ibid.* at 62-63.

> The Tribunal believes that the measures proposed are adequate to meet the objectives of the *Competition Act* and that they are well within the range of reasonableness. The Tribunal is not, however, making a finding that these are the best possible remedies to solve the problem. Such a finding would be outside of its role.[9]

While there is a range of acceptable solutions to an uncompetitive post-merger situation, the scope of that range is conditioned by the extent to which the pre-merger situation was itself uncompetitive. Where the pre-merger situation was highly uncompetitive, any solution, short of restoring to the fullest extent possible the pre-merger market situation, may have difficulty falling within the acceptable range.

Counsel for the Director argued that, in order to successfully challenge the DCO, the intervenors have to prove that with the DCO in place there will still exist a substantial lessening of competition. This is too stringent a way of framing the burden which is on the intervenors. It is too stringent a way of framing the test which the Tribunal must apply when assessing a draft consent order.

A consent application proceeds on the basis of an evidentiary vacuum -- an evidentiary vacuum with respect to the degree, nature and extent of the substantial lessening of competition which will occur as a

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[9] *Director of Investigation and Research* v. *Asea Brown Boveri Inc.* (September 6, 1989), CT-89/1, Reasons for Consent Order Dated June 15, 1989 at 22 (Competition Trib.).

result of the merger. While the intervenors may elect to challenge the order by filling the vacuum, they also may elect to challenge the order without doing so and by relying instead on the presumption which the parties have accepted as the base of their case. It is sufficient, then, if it can be shown that the DCO is not likely to accomplish the objectives which the Director claims for it because, for example, the terms of the order are contradictory or inconsistent or the terms of the order are not likely to be effective because they lack enforceability, either as being imprecise, impossible to monitor or because a breach, as a practical matter, would not be susceptible of proof.

The Tribunal must assess the RDCO in the light of these considerations and the evidence which was placed before it. The assessment which follows will refer to both the DCO and the RDCO. Their basic thrust is the same and, as has already been noted, the RDCO was filed to cure defects which the Tribunal perceived existed with the proposed solution, as originally set out in the DCO. In the reasons which follow there is agreement among all members of the Tribunal on the characterization of the facts, and on the conclusions which follow therefrom, unless expressly otherwise indicated.

## III Scope of the Director's Application

It is necessary, first, to describe the extent of the Director's concerns respecting the anti-competitive effects of the merger. He is not concerned about all aspects of the petroleum industry.

As integrated oil companies, both Imperial and Texaco participate in more than one facet of the petroleum industry: from the exploration for and production of crude oil, through refining and distribution, to the sale of refined petroleum products to the consumer. Crude oil exploration and extraction is the "upstream" sector of the industry; all the later stages from the refinery to the retail outlet are part of the "downstream" sector.

The Director is not concerned about the effect of the merger in the upstream sector nor is he concerned with all products and markets comprising the downstream sector. His officials analysed the effects of the merger in those markets and found no competitive concerns. The Director's application is directed at the competitive problems caused by the merger in specified product and geographic markets only. These markets will be described below but first it is useful to set out some general comments with respect to market definition.

## IV Market Definition

The definition of a market, for a good or service must be considered from two perspectives: the product market and the geographic market. Identification of the product market requires an assessment of whether or not there are close substitutes for the product in issue which should be considered to be part of the same product market as the good or service under review. Identification of the geographic market usually proceeds by reference to the homogeneity of the price of the product over the relevant geographic area.

### A) Product Market

In all areas of the country, except the Atlantic, the only product with respect to which it is alleged there will be a substantial lessening of competition is gasoline. In the Atlantic region, heating oil as well as gasoline is a product with respect to which there are concerns. There are no readily available substitutes for gasoline and its purchase is largely an unavoidable one. The majority of Canadians own a car and must purchase fuel for it. Heating oil was excluded by the Director from the competitive analysis because acceptable substitutes exist, for example, natural gas and electricity, except in Atlantic Canada, where substitutes are less readily available.

Since the industry is vertically integrated, with the refiner (wholesale supplier) also owning retail outlets, the gasoline market must be considered from two perspectives: the wholesale market and the retail market. The effects of the Imperial acquisition of the Texaco assets extend to both the wholesale supply of gasoline (control of refinery capacity and terminal facilities for storage and distribution and access to alternative sources of supply) and its retail marketing (control of branded retail outlets). In the Atlantic region the wholesale supply, but not retail marketing, of heating oil is also relevant.

**B) Geographic Market - Wholesale (Refinery) Level**

Insofar as the geographic market is concerned, it is the Director's position that at the wholesale (refinery) level there are three distinct geographic markets in Canada: the Atlantic region, Ontario/Quebec and Western Canada. The Director justifies the drawing of these regional markets primarily on the basis of product movement, both physically at a reasonable cost and through reciprocal supply agreements. Conversely, the absence of product movement between regions is also considered relevant. The evidence of Professor Waverman supported the Director on the geographic extent of the relevant wholesale markets. At the same time, on the basis of the other evidence adduced, there is considerable question as to whether Ontario and Quebec should have been treated as two markets instead of one. The Attorney General of Newfoundland and Labrador questioned whether that province is

properly a part of an Atlantic market or should have been treated as separate from the Maritime provinces of New Brunswick, Nova Scotia and Prince Edward Island.[10] (The province of Newfoundland and Labrador will hereinafter, for ease of reference, be referred to as "Newfoundland".) In any event, the definition of markets by reference to provincial boundaries automatically carries with it a certain degree of artificiality.

### C) Geographic Market - Retail Level

With respect to the geographic extent of the various retail markets, urban areas were chosen by the Director and Imperial as separate markets. As will appear from what is said below, there is only a limited economic rationale for this choice. The choice proceeded on the basis of administrative convenience in the absence of a practical means of identifying the actual markets.

As noted above, identification of a geographic market requires an assessment of the homogeneity of price. In defining an "ideal" geographic market it should be possible to find that all transactions, at a point in time within the defined market, could be at the same price. Since this ideal is rarely met, the question is the extent to which departures are considered sufficiently unimportant so that transactions at different prices are still considered part of the same market. A comparison of retail prices in the greater Toronto area

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[10] see *infra* at 57ff.

by Professor Waverman and Dr. Yatchew, showed a high degree of uniformity across the urban areas assessed.[11]

This is not surprising given that consumers of gasoline are inherently mobile and the search for a better price is relatively cost- free -- it can be undertaken while travelling for some other reason. Switches in consumer demand can readily be accommodated on the supply side since virtually all retail gasoline outlets have the capacity to sell more gasoline and they also have the incentive to maximize volume, fixed costs being high. Because of the exposure of consumers to a fairly large number of retail outlets during the period of time when they are considering a purchase, any price change in one part of a city is transmitted rapidly throughout the urban area: the "domino effect". The evidence of Professor Trebilcock described the situation:

> While industry data suggest that up to 70% of consumers tend to buy most of their gasoline within two miles of their homes, the structure of this market ensures that price changes move both rapidly and pervasively through most large metropolitan areas. This is because each consumer's two mile radius overlaps with the next consumer's such that a net of interlocking submarkets spans the city. Any price decrease in one area of the city is transmitted by a domino effect, to other areas of the city through these interlocking submarkets…..[12]

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[11]Affidavit of Prof. M. Trebilcock, dated July 24, 1989, Appendix 3: The Pricing of Gasoline in the Toronto Area (May 29, 1989). A similar, more current study surveying retail gasoline prices in both Toronto and Montreal forms part of the confidential record: A. Yatchew, Retail Prices of Gasoline in Toronto and Montreal (October 5, 1989).

[12]Affidavit of Prof. M. Trebilcock, dated July 24, 1989, Exhibit A at para. 14. See also Notice of application, Appendix 2: Overview of the Industry at para. 115, which is to the same effect.

Apart from the use of the term submarket, which could create confusion and is somewhat of a contradiction, the description of how a large urban market for gasoline is tied together is a reasonable one. It becomes evident from that description, however, that the choice of urban boundaries is necessarily arbitrary because the interlocking "submarkets" do not stop at those boundaries but interlock with adjacent non-urban areas. The evidence adduced respecting one particular situation in Ancaster, Ontario underlines this fact.[13] In the case of medium-sized and small communities, equating the geographic market with the boundaries of those communities understates the true size of the relevant market because the purchasers are mobile; they clearly purchase outside the local community as well as within it.

While it is evident that it would be a near impossible task to accurately trace all of the overlapping areas that make up retail gasoline markets in Canada, the deficiencies inherent in choosing arbitrary limits, such as urban boundaries, have to be recognized. This is particularly so given the task which the Director and Imperial set for themselves of basing the required divestitures of retail stations by Imperial on those boundaries.

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[13] see *infra* at 106.

## V Retail Markets

There were 19,283 retail gasoline outlets in Canada in 1988. Imperial branded stations accounted for 3,118 of this number and Texaco for 2,023. Together the two networks represented somewhat more than a quarter of the total number of outlets. The RDCO requires Imperial to "divest" a certain number of retail stations (346 outside the Atlantic region).

### A) Dealer-Owned and Company-Owned Stations

As is common in the industry, the majority of the outlets are owned not by the companies (refiners) but by the dealers themselves. The dealers enter into supply arrangements with refiners, such as Imperial. The supply agreements often include financial arrangements such as loans or cross-leases that are part of the inducements used by refiners in competing to sign up dealers. Supply contracts ordinarily run five years and are subject to renewal. Approximately 63% of the Imperial/Texaco outlets are dealer owned, and on average one-fifth of them have contracts coming up for renewal in any year. The dealer-owned stations tend to be in rural areas and smaller population centers. Company owned stations are concentrated in larger cities and are usually higher volume outlets.

It has to be noted, then, that "divestiture" with respect to the dealer-owned stations is somewhat of a misnomer since the placing of a dealer-owned station on the "divestiture" list means only that the station will no longer have a brand identification with the company (Esso or Texaco as the case might be) or enjoy its associated support services, such as the ability to accept credit card sales on that company's system. Thus, in the case of dealer-owned stations, what is being divested by Imperial is a supply contract to sell gasoline for resale under Imperial's or previously Texaco's brand. Imperial would, of course, with or without the order, still be free to provide these "debranded" stations with unbranded gasoline should such be mutually commercially advantageous.[14]

## B) Divestment Criteria

As was noted above, the geographic boundaries of the retail markets were arbitrarily chosen (for lack of a better way of defining them). Urban areas were classified into three groups: (1) "Kent Areas" which include all municipalities having a population in excess of 25,000 as well as many smaller municipalities (gasoline sales figures with respect to these areas are collected by Kent Marketing Services Limited); (2) "Non-Kent Areas" which

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[14] The DCO requires that Imperial offer unbranded supply for a maximum period of five years following termination or non-renewal of a branded supply contract (para. 34). See *infra* at 35ff. for further discussion of this guarantee.

comprise communities with populations in excess of 10,000 but not surveyed by Kent Marketing Services Limited (sales figures for these areas were obtained by the Director from government and private sources); (3) "Town Areas" which are communities having a population of less than 10,000 for which no sales figures are available. No analysis was made of highway markets because of the virtual impossibility of accomplishing such a task. This virtual impossibility exists not only because of the potential overlap of trade areas between highway locations and communities close to the highway but also because of the transient nature of the customers who purchase from those locations.

The principles which were applied to determine when divestiture (debranding) would be required were restricted to urban areas because of the difficulty of defining markets generally and the fact that there are no easy boundaries (municipal or otherwise) which might be applied in non-urban areas. The principles applied were different for those areas where sales figures were available (the Kent and Non-Kent Areas) and for those where no sales figures were available (the Town Areas). In the Kent Areas, Imperial is not to keep stations having an aggregate sales volume of more than 25% of the market, unless there is a non-negligible independent presence in that market (i.e. independents holding 15% or more of the market). Where independents have, on a sliding scale, up to 20% of the market, Imperial may keep up to 30% of the market. In particular cases, if the independent sector is

significant and growing, although less than 20%, and there has been recent substantial variation in market shares, Imperial is permitted to retain 30% of the market. In non-Kent Areas, Imperial may retain only a 30% share of sales in all markets. In the Town Areas the required divestitures are based on the number of outlets:

| No. of Outlets | Maximum No. of Allowed Imperial Outlets |
|---|---|
| 3 or fewer | 1 |
| 4 to 7 | 2 |
| 8 or more | one-third |

A number of other rules regarding divestitures were applied. One requires that a certain number of company-owned stations be included on the list for the Kent Areas. Since company- owned outlets tend to be better located on the average and have higher sales volumes, they are more likely to remain viable stations post-divestiture. The percentage of company-owned stations required to be divested mirrors to some extent the percentage of company- owned stations which exist in a given market area.

Another requirement is that when the market share held by independents in a given Kent Area is below 20%, at least one- half of the stations identified for divestiture have to be stations which in 1988 had sales equal to or greater than the independents' average sales per site in that area. This is seen as a means of ensuring that a significant proportion of the divested sites possess sufficient viability to continue as gasoline retail sites.

The Director identified the general criteria according to which retail stations were to be divested (what can be called the 30%-20% and associated rules). Imperial chose the specific stations which would be placed on the divestiture list.

Professor Trebilcock referred in oral evidence to some of the factors which had been considered by Imperial in making the choice of one station rather than another in any given area: historical volume; future volumes in the light of changing conditions in the local market; facility image; other business dealings with the dealer; time left on the contract; length of time the dealer had been a Texaco or Esso branded station; rebranding costs. These are the type of criteria which Imperial would have applied in deciding which stations to sell as part of a normal process of rationalization as a result of the merger, without any divestiture order.

### C) Station Closures Occurring Independently of RDCO List

The divestitures which Imperial is being required to make, take place in the context of a market situation where a significant decrease in the number of viable retail outlets is already occurring. In recent years, the number of gasoline outlets in Canada has declined dramatically.[15] In 1970, there were approximately 36,000 retail gasoline outlets in Canada. By 1988, this number had fallen to 19,283. Professor Trebilcock describes the situation:

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15 Professor Trebilcock's description noted that the net decrease in service stations since the 1950s, especially those associated with integrated marketers, had not primarily been the result of an overall decline in demand for gasoline; in fact, demand had grown. The pressures to rationalize, to reduce costs, arose partly from lost sales due to competition from independents, partly from falling demand for repair services at conventional gasoline outlets as a result of factors such as changes in car design which, required fewer oil changes and tune-ups, the emergence of specialized muffler and repair shops, more expensive new car warranty coverage, and partly from higher land values in alternative uses in urban centres. These pressures led to a reduction in the number of outlets maintained by the major integrated firms and to an increase in the average volumes at the remaining outlets which were made possible through innovations such as self-service facilities and greater pumping capacity. Affidavit of Prof. M. Trebilcock dated July 24, 1989, Exhibit A at para. 10.

> ... This decline reflects rationalization programs carried out by virtually all of the integrated marketers whereby older inefficient service stations have generally been closed and replaced in fewer numbers by high -volume stations, particularly self-serve outlets. Reductions in Imperial's and Texaco's networks are representative of what has occurred:

**TABLE I**

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% [16] |

In addition, Imperial's acquisition of Texaco would lead to a certain number of terminated supply contracts, sales or closures as a result of the merger itself. For example, it is not likely that Imperial would wish to continue to operate two neighbouring stations under the same banner when they were mainly drawing on the same customers.

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[16] *Ibid* at para. 8. Table I is taken from the Notice of application, Appendix 2: Overview of the Industry at para. 103

That there would be certain economic efficiencies arising from retail closures was attested to by Professor Trebilcock:

> Significant efficiencies from the merger are likely to be realized at the retail level: lower productivity retail sites will move to higher valued social uses; average throughputs at remaining sites will be increased, lowering unit costs; ... . (underlining added) [17]

The Attorney General of Quebec argued that the criteria chosen by the Director (i.e. the 30%-20% and associated rules) were inadequate to ensure competition in Quebec. That argument was related to the assertion that urban boundaries were not appropriate for defining markets in large metropolitan areas such as Montreal, Toronto and Vancouver. In Montreal, for example, 73 municipalities were included as one market. The Attorney General of Quebec recognized the difficulty of accurately identifying the overlapping local markets but submitted that each of the 73 municipalities making up greater Montreal should have been considered as a separate local retail market.

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[17] Affidavit of Prof. M. Trebilcock, *ibid.* at para. 46(v).

Imperial and the Director took the position that the criteria which had been established and applied in Quebec, which were identical to those applied elsewhere, were appropriate and sufficient. At the same time, at the commencement of the hearing counsel for the Attorney General announced that he would not participate formally in the proceedings because Imperial had agreed that an additional 68 station sites would be divested in Quebec. While Imperial and the Director maintained that no additional divestitures were necessary to meet competition concerns, Imperial stated that since it intended to divest stations additional to those identified on the divestiture list, it could see no reason not to inform the Attorney General of Quebec of that fact immediately. Imperial was willing, therefore, to make the commitment to divest an additional 68 stations in the province of Quebec.

It seems clear that the divestiture list, in many instances, probably does little more than identify stations which Imperial would have divested in any event.

**D) Choice of Individual Stations Not Dictated by Competition Concerns**

Many of the representations that the Tribunal received were from station owners pointing out the unfortunate economic consequences that the divestiture of their stations would have for them personally and seeking an explanation as to why they were being divested. For example, the Tribunal received the following representation from Mr. E. Koptie, dealer/owner of Texaco Car Wash, Weyburn, Saskatchewan:

> We established this facility [the Texaco Car Wash] knowing very well, *the key* to our business success was being associated with a major oil company. We invested our savings and borrowed the balance from the bank. My wife, 2 sons and myself have put in long hours into this venture and now find ourselves being left out. ...
>
> In view [of the fact that] the Director of the Bureau of Competition Policy excludes us from the acquisition of Texaco's operations, we feel the Director [should] be held responsible for our loss ... .[18]

Another representation, by way of example, was received from Lyn-Den Distributors, dealer/owner of an Esso station in Ashern, Manitoba:

> [If we operate as an unbranded retail facility] At what price are we to purchase future products in order to compete with branded retailers? ...
>
> [If we attempt to secure a favourable agreement with another oil company]... Our station has recently been converted with major expense on our behalf plus allowing a second mortgage on our property to Imperial Oil to appear [under] the new "ESSO IMAGE" and [as a result of the divestiture it] would have to be converted to other specifications. ...[19]

Counsel for Lyn-Den Distributors pointed out that the neighbouring Texaco station, which Imperial is keeping, is the more effective competitor. In his view, it would have been more pro-competitive if Imperial had been required to divest the stronger of the two stations.

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[18] Letter from E. Koptie to the Registrar (September 26, 1989) at 2.

[19] Letter from D.M. Geisler, c.o.b. as Lyn-Den Distributors, to the Chairman (September 27, 1989) at 2, 3.

Mr. Merchant's representations on behalf of Beacon Hill Service (2000) Ltd., a dealer-owned Imperial-branded station in Fort McMurray, were of a similar nature. He expressed concern about finding a major supplier after his current supply agreement ends in 1993. He is concerned that he might have to repay Imperial monies owed to it at that time. He believes that it would be fairer if a nearby Texaco station were divested since this is a more successful outlet than his own and therefore should have no difficulty finding another major brand supplier[20].

It is clear on the basis of the evidence that Imperial would have divested both Lyn-Den Distributors and Beacon Hill Service (2000) Ltd. regardless of any requirement of the Director in this regard. Mr. Merchant recognized that this was the case, with respect to his station. He argued that merely removing his station from the divestiture list would not help. He noted that it would be necessary for the Tribunal to order divestiture of the stronger neighbouring station in order to lessen his difficulties. But there is insufficient evidence before the Tribunal to demonstrate that such an order is necessary, to ensure competition, in the respective markets served by either Lyn-Den Distributors or Beacon Hill Service (2000) Ltd. The evidence demonstrates that in both areas there is a significant number of competing retail stations. The situation which both these retailers face is a consequence of the merger itself. They are on the divestiture list because Imperial wants them there. For the Tribunal to insist upon their removal from the list would not, as a practical matter, assist these stations in remaining as Esso brand stations. In addition,

[20] The positions of the various intervenors are dealt with in more detail *infra* at 98ff.

the evidence is not such as to allow the Tribunal to require the substitution of another station in order to meet competitive concerns.

In this context, while negotiations between the Director and Imperial influenced the selection of outlets to be divested, the Tribunal is concerned that the naming of outlets creates an aura of certainty about the analysis of the competitive effects of individual divestitures that is totally unjustified. The Tribunal was concerned at the outset of the proceedings by the fact that an order proposed for its signature, in these circumstances, was so detailed and specific. The fact that franchisees could perceive that the proposed divestitures resulted from a decision by the Tribunal heightened this concern.

The draft consent order is unusual in this regard. Consent orders requiring divestiture in the United States, where there is a longer history with orders on consent in competition matters, usually require divestiture of all retail outlets in a specified geographic area.[21] Given the above considerations and the apparently extensive efforts spent in discussions regarding the identified outlets, there is good reason to question whether the approach adopted was preferable to one using more general and broadly descriptive terms to define the required divestitures. Given that individual outlets were identified, it would have been more honest if it had been made clear to the dealers that their outlets had been selected by Imperial even if it is possible that the named outlets were not always Imperial's first choice.

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[21] Mr. Addy's response to a question from the Tribunal stated (transcript at 14- 15): "There is no precedent that I am aware of in Canada, and the divestiture orders that I have seen as issued in the United States by way of parallel are geographically based as opposed to asset-based, in the sense that the company is ordered to divest everything within the State of Georgia or in whatever state is affected

**E) Guarantee of Unbranded Supply**

Imperial is required to offer unbranded supply to the stations which are being debranded for a period of five years. At the time of the hearings, Imperial had not established a price at which it would sell on an unbranded basis. It is highly unlikely that this option is of important practical significance or that it was developed after consultation with dealers to ensure that it was one they might take up. Certainly, with respect to those stations located on highways, the evidence adduced before the Tribunal indicates that a major brand identification is very important for their continued viability. In such circumstances, whether a guarantee of unbranded supply is useful to them is at best doubtful. In addition, Imperial wrote to all those dealers being debranded and indicated an intention to deal with them fairly. This commitment might have led Imperial, independently of any draft consent order, to have made offers respecting unbranded supply for a period of time to those stations. In any event, on the basis of the evidence before the Tribunal, the only conclusion that can be drawn is that the positive benefit of this obligation is problematic. It may allow some debranded stations a chance at continued viability which they might not otherwise have had.

**F) Anti-Competitive Aspects of Mergers Evidence Respecting Those Concerns**

Professor Trebilcock set out what he considered to be the two possible anti-competitive effects which the Tribunal should focus upon in considering any merger: whether the merger would lead to the merged firm

acquiring a dominant market position; whether the merger would enhance the ability of firms in the market (in an oligopolistic situation) to engage in various implicit forms of collusion (with respect to price, market share, etc.).[22] No one disputed the appropriateness of the conceptual framework which Professor Trebilcock suggested.

In the context of this framework, Professor Trebilcock gave evidence with respect to the retail markets which was not seriously contested:

> 29. The profile of a dominant firm dictating the market price does not fit the retail gasoline market. ... The retail gasoline market post-merger will not remotely exhibit the profile of a market dominated by a single firm.
>
> 32. With respect to the application of theories of tacit collusion to retail gasoline markets, retail gasoline markets ... [are] not generally predisposed to tacitly collusion behavior. First, ... [t]he thriving presence of independent retailers typically competing primarily on price ... effectively disciplines the pricing practices of the larger retailers and prevents any serious prospect of tacit collusion over price.
>
> 33. Secondly, there are relatively low barriers to entry in most Canadian service station markets (with the exception of regulatory barriers in the Atlantic Region).
>
> 34. Thirdly, ... [f]or tacit collusion to be effective ... all the dimensions of product offerings would have to be standardized or at least accounted for in tacitly agreed pricing strategies.

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22 Reference was made to an article by F. Warren-Boulton, "Implications of U.S. Experience with Horizontal Mergers and Takeovers for Canadian Competition Policy" in F. Mathewson, M. Trebilcock & M. Walker, eds, *The Law and Economics of Competition Policy: The Current Learning* [forthcoming]. Affidavit of Prof. M. Trebilcock, dated July 24, 1989, Exhibit A at para. 23.

> 35. As mentioned ... fixed relative market shares, price stickiness in the face of significant changes in underlying cost or demand conditions.... [N]one of these patterns are observed in the Kent or other relevant data. [R]ecent industry price data demonstrate that price competition in Canadian 3etail markets for gasoline is, in fact, highly rivalrous....[23]

In response to a question from Mr. O'Grady, counsel for the Consumers' Association of Canada, as to whether or not the uniformity of price across a large urban area might be attributed to deliberate parallel pricing rather than, as Professor Trebilcock suggested, to a highly competitive market situation, Professor Trebilcock responded:

> I find that a quite implausible explanation. In the Toronto market we have about 700 retail outlets.... In Montreal, over 1400 retail outlets.... For the tacit collusion theory to fly you would have to have a massive cartel amongst 1400 retailers. In Regina we observed the same phenomenon [i.e. price uniformity] where there is a very high percentage of independents.[24]

Professor Trebilcock's evidence, with respect to tacit collusion, was that while there might be some concern m that regard in the case of small communities (where only one, two or three stations exist), the geographic market definition which had been applied by the Director to those small communities so understated the actual scope of the markets that the concern would not be significant:

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[23]Affidavit of Prof. M. Trebilcock, *ibid.* at paras 29, 32-35.

[24]Transcript at 1677-78.

> ... These concerns are allayed by two factors in the case of retail gasoline: (a) ... the ready availability of substitute sources of supply outside the immediate community and the mobility of consumers ... and (b) [t]o the extent that collusion is attempted, it will often be explicit and readily observable rather than implicit, and thus is likely to be subject to criminal sanctions ....[25]

In the light of this evidence there can be absolutely no dispute that the order, insofar as it relates to the retail market, meets the applicable test. Indeed, as has already been noted, there is considerable reason to doubt whether much of it was necessary at all.

Professor Trebilcock's analysis, of course, did not deal with the Atlantic region.

## VI Atlantic Region

### A) Substantial Lessening of Competition is Clear

There is no doubt that in the Atlantic region the merger results in a substantial lessening of competition. The presumption on which the parties proceeded is buttressed by evidence that is clear and unequivocal in this regard.

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[25] Affidavit of Prof. M. Trebilcock, dated July 24, 1989, Exhibit A at para. 36.

With respect to the wholesale market there were four refiners in the Atlantic region pre-merger: Imperial, Texaco, Irving Oil Limited ("Irving"), and Newfoundland Processing Limited. This list, however, overstates the availability of wholesale supply throughout the region since Irving has a policy of not selling to independent resellers and Newfoundland Processing Limited is subject to a restrictive covenant limiting its sale of refined products to Newfoundland.[26]

Post-merger there would be only three refiners. Irving would continue to own the majority of Atlantic crude refining capacity with over 50%, followed by Newfoundland Processing Limited with about 24%. Imperial's share of crude refining capacity in the region would increase from approximately 19% to 23%. It would also own both the refineries located in the Dartmouth area, its own and the Texaco Eastern Passage refinery. Barriers to entry into refining are high: growth in demand is slow; sunk costs are large; economies of scale are present; and increasingly stringent environmental regulations operate to deter entry at the refinery level.

Although there have not been any governmental trade barriers limiting petroleum imports into Canada since June 1985, imports do not provide, at present, a viable alternative source of supply for independents or potential independents in the Atlantic region. In 1988, refiners accounted for 100% of

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[26]The covenant requires Newfoundland Processing Limited to restrict its sales in Canadian markets to the province of Newfoundland only. The refinery is of course free to sell into the export market without restriction.

the volume of motor gasoline imported into the Atlantic;[27] some non-refiner heating oil importation does occur.

The costs of trucking into this market are generally prohibitive and there is a lack of independently operated marine terminal or storage space. This latter factor is aggravated by the merger which would increase the concentration of terminal ownership, in various cities, in the hands of Imperial. New marine terminals are unlikely to be built for many of the same reasons impeding entry into the refining industry plus the absence of a guarantee of high volume throughput given an insignificant independent customer base.

With respect to the retail markets, in the absence of the RDCO five branded retailers would have over 95% of the gasoline sales volume in this region post-merger. The branded sector will no longer include Texaco, which had a reputation as a vigorous competitor in the region. There are few independent marketers in the Atlantic; only 48 of some 2700 service stations are independently operated and three small chains account for most of these. The total independent share of the retail gasoline market amounts to only 4.5%. In addition, Nova Scotia and Prince Edward Island engage in direct regulation of both wholesale and retail petroleum distribution facilities.

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[27] Since all petroleum products are jointly produced from crude oil, refiners may find it economical to import or export particular products as required, depending on the prices in different product markets.

**B) Degree of Divestiture Required**

There is no doubt that the provisions of the RDCO with respect to the Atlantic region gave the Tribunal the most difficulty. In summary, those provisions raise the question of the extent to which the assets of an acquired company can be divided between the acquiring firm and a potential third party purchaser, when the pre- merger market situation is already highly uncompetitive. They raise the question as to what degree of divestiture, in the case of an uncompetitive pre-merger market situation, short of full divestiture of all the assets in that geographic area will meet the required test. Two members of the Tribunal are of the view that the parties have not persuaded them that the degree of divestiture required by the DCO or by the RDCO is such as to meet the test. That is, they are not convinced that the provisions of the DCO or RDCO are such as, in all likelihood, will eliminate the substantial lessening of competition in the Atlantic region which it is presumed will arise as a result of the merger. The third member is of a different view.

**C) Original Draft Consent Order and Director's Evidence**

The DCO requires Imperial to divest: the Eastern Passage refinery, which includes the Dartmouth marine terminal; 4 terminals;
74 company-owned service stations and 123 dealer-owned service stations; and possibly, at the purchasers' option, the Ultramar/Texaco reciprocal supply agreement.

There are no conditions in the DCO governing the eligibility of a particular bidder for the Atlantic assets. Paragraph 14 contains an "expression of intent" to the effect that:

> 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 to supply the domestic downstream petroleum products market.

The sale of the Texaco assets is subject to the prior approval of the Director.[28]

Professor Stanbury, who was called as an expert witness on behalf of the Director, explained the Director's position as follows:

> The general idea of the DCO is to divest the refinery, together with whatever set of stations the purchaser thinks would represent an efficient combination to enter that market and to be a viable competitor. Some purchasers may find that they need fewer than all the stations that are currently being offered; some purchasers may find they don't need all the terminals, and so on. So that I think the market is the best judge of the particular combination of the assets that should be purchased.[29]

Professor Stanbury expressed the opinion that the draft consent order would remove the substantial lessening of competition which would otherwise have arisen in the Atlantic region because the draft consent order required Imperial

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[28]Para. 5. If the Director refuses to approve the sale, Imperial may apply to the Tribunal, which may vary the lists of assets subject by the DCO to divestiture (paras 5-8, 10). All divestitures under the DCO are to be completed within twelve months of the order, subject to the right of the Director to grant an extension, after which a trustee will be appointed by the Director. The trustee must sell the assets within 6 months of his appointment on terms acceptable to the Director, with the assistance and at the expense of Imperial. If assets remain unsold after 6 months, either party may apply to the Tribunal for a variation of the schedules listing the assets to be divested.

[29]Transcript at 464.

to divest itself "of substantially all" of Texaco's assets in the Atlantic region and that "the scale of the divestitures is almost equivalent to the total divestiture of Texaco's assets in the Atlantic region." Professor Stanbury's opinion that the substantial lessening of competition would be eliminated was also based on the fact that "the Director must approve the purchaser(s) of the divested assets."[30] In this regard, he gave the following evidence:

> As I emphasized in the affidavit, the potential impact on competition depends (a) on who buys it [i.e. the assets] and (b) what they do with it. So, I will give you the extreme. Let us suppose you have Wild Cat independent buy them. Wild Cat independent could then simply follow a high margin, no price cut, no offer, no deals et cetera strategy and would be, for all practical purposes indistinguishable from the major, except for the name and they might not have the credit card.
>
> …
>
> You could imagine another world in which a major, not now in the region, might be approved by the Director and they might come in and, again, they might be aggressive for a while and expand the market share and might then stabilize. ...

And at page 583 of the transcript, in response to a question by Mr. O'Grady:

> What would it do for the competition situation if Shell, Ultramar or Petro-Canada were to acquire this refinery? Would it better it, worsen it, or leave it about the same?

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[30] Affidavit of W.T. Stanbury, dated July 20, 1989, Exhibit A at paras 31-35.

[31] Transcript at 574-75.

Professor Stanbury answered:

> I have not done an assessment, I'm sorry. I just haven't done it. We know that the Texaco assets are approximately, at retail, about a 10 per cent market share. Now, you would have to adjust it for the fact that all the stations are being divested, and so on. And it's a good network, and so forth. But I really haven't done the type of careful analysis that that merits. ...

Also, there was a strong indication in the opinion evidence filed by Professor Stanbury that the best purchaser would be an independent or a joint venture of two or more independents:

> 32. ... if all the assets to be divested in the Atlantic region are purchased by an independent reseller (or as a joint venture by two or more independents), this would create new entry and foster competition for several reasons....
> 33. Second, the sale of all the assets to an independent (or joint venture of two or more independents) would have the highest likelihood of *increasing* the intensity of competition in the region. The new entrant would not have to rely on Imperial for its supply of refined products (or Newfoundland Processing in Newfoundland). It could either operate the Texaco refinery or use the site as a marine terminal to distribute imported refined products. Moreover, an independent refiner or importer would be more likely to supply new entrants at the retail level, thus increasing competition at that level. Since the Texaco terminals have excess capacity, an independent could easily increase the supply of other refined products (diesel and heating oil) to existing independent resellers. ...

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[32] Affidavit of W.T. Stanbury, dated July 20, 1989, Exhibit A at paras 32-33.

The Director stated that the draft consent order would create an opportunity for a totally new participant to enter into the downstream segment of the Atlantic petroleum industry.

> ... !f that participant is a new and effective competitor the market may be at least as competitive as it was before the merger. Even if the assets are acquired by a smaller refiner-marketer with refinery operations outside the Atlantic region, at a minimum the divestiture will return e supply structure to where it was before the merger. (underlining added)

Oral evidence indicated that even a piecemeal sale of the assets might be acceptable to the Director.

**D) Position and Evidence of the Atlantic Marketing Refining and Employees Association and Oilworkers' Union the Atlantic Local I**

The Atlantic Refining and Marketing Employees Association and the Atlantic Oilworkers' Union Local I (sometimes referred to, for ease of reference, as "Mr. Pink's clients")[34] challenged the characterization that "substantially all" of the Texaco assets were being divested. They also challenged the Director's seeming receptivity to a purchase by an independent or a joint venture of independents or on a piecemeal basis.

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[33] consent Order Impact Statement at para. 31.

[34] cook's Oil Company Limited and the Texaco Retail Council, Halifax-Dartmouth Metropolitan Area were also represented by Mr. Pink but have been individually named in these reasons when their representations and evidence are referred to.

With respect to the conclusion that Imperial was being required to divest "substantially all" of the Texaco Atlantic assets, Mr. Pink's clients pointed out that the national accounts of Texaco, which were administered out of Toronto, would be retained by Imperial. Prior to the merger the revenue flowing from these had been fed back into the Atlantic region, insofar as that revenue was related to the Atlantic region. (The extent and the importance of these were not addressed by the Director or Imperial in their evidence.) Texaco's land bank in the Atlantic provinces (the extent of which was not expressly addressed by the Director or Imperial) would also remain with Imperial.

Mr. Pink's clients noted that the retail gas stations which Imperial was being allowed to keep in the Atlantic region accounted for 18%-20% of the retail gasoline sales of Texaco in that region. It was argued that this is not "almost equivalent to the <u>total</u> divestiture of Texaco's assets". Indeed, Professor Stanbury conceded on cross- examination that there was a <u>substantial</u> volume of gasoline sales being retained by Imperial. The Atlantic Refining and Marketing Employees Association and the Atlantic Oilworkers' Union Local 1 noted that *all of* the Texaco stations which Imperial was being allowed to keep were company-owned or controlled stations. As noted above "divesting" dealer-owned stations is a bit of a misnomer since the dealer is only tied to the supplier (Texaco or Imperial as the case may be) for the life of a particular contract. In such a situation, dealer-owned stations, once divested, need not stay with the new purchaser when their present contract

expires. This creates a rather precarious situation for the continued viability of the dealer-owned network as a collective competitive force in the Atlantic region, if the purchaser of the Texaco assets does not have the confidence of those stations.

It was clear that the retail stations which Imperial was being allowed to keep, at least in the Halifax-Dartmouth area, were strategically located. As Mr. Pink argued, there was reason to believe that the stations being retained in that area, and elsewhere, were "the cream of the crop".[35] The 25% rule which the Director applied to retail markets elsewhere in Canada when there was no significant number of independent retail stations in the market was not applied in the Atlantic region. There are few independents in the Atlantic region and, as noted, one of the refiners, Irving, has a policy of never supplying refined product to independents.

Imperial is being allowed to keep the assets of the Great Eastern Oil Company. The Great Eastern Oil Company was supplying a certain number of stations in Newfoundland with Texaco products. It also supplies middle distillates (heating oil) into the Newfoundland market. Thus, in Newfoundland, 17 retail stations previously supplied by Texaco would be supplied by Imperial while six would be sold to the new purchaser. The Atlantic Refining and Marketing Employees Association and the Atlantic

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[35] see also the representations of Cook's Oil Company Limited and the Texaco Retail Council, Halifax-Dartmouth Metropolitan Area, *infra* at 111ff.

Oiworkers' Union Local 1 argued that this effectively eliminated the Texaco successor from the marketplace in Newfoundland. They argued that the retention of six retail outlets is simply insufficient for a purchaser to find it economically feasible to continue to operate the Long Ponds terminal to supply those six stations (stations having a total annual sales volume of under 7 or 8 million litres). In addition, by retaining the Great Eastern Oil Company Imperial also retains all the Newfoundland commercial accounts which were previously supplied by Texaco through the Long Ponds terminal from the Eastern Passage refinery.

It is uncertain as to whether or not the exchange agreement between Texaco and Ultramar will form part of the assets which are sold. Under this agreement, Ultramar takes gasoline from Texaco in Dartmouth (from the Eastern Passage refinery) and Texaco takes gasoline from Ultramar in Quebec (from the St-Romuald refinery). If the purchaser of the Texaco Atlantic assets does not have a need to supply customers in Quebec, it might not wish to accept the exchange agreement. The exchange agreement is to be included in the package of assets being sold if the purchaser wishes to have the agreement included, otherwise it is an asset which will remain with Imperial. The exchange agreement accounts for 30% of the gasoline produced at the Eastern Passage refinery. It seems clear that if that exchange agreement is not part of the sale package, the Eastern Passage refinery will find its viability significantly undercut, if not entirely jeopardized.

It was pointed out that unless the Texaco Atlantic assets were supported by an infrastructure comparable to that which had existed when those assets were part of the Texaco enterprise there would be a diminished viability thereof. Separation from the expertise and financial resources, which previously existed as a result of being part of a large national, vertically integrated Oil Company, would itself, without more, be a diminution of the Atlantic assets. The need for the assets to be sold to a purchaser who could be a vigorous and effective competitor in the Atlantic market was stressed. The evidence of Cook's Oil Company Limited and the Texaco Retail Council, Halifax-Dartmouth Metropolitan Area was similar to that of The Atlantic Refining and Marketing Employees Association and the Atlantic Oilworkers' Union Local 1 in this regard.[36] In their view, all the assets should be sold to a purchaser who has experience, financial resources and expertise comparable to Texaco in order to ensure that a competitor of equal vigour takes Texaco's place in the Atlantic region.

With respect to the Director's seeming receptivity to a purchase of the assets piecemeal or by an independent or by a joint venture of independents, Mr. Pink's clients adduced evidence demonstrating that independent gasoline resellers do not find it easy to survive in the Atlantic market and that Maritimers are not receptive to non-national brand stations. Independents own only 2% of the retail outlets in the region. Some independents such as Metro have failed. OLCO did not prosper when it

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[36] see *infra* at 111ff. for further discussion.

switched stations from a national brand to an independent.[37] The conclusion that must be drawn from the evidence is that purchase by someone lacking

[37] It is useful to refer to part of the evidence of Professor Stanbury, in response to questions from Mr. Pink (transcript at 454-55, 507-9):

> Q. You will agree with me, Dr. Stanbury, that the Atlantic Canada industry, is different in many ways from the industry in the rest of Canada?
>
> A. In some ways, yes.
>
> Q. You will also agree with me that there have been no studies done which will point to the brand loyalty trends of consumers in Atlantic Canada to a major or a regular supplier vis-a-vis a non-regular supplier?
>
> A. I raised that question in the preparation of this evidence with officials of Imperial Oil. It is my understanding that they have internal market studies which deal with that particular issue, although I have not seen them.
>
> Q. You have not seem them and they are not part of the record here?
>
> A. They have not been put into the record, no.

> Q. In paragraph 19 [of your affidavit], you talk there again about those 44-50 stations [independents]. But you recognize that when you say, at page 7, that to support a low price strategy, they found ways of lowering the cost of distributing gasoline, e.g. self-serve gas bars, that sort of thing.
>
> You recognize that in Nova Scotia, for example, you cannot have a self-serve gas bar, silly as that may be.
>
> A. Your words, and I would certainly agree with you.
>
> Q. So, the ability of an independent to operate at lower cost is very difficult in many respects, because he would have to operate just like the big boys across the street -- two bays; hours are restricted; have to have attendants; have to have washrooms; all those sorts of things.
>
> A. Yes. ... It raises the cost of distributing gasoline in those provinces.

the type of experience and expertise of a major integrated oil company, or on a piecemeal basis, is not likely to result in a long- or medium-term viable successor to Texaco as a competitor in the Atlantic market.

Lastly, it is clear that some of the factual information on which Professor Stanbury based his opinion was, at best, incomplete. This information was, of course, supplied to him by third parties. Mr. Pink summarized the deficiencies in the evidence.[38] Reference will be made to

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> Q. ... [M]y point to you is that just because they are an independent in the regulated provinces would not necessarily permit them to operate at any significant lower cost?
>
> A. ... [Y]ou are right, ...
>
> A. I think it is a fairly decorous form of competition in the sense that price competition seems to be limited, the margins seem to be high and relatively stable, and the form of competition is even constrained as to whether or not you can offer a limited service operation, the hours of operation are constrained, although some people have 24-hour permits, and so forth.
>
> Therefore, it boils down to the kind of product differentiation, brand name, advertising form of competition, particularly where there is provincial regulation.
>
> Now, outside those provinces, obviously there is more room for competition, but I would not draw the conclusion that competition is particularly intense or vigorous, no.

[38]Transcript at 2394-99.

only one such, by way of example. Professor Stanbury referred to the existence of excess capacity in the Atlantic refineries.[39] This conclusion is not supported by the evidence. One recognizes that there is difficulty in defining capacity and that it is not unusual for a refinery to operate 10%-15% above its rated capacity. Nevertheless, while Newfoundland Processing has excess capacity, it is also subject to a restrictive covenant and cannot supply product in Canada outside the province of Newfoundland. The evidence indicates that the Texaco and Imperial refineries do not have excess capacity and the situation at the Irving refineries is unknown -- that company does not disclose enough information to allow an assessment to be made.

### E) Significance of Continued Operation of Eastern Passage Refinery

As noted, the Director indicated in the DCO that the purchaser of the Eastern Passage refinery should be, to the extent reasonable and possible, someone who would continue the operation of that refinery as a viable concern in order to supply petroleum products into the Atlantic wholesale markets. The continued operation of the refinery is, of course, also the motivating concern of the Atlantic Refining and Marketing Employees Association and the Atlantic Oilworkers' Union Local I.

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[39] Affidavit of W.T. Stanbury, dated July 20, 1989, Exhibit A at paras 8, 13(c).

In giving oral evidence, Professor Stanbury indicated that, in his view, the continued operation of the refinery, as such, should not be the focus of the Tribunal's attention. In his opinion, if a purchaser could import the appropriate product, using the terminaling facilities adjacent to the Eastern Passage refinery, that purchaser would be able to provide the wholesale market with petroleum products of the same kind and in the same amounts as Texaco had previously been supplying.

It is clear that there is a social value in keeping the refinery running. It is common knowledge that employment opportunities are not as numerous in the Atlantic region as elsewhere in the country. At the same time the focus of the Tribunal's attention could not be primarily on that consideration, if competition concerns could equally be met by use of the terminaling facilities. There was some concrete evidence that this might be the case. The primary concerns of the Tribunal have to be factors such as those listed in section 93 of the *Competition Act*,[40] with a view to the issues which Professor Trebilcock indicated should be the focus of attention in any merger case: possible emergence of a dominant firm; enhanced ability for tacit collusion.

Despite the evidence of Professor Stanbury, it has to be assumed that the Director, in expressing the desire that the refinery continue to be

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[40] Also, subsection 96(2) of the *Competition Act* provides that in evaluating efficiency gains it is relevant to consider factors such as whether there will be, as a result of the merger, a significant substitution of domestic products for imported products.

operated as a going concern, was proposing such in order to serve a competitive purpose. His application does not indicate that the hoped-for, continued operation of the refinery was being put forward as mere window-dressing to serve a purpose unrelated to competition concerns.

The evidence g1ven by Mr. Pink's clients respecting the refinery demonstrates that while it is a small and older refinery, it is operating at capacity and profitably. However, it is a marginal operation; its viability varies from time to time in relation to the price at which product is sold in the market. The assets which are to be retained by Imperial would mean a loss to the refinery of: 18-20% of the Texaco retail market gasoline sales m the region (this amounts to almost 10% of the refinery's gasoline production); the sales volume of both gasoline and heating oil attributable to the national accounts; the sales volume of both gasoline and heating oil previously sold to Great Eastern Oil; and, if the Ultramar exchange agreement is not taken up by the purchaser, another 30% of the refinery's total volume of gasoline sales.

It was suggested that the refinery might adjust to this diminution in volume of sales by selling more middle distillates or by exporting gasoline into the United States. Mr. Pink's response, in argument, was to note that while those are possibilities, they are just possibilities. And, he noted, the loss of gasoline sales is a loss at the higher end of the market which cannot profitably be replaced by selling middle distillates. The evidence of Dr. Watkins

emphasized that given the particular (financial) position of this refinery, it was not reasonable to expose it to any more risk than was necessary.

**F) Tribunal Concerns of November 10, 1989 and RDCO provisions**

The cumulative effect of the evidence adduced respecting the Atlantic region led the Tribunal to express reservations, on November 10, 1989, concerning the draft consent order as it then existed.

The RDCO filed with the Tribunal, following the provisional comments of November 10, 1989, differs from the earlier DCO in three ways: (1) there is an additional provision respecting the Newfoundland situation; (2) the provisions respecting approval of a potential purchaser have been revised; (3) the same rules have been applied to the retail market as were applied to retail markets elsewhere in the country (subject to what is said below).

The additional provision respecting Newfoundland allows the purchaser of the Newfoundland assets (now including 11 instead of the earlier six retail stations, as a result of substitutions in the list of stations to be divested combined with the addition of three more stations to the total) to have the option of either (i) purchasing the Long Ponds (Newfoundland) terminal or (ii) being given long-term access to the terminal facilities of Imperial at St-John's on

reasonable commercial terms. This addition is a response to criticism that by allowing Imperial to keep all the Great Eastern Oil Company assets and expecting a purchaser to buy the Long Ponds terminal to service six gas stations the viability of any Texaco successor, as a vigorous competitor in Newfoundland, was being severely undercut.

While the additional provision respecting Newfoundland is clearly an improvement, there are still a number of unanswered questions. One of these is whether Newfoundland, from the beginning, should have been treated as a separate market.

When Dr. Stanbury was asked about this, he said:

> The question that I was asked by the Bureau in preparing the affidavit was whether in the region, as a whole, there was, in my view, a substantial lessening and whether or not that substantial lessening would be offset by the terms of the draft consent order.
>
> In looking at that, the first thing I had to determine was that the unit of analysis, mainly the Atlantic, the four provinces taken together, represented a distinguishable market within the Canada context.
>
> At the opening few paragraphs of the affidavit I point out how I concluded that it was distinguishable, namely that there is relatively little trade in either products or crudes between the Atlantic and the rest of Canada.
>
> For that reason, I assumed that it was appropriate to consider it as a separate regional territory.

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[41] Transcript at 458.

Without some greater analysis of the flow of refined product between the Atlantic provinces themselves, it is not too convincing to rely heavily on this analysis. The Attorney General of Newfoundland and Labrador filed submissions with the Tribunal contending that all the Texaco assets in Newfoundland should be sold as a block separately from assets located in the other Atlantic provinces.[42] It is unfortunate that the Attorney General did not choose to take a more active role in the proceedings at an earlier stage. This might have allowed the issues of market definition and the competitive impact of the DCO in Newfoundland to be more thoroughly examined than was possible in the circumstances. As we understand the Director's position, however, it is that the pre-merger Texaco presence in Newfoundland was minimal at best. Therefore, we understand his argument to be that, if Newfoundland were to be considered a separate market, there would be no reason to ensure the continued viability of the Newfoundland assets as an entity separate from Imperial.

The revised consent order also shows a changed attitude on the part of the Director as to an appropriate purchaser for the Atlantic assets. As noted above, the original draft consent order provided:

> 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 financially

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[42] For further discussion of the position of this intervenor see *infra* at 108.

> sound, is likely to ensure the continued operation of the Eastern Passage refinery as a viable concern and supply the domestic downstream petroleum products market. (underlining signifies an addition made to the original draft consent order as a result of the representations of the intervenors during the hearings of October 16- November 10, 1989)

In the revised draft consent order paragraph 14 has been changed to read:

> 14. The divestiture of the assets in the Atlantic Region shall, to the extent reasonable and possible, be to a single purchaser who, in the Director's opinion, has the intention and the ability to become a vigorous and effective competitor in the Atlantic Region. In exercising his rights of approval under this Order and in accordance with the provisions of the Act the Director in addition to the considerations with respect to acquisitions provided for in the Act, will have regard for (i) the financial soundness of the proposed purchaser of the assets and their continued operation, (ii) the business plans of the proposed purchaser for continued maintenance and operation of the assets, and (iii) the availability to the proposed purchaser of technical and marketing expertise to continue operation of the assets on an integrated basis. The Director retains the right to require further divestiture of Texaco's assets in the Atlantic Region should the initial offering of the Atlantic assets not attract an appropriate purchaser. (underlining added)

The application of the 25% rule which had been applied to retail markets elsewhere in the country led to additional stations being listed for "divestiture". These stations, however, are not mere additions to the earlier list. The change was effected by the creation of a revised list (i.e. some stations were added, others deleted from the original list). Mr. Pink's clients argued that the changes still reflect an intention on the part of Imperial to retain the

best stations and divest itself of those in decline. In addition, they argued that the volumes being kept, in some cases (in particular, Halifax and Charlottetown), were still above the 25% requirement. Imperial responded that it was difficult to comply exactly with the 25% rule in a market like Charlottetown where each station accounts for 4 to 5% of the market. With respect to the Halifax station in dispute, Imperial relied on an estimated 1988 volume, adjusted to account for the fact that the station had only been open part of the year, rather than on the 1989 data put forward by Mr. Pink. Counsel for Imperial argued that the available 1989 figures were distorted since they were based on one 2-month period, one half of which included a successful promotion. Nowhere else in the country was 1989 data used to calculate retail market share.

Given the necessary inexactitude, demonstrated elsewhere, with respect to the divestitures of retail outlets and the fact that it is possible that there are other occasions where 1988 data has been used with respect to new stations, this is not a situation in which the Tribunal thinks the deviation from the prescribed market share requires a more precise determination.

## G) Assessment of Terms of the RDCO

The revised draft consent order has addressed, in part, the concerns which the Tribunal expressed. Some slight amelioration has occurred with respect to the Newfoundland situation. With respect to the divestiture of the

assets in general, the Director retains the right to require the divestiture of additional assets if the existing package does not attract a purchaser who is likely to become a vigorous and effective competitor in the Atlantic region. The Director obligates himself "to the extent reasonable and possible" to only approve a purchaser who has the ability to become a vigorous and effective competitor in that region. And the 25% rule applicable to urban retail markets elsewhere has, in a general way, been applied.

The Director and the respondent rejected the suggestion which appeared in the November 10 comments that, in the circumstances of this case, the most appropriate course of action was for the Tribunal not to make a final decision with respect to the Atlantic assets until the identity, experience and plans of the proposed purchaser were known.

As has already been noted, the Tribunal members hold different views on whether or not the terms of the RDCO with respect to the Atlantic region should be approved. The division of the Atlantic assets between Imperial and an as yet unknown third party purchaser raises questions which would not have arisen had all the assets in the region been ordered divested. This is particularly true in a context where the severing of those assets from the infrastructure, previously provided by being a part of a large, national, integrated oil company, itself, constitutes a potential diminishment. It is

unfortunate that the Director's analysis, as presented to the Tribunal, did not address some of the issues in more detail. The generalized opinion given by Professor Stanbury simply restates the conclusion which the Tribunal itself must make. It is certainly not possible to conclude, as the Director has done, that "in Atlantic Canada, the Draft Consent Order effectively re-establishes the market structure that existed pre-merger ...."[43]

On the basis of the evidence as it stands, two members of the Tribunal are of the view that they cannot conclude that the merger, as conditioned by the terms of the RDCO, results in a situation where the substantial lessening of competition which it is presumed will arise from the merger has in all likelihood been eliminated. The remaining member would approve the RDCO.

The two members are of different views, however, with respect to the appropriate disposition flowing from that conclusion. One is of the view that the appropriate disposition is to require Imperial to put all the Atlantic region assets up for sale and, that the Tribunal should not retain jurisdiction to review the plans and expertise of a prospective purchaser, for the purpose of deciding whether it will be a vigourous competitor in that region. The other member is of the view that the Director and Imperial should be given further opportunity to detail the identity, experience, financial resources and plans of the proposed purchaser.

[43]Notice of application at para. 89.

## VII Terminals

The draft consent order requires Imperial to divest nine terminals in Central and Western Canada. These are located in Baie Comeau, Rimouski, Sault Ste Marie, Thunder Bay, Sudbury, Ottawa, Calgary, Prince George and Victoria. The sale of the terminals in Sault Ste Marie and Victoria may be made conditional on Imperial being able to negotiate terminaling rights for a specified time period for a part of the capacity of those terminals. All terminals are to be offered in operating condition at fair market value.

It is almost certain that the terminals, save for those in Sault Ste Marie and Victoria, would be closed without the requirement of the draft consent order. Substantial savings are predicted to occur from the closure of the terminals and the diversion of their volume of product to other facilities to be maintained by Imperial.

Professor Lermer's evidence is relevant:

> ... [I)t would be inappropriate and wasteful to consider imposing substantial private costs on the parties to a merger and social costs on the community by preventing the merger's efficiency gains to be realized. There are real and significant efficiency gains to be realized from the merger, especially through Imperial's joint operation of the Nanticoke and Sarnia refineries. <u>Only low cost</u> remedies having the effect of constraining any future potential for the industry to cartelize should be applied.

> ... By agreeing to divest marine terminals, Imperial will be potentially making available facilities to independent marketers for importing and distributing gasoline. This latter remedy seems to meet Imperial's needs because it has sufficient storage facilities for its own requirements. However, the DCO ensures that Imperial does not hoard the facilities and that the facilities must be made available without petroleum use covenants. ... (underlining added)[44]

It is the Tribunal's understanding that what the Director has "gained" in the divestiture of terminals is that Imperial will sell them without a restrictive covenant requiring that they only be used for non-petroleum storage purposes.

## VIII Supply Assurance - Ontario/Quebec

### A) Nature of Presumed Substantial Lessening of Competition

One of the main difficulties in assessing the appropriateness of the supply assurance provisions is identifying the nature and extent of the likely substantial lessening of competition which they are designed to eliminate. This is a difficulty which arises, naturally, in a consent order application because, as noted above, such applications are based on an assumption that a substantial lessening of competition will m all likelihood result from the merger. The parties forgo the obligation, which would otherwise exist, of adducing evidence on that point and the Tribunal starts

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[44] Affidavit of G. Lermer dated July 17, 1989, Exhibit A: Competition in Canadian Gasoline Refining and Marketing: An Economic Analysis of the Director's Draft Consent Order at paras 56-57.

its consideration of the draft consent order on the basis of the assumption which the parties have adopted.

At the same time, in order to assess the effectiveness of the various terms of a draft consent order, some appreciation of the extent and nature of the substantial lessening of competition which is likely to occur is necessary. In this case, a review of the evidence, the pleadings and the arguments discloses some difficulties in this regard. The Director summarized his position as follows:

> 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 refining 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. (underlining added)

While the above paragraph seems to indicate that it is the Director's view that both excess capacity and the import option must disappear before there could be a substantial lessening of competition, a subsequent paragraph of the Director's notice of application indicates that the absence of either one or the other (excess capacity or the import option) would destroy the viability of the independents:

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[45] Notice of application at para. 30.

> 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. (underlining added)[46]

This same approach is reflected in counsel for the Director's closing argument.

Some argue, however, that excess capacity inhibits rather than promotes competition. Professor Lermer explained that point of view:

> The impact of excess refinery capacity on the potential to cartelize is more problematic than is the impact of imports. ... [S]everal theorists argue that both planned and unplanned excess capacity facilitate cartelization in two ways. First, excess capacity creates an entry barrier and second, excess capacity gives credibility to aw threat of immediate retaliation and deters cheating.

It is clear that, if the substantial lessening of competition which the Director alleges was based solely on a remote possibility that at some time in

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[46] *Ibid.* at para. 72.

[47] Affidavit of G. Lermer, dated July 17, 1989, Exhibit A: Competition in Canadian Gasoline Refining and Marketing: An Economic Analysis of the Director's Draft Consent Order at para. 16.

the future foreign government action or other, at the moment unknown, event might interrupt imports, then it would be hard to justify imposing obligations on Imperial through a draft consent order. The "likelihood" of the merger substantially lessening competition would be difficult to prove or even to presume. The basis of the Director's concerns about the lessening of competition which will arise from the merger must be more strongly founded than that.

The Tribunal understands the Director's concerns to be based on a stronger ground. It is useful in this regard to quote part of the evidence of Professor Waverman:

> The merger does reduce the number of participants in the petroleum refining sector in Central Canada by one and, therefore, could increase the risk of collusion. One of the Director's concerns is that a high degree of vertical integration and increased concentration at the refinery level might increase transparency of integrated refiners` strategies and thus the potential for interdependent behaviour.[48]

Thus, the Director alleges that the increased concentration at the refinery level, given a vertically integrated industry and an increased concentration at the retail level, enhances the stability of the refiner oligopoly. This helps to insulate the integrated oil companies from the competitive pressures which operate in the Ontario/Quebec regions as a result of the existence of a significant number of independents.

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[48]Affidavit of D. Dorenfeld, dated July 24, 1989, Exhibit A by L. Waverman (July 24, 1989) at para. 26.

Pre-merger there were six refiners operating m the Ontario/Quebec region. Post-merger there will be only five. Imperial's acquisition of Texaco's Nanticoke refinery in addition to its own refinery at Sarnia will give it 28% of the crude refining capacity in the region, a jump from third to first (a position it will share with Petro-Canada which also has 28% of the crude refining capacity). More importantly, Imperial's post-merger share of the maximum gasoline capacity will be at least one-third, the highest in the region. Obviously, the same barriers to entry into refining exist as were mentioned in the Atlantic region.

At the retail level, in the Ontario/Quebec region, Imperial's post-merger gasoline market share would exceed 30% in 17 cities and 25% in 18 additional cities, including Toronto and Montreal without the divestitures contemplated in the DCO. In addition, Texaco was an equally dynamic competitor in the retail branded sector in this market as in the Atlantic.

**B) Role of Independents**

The Director's position is that the independents play an important role in the Ontario/Quebec market because they:

> 76. ... remove the option for the concentrated refiner/marketer group [the integrated majors] 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:
>
> > "... 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 the power is not misused. (RTPC, p. 448)" (underlining added)[49]

Through its Nanticoke refinery in Ontario and through a reciprocal supply agreement with Petro-Canada in Montreal, Texaco was an important supplier to independents in both Ontario and Quebec. Historically, Texaco did a much higher volume of business with independents than Imperial.

Professor Lermer, who assisted the Director m the preparation of his application, explained the position:

> 17. The presence of independent marketers is important to competition at the refinery level for a number of reasons. First, there is little evidence that vertical integration from refining to marketing carries substantial efficiencies, so that independents with access to competitively priced supply can place a cap on the refiner-marketers' distribution margins (encompassing wholesale and retail margins). Second, independent marketers create a market for refinery sales at the wholesale level which helps destabilize a cartel. Finally, a large, successful independent marketing network, or buying group of independents, can invest in facilities for importing gasoline or many even backward integrate into refining.

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[49] Notice of application at paras 76-77.

> 53. The supply order is properly an interim measure. ensuring that the independent marketers are protected during the immediate aftermath of the merger and before expanded terminaling facilities can be put in place. It also ensures the survival of the independent marketers during any temporary break in imports. Finally it undermines any possible effort by a concentrated refinery sector to reduce domestic gasoline supplies to independent marketers.
>
> 55. The DCO recognizes that the structural change brought about by the merger would likely substantially limit competition should the import option be interfered with. Protectionist policies, the future disappearance of surplus refinery capacity and the potential inadequacy of the infra-structure for importing large volumes of gasoline, all threaten the independent marketers' sources of competitively priced gasoline supplies. The DCO's remedies address these concerns. (underlining added)[50]

## C) Industry Context - General

The Director and Imperial adduced evidence concerning the industry context within which the supply assurance provisions would operate. This evidence had a strangeness about it given the assumptions of the application. That is, the Director and Imperial assumed a likely substantial lessening of competition as the basis of the order they seek and then adduced evidence aimed at refuting that assumption. This evidence sought to demonstrate that the merger raised no competitive concerns because there would be excess capacity for a number of years yet and because the import

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[50] Affidavit of G. Lermer, dated July 17, 1989, Exhibit A: Competition in Canadian Gasoline Refining and Marketing: An Economic Analysis of the Director's Draft Consent Order at paras 17, 53, *55*.

option operated so as to discipline domestic prices. The Tribunal understands this evidence to have been put forward to support the conclusion that no more stringent obligation need be imposed on Imperial than the supply assurance provisions set out in the draft consent order - that is, to demonstrate that divestiture of the Nanticoke refinery was not required.

## D) Industry Context - Excess Capacity

With respect to excess capacity, the Director adduced evidence through Mr. Brown that excess capacity in the Ontario and Quebec refineries would disappear in the mid-1990s. This estimate was based on National Energy Board forecasts (published in September 1988). The data in these forecasts were analyzed by Mr. Brown using a linear programming model which he had developed for that purpose. Pioneer Petroleums challenged the accuracy of Mr. Brown's estimate on the basis that the National Energy Board forecasts for 1988 and the first half of 1989 were too low. It was submitted that more current information led to an estimate that excess refinery capacity would run out, at the latest, in 1992-1993.

One has to recognize that any estimate of this nature is necessarily inexact. Mr. Brown indicated that, in his view, his estimate was conservative because he had not taken account of planned expansion and refinery up-grades about which he knew. When questioned as to whether, if those expansion plans were carried out, there would be an expansion in capacity by 1995, he responded:

> That is generally what happens. Everybody runs out and builds something new or de-bottlenecks and the first thing you know the surplus is worse than it ever was. It is a herd instinct.[51]

With respect to the larger world market, Mr. Brown noted that the June 5, 1989 Oil and Gas Journal had forecast that tight supply would occur over the summer and that a shortage

> did not in fact occur. Stocks remained comfortable to high, both in Europe and the U.S., throughout the summer.
>
> Stocks currently in Europe are g out 8 million barrels higher than they were a year ago.[52]

Mr. Hervieu, whose industry analyses were filed as evidence by Pioneer Petroleums, concluded, however, that "[u]nleaded gasoline will be in tight supply in North America for the next three-to-five years. Demand is growing, domestic supply is limited and imports are being constrained by strong demand from other countries (especially from Europe)``[53]. A second article was to a similar effect.[54] The Tribunal recognizes that there is a difference between excess capacity in Canadian refineries and a worldwide tightening of supply but the effect on the market is similar.

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[51]Transcript at 834.

5 2-rranscript at 682.

In any event, for the Tribunal's purposes, it is not important to choose one estimate respecting the possible disappearance of excess capacity over the other. It is sufficient to note that the Director is concerned that within a few years excess capacity may disappear. Whether this be in two years or in five is not of immediate concern to the Tribunal, given the fact that the supply assurance provisions being sought from Imperial will extend over a seven to ten year period.

**E) Industry Context - Import Option**

With respect to the evidence concerning the import option, it must first be noted that imports of gasoline into the Ontario/Quebec region are more extensive than into the Atlantic region. In 1988 just over 12% of the net supply of motor gasoline in Quebec was imported, while almost 4% of the Ontario supply came from imports. However, a significant portion of these imports is used by refiners to optimize refinery runs. Even though there are no tariff barriers, the ability to import is restricted

[53] Evidence Statement: Pioneer Petroleums, dated September 25, 1989, Schedule B: Refined Petroleum Products: Interim Monitor (August 1989) by P. Hervieu at 1.

[54] *Jbid.*, Schedule C: A Special Report on Refining & Marketing (September 1989) by P. Hervieu.

by quality problems caused by different gasoline octane levels, exchange rate fluctuations, onerous credit terms and the risk of supply interruption. In addition, marine cargoes into Ontario are limited by the necessity for smaller-sized cargoes and the shorter navigation season while trucking into Quebec is, in general, prohibitively expensive. Importing by truck is extensive only in the Southern Ontario region and the existence of this activity depends on the availability of supply at terminals at two key supply points -- Buffalo and Detroit.

Imperial's evidence respecting the discipline imposed on Central Canadian refinery prices by the wider international market was based on the assertion by Professor Waverman that the Central Canada market is an extension of the Eastern United States, United States Midwest and Gulf Coast refining and wholesale gasoline market. A large number of foreign refineries are situated close to Central Canada or are connected to pipelines with terminals close to the border. A number of pipelines service border markets: the Atlantic and Mobil pipelines connect the Philadelphia area refineries to Buffalo; the Buckeye pipeline, which connects to the Atlantic pipeline, carries petroleum products from marine terminals and refineries located in the New York/New Jersey area; the Buckeye pipeline also connects with a pipeline carrying product from the Gulf Coast area; two other systems transport from the Gulf Coast and more than a dozen pipelines in the Michigan-Ohio area connect local refineries to the larger United States supply network adjacent to the Canadian border.

Imperial's further evidence, also adduced through Professor Waverman, was that gasoline passes freely from one side of the border to the other, that is,there are no governmental restrictions; transportation, terminaling and related costs between United States refineries or terminals and Canadian facilities are low (1.8 to 2.2 cents per litre); wholesale gasoline prices in the two major markets in Central Canada (Toronto and Montreal) are highly correlated with corresponding wholesale prices of gasoline imports (from Buffalo and Gulf Coast). It was asserted that this correlation "indicates there is a clear connection between the Toronto and Montreal markets and international markets for regular leaded and unleaded gasoline".[55]

Pioneer Petroleums challenged the validity of many of these assertions. Professor Waverman's assertions were made, of course, from the position of an observer of the industry. Pioneer's assertions were those of a participant. Pioneer's evidence was that the possible flow of imports was not as smooth as Professor Waverman's evidence would seem to indicate. There were costs arising out of United States and Canadian tax requirements which did not pertain in the case of domestic supply. Long term supply commitments were difficult to obtain from American suppliers. Credit terms demanded by those suppliers were often more onerous than was the case with domestic supply.[56]

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[55] Affidavit of D. Dorenfeld, dated July 24, 1989, Exhibit A by L. Waverman (July 24, 1989) at para 23.

[56] Many of these were recognized by the Director in his Industry Overview document as relevant considerations.

Pioneer made the following comments about the six wholesalers which Professor Waverman indicated were potential suppliers located close to the Canadian border: one was not considered a reliable supplier because product shortages often occurred; another was not considered reliable because limited loading facilities existed and the source of its product was unknown; another (Mobil Oil Company) did not sell to unbranded customers; a fourth was reducing its storage capacity and Pioneer had experienced product shortages when dealing with it. The fifth, Pioneer's best supplier, Sun Refining and Marketing Company, has given notice that it will no longer be supplying the wholesale market. This notice is coincident with the merger of Sun with the Atlantic Refining and Marketing Corporation, which will also exit the wholesale market. This latter is the sixth source of supply on Professor Waverman's list. The merged company has indicated that it will need all the product available to it to supply its own network.

At the same time, a new venture to import off-shore product into Southern Ontario, for sale to independents, was just getting underway during the hearings (Montank). At present all that can be concluded from this is that one entrepreneur considers it economically feasible to attempt to establish such a source of supply.

In addition to the factual limitations on the import option which were highlighted by Pioneer's evidence, the theoretical analysis of the price correlations between the Toronto and Montreal markets and the Buffalo and Gulf Coast markets did not stand up on examination.

Since there are no governmental barriers to the import of refined petroleum products and petroleum products are commodities, it would be surprising if imports did not constrain domestic prices. Some evidence that this is the case was seen in the terms of contracts that explicitly tie the price to be paid under the contract to crude prices or to spot foreign prices. A number of contracts introduced in evidence show that the prices of large volumes of sales are tied to crude prices or to spot foreign product prices.

With respect to the analysis of price correlations, the comparisons were made between prices in the United States Gulf plus transportation to Montreal and the posted prices of refiners in Montreal, and between the landed price in Toronto of product purchased in Buffalo and the prices charged by refiners in Toronto. The econometric model employed by Dr. Dorenfeld, an Imperial employee, and later by Professor McFetridge, after he had explored other possibilities, led Professors McFetridge and Waverman to conclude that, over the cycle, there is no difference between prices in Montreal and Toronto when compared with their respective foreign counterparts. The conclusion regarding the Montreal/Gulf comparison was stated by Professor McFetridge

with less confidence than that respecting the Toronto/Buffalo comparison.[57]

The conclusions of the witnesses that domestic and foreign prices are the same over the cycle greatly overstates what the evidence will bear. A close examination of the respective price series shows that the model and its underlying rationale are not helpful in understanding the extent to which domestic and foreign markets are integrated.

## F) Efficiency Gains

According to the Director's analysis efficiency gains will arise as a result of the merger because: (i) the same amount of refined product will be distributed using fewer terminals resulting in lower inventories and other costs; (ii) advertising expenses and the sales force infrastructure will be reduced from the pre-merger totals; (iii) the level of inventories required to be held by the combined Imperial/Texaco enterprise will be less than the aggregate of that held by each separately; (iv) overhead expenses of the combined enterprise will be less; (v) more efficient use of the Sarnia and Nanticoke refineries will be possible by virtue of product specialization. This will

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[57] Comparisons were also made between U.S. posted prices and confidential transaction prices in Montreal and Toronto. There is little reason to have much confidence in these comparisons since discounts off posted prices in the U.S., as well as in Canada, are available.

increase output and reduce investment that would otherwise have been required at Sarnia.

Efficiency gains claimed by Imperial in a number of areas have been accepted by the Director. The Director asserts, however, that the gains are not sufficient to overcome the alleged substantial lessening of competition from the acquisition. This assertion was not put to the test but it should be noted that the dollar total of the claimed efficiencies is substantial.

There is good reason to believe that the various amounts are open to serious question; in most areas they depend on what happens, post-merger, to the combined pre-merger market shares of Imperial and Texaco. This can best be explained by reference to the example of claimed savings from building only one gasoline outlet in a new area rather than two. Imperial's expenditures on new stations may well be lower than what the combined Texaco/Imperial expenditure for this purpose would have been in the absence of the acquisition. This does not mean that there is any efficiency, i.e., that Imperial will enjoy lower unit costs of distribution than prior to the merger. What happens to its unit costs depends on how many of the customers who, pre-merger, would have been Texaco customers it can attract. A similar comment is in order with respect to all the claimed efficiencies, save for those arising from refinery synergies. Whether the reduction in expenditures translates into efficiencies depends on what happens to the level of sales. This is particularly appropriate where the expenditures are of a nature that affects demand for a company's product, as is true for the number of retail outlets and the expenditures on advertising.

Other areas where Imperial foresees savings are in head office activities and in reductions in the retail and commercial sales and support workforce. Significant savings are also anticipated from combining terminaling in a single facility where there are duplicate terminals. The Consent Order Impact Statement correctly notes that whether there will be savings and their amount depends on whether the terminals are acquired and maintained in operation.

One of the largest sources of claimed cost savings is through combining the operations of the Sarnia and Nanticoke refineries. While the exact nature of the synergies is not clear, according to Professor Waverman the savings arise because Sarnia has excess crude refinery capacity, of which Nanticoke is somewhat short, and Nanticoke has excess capacity for treating partially refined streams. In any event, the result of operating the refineries jointly is that there is an increase in output that consists almost totally of gasoline (in excess of 85%) and diesel. All of the net revenue from this additional output is counted as an efficiency. This is justified only if the sole alternative to combining operations was to stay with "as is", separate operations. Such a comparison is incomplete because it fails to take into account the costs and additional output that would have resulted from separately removing the bottlenecks in each of the refineries. A comparison of the claimed efficiencies with the cost of adding new refinery capacity suggests that if the analysis had been completed the value of the claimed synergies would have been much less.

The foregoing consideration raises a question regarding the potential effect on competition from the merger. While much has been made of the benefit from the increase in output resulting from combining operations, the increase in capacity that would have resulted if the capacity problems of the refineries had been resolved independently and the effect that this would have had on competition have apparently been lost sight of.

**G) Supply Assurance provision - Adequate Remedy**

In this context, it is necessary, then, to assess the supply assurance provisions. As has been noted, the purpose of the supply assurance provisions is to ensure the continued viability of the independent retail gasoline sector in Ontario and Quebec. Despite the weakness of some of the evidence put forward respecting the import option and the efficiency gains, the Tribunal accepts the conclusion that a supply assurance provision will be adequate to meet the concerns which have been identified as arising out of the merger.

**H) Terms of Supply Assurance - DCO - Assessment**

The focus of the Tribunal's attention in this case was on the effectiveness and enforceability of the particular supply provisions which are proposed. In simple terms: will the provisions operate so as to achieve the results which the Director says they are designed to achieve? Will they ensure competitive supply to the independent retail segment of the market to at least the same extent as it existed pre-merger? The Tribunal's concerns focused on

two aspects: (1) whether the terms of the provisions are precise and enforceable; (2) whether the volumes required to be made available really accomplish what the Director asserts will be their effect.

The DCO contained provisions requiring Imperial to "make available" to independents a certain volume of unbranded gasoline over a 7 to 10 year period. There was no requirement that this offer be made at a specific price, within a specific price range or as determined by any given process of arbitration. The supply was to be made available to independents on reasonable commercial terms and Imperial's standard form contract was deemed to constitute reasonable commercial terms for this purpose.

The initial volume to be made available was 1511 million litres (i.e. the volume supplied to independents in 1988 by Texaco and Imperial from the Nanticoke and Sarnia refineries). The volume required to be made available was to increase or decrease each year depending upon industry demand but would never exceed 26.4% of the total gasoline refining capacity of the combined Nanticoke and Sarnia refineries. The volume to be made available was also to vary from year to year (what has been described as "ratcheting" up or down) depending upon the amount purchased by the independents from Imperial in the previous year. Professor Lermer's evidence in this regard was that the merger combined with the retail divestitures west of the Atlantic opens up an additional billion litres of gasoline each year, including (i) synergy volumes from the joint operation of Sarnia and Nanticoke and (ii) divested gallonage previously committed to branded stations. It was his position that

the supply assurance in the draft consent order "ensures the volumes available to the independent sector will be at least as large, indeed larger, than was available from Imperial and Texaco combined, pre-merger." [58]

Some changes were made to the supply assurance provisions, as a result of representations made by the intervenors, even before the end of the hearing. It was recognized that the inclusion of Imperial's standard form contract as "deemed" reasonable commercial terms was not appropriate. Pioneer's representations on this point had been that a term such as: "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" was not a reasonable commercial term in an industry where 30 or 60 day credit terms were usual. Pioneer argued that it was not a reasonable commercial term to allow Esso to change to a cash basis without notice or explanation. It was argued that it was not a reasonable commercial term to provide: "... if at any time during this Agreement ... 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." Also, the default clause of the standard form contract provided that Esso could treat the agreement as repudiated:

> [i]f 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.

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[58] Transcript at 1367, 1373.

This, it was argued, was not a reasonable commercial term in an industry where the practice was to allow for underliftings and overliftings. In addition, it would be a disincentive for independents to use the import option when so doing would likely put them in breach of their supply contract with Imperial. The provision which stated that Imperial's standard form contract constituted "reasonable commercial terms" was removed from the DCO.

In response to Pioneer's representations, terms were added to the DCO to require that the volumes which were to be supplied to independents should be of a grade mix approximately proportionate to the grade mix being sold by Imperial to the industry generally in Ontario and Quebec (and supplied directly or indirectly from its Sarnia and Nanticoke refineries). Pioneer had argued that without such provision, Imperial would have been able to offer the independents only the least commercially attractive grades of gasoline.

The volume to be sold to independents each year is to be adjusted from the prior year by reference to increases or decreases in general industry growth. Pioneer argues that the annual adjustment should be by reference to increases or decreases in the growth of the independent segment of the market, not the industry in general. This again might be an improvement which would create a stronger guarantee for the independents but it would be hard to argue that a guarantee to supply commensurate with industry growth is not also acceptable within the context of the guarantees sought to be established by the Director.

Despite the changes made to the DCO by the Director and Imperial before the end of the hearing, the Tribunal remained concerned. The Tribunal was concerned that an obligation to "make available" or offer for sale, in the absence of any provisions or mechanism for determining a competitive price, would not be an effective supply provision. While the Tribunal recognized that a price clause could be anti-competitive (in establishing a focal point around which a minimum price for the industry would stabilize), without some mechanism (even ex post facto) for determining price or some alternative scheme guaranteeing supply, a requirement that a certain volume of gasoline "be made available" seemed both unenforceable and ineffective. As was noted, when the position of the supplier on both the supply axis and the price axis is indeterminate one does not have much of a guarantee of supply.

It was argued that on each occasion when a would-be purchaser wished to buy from Imperial and either Imperial offered or the purchaser requested terms that were not "commercially reasonable", then that issue would be litigated in front of the Tribunal. If Imperial did not comply with an adverse ruling, a contempt order would issue. Orders which are sought from the Tribunal should be precise and enforceable without the need to return to the Tribunal for a variation or interpretation of those orders before they can be enforced. The Tribunal is not a regulatory agency. It does not see its role as one of continually monitoring an industry participant by reference to general standards. It has neither the staff nor the expertise to do so.

In addition to concerns about enforceability of the supply assurance provisions, the Tribunal also expressed concerns about the volume of gasoline the supply provisions purported to cover. The Tribunal expressed three concerns about the adequacy of the volume of gasoline being required to be made available by Imperial to independents: (1) it questioned whether the volume in the base year covered the amounts which Imperial and Texaco presently sell to independents; (2) it was concerned that the cap, 26.4% of the combined Nanticoke and Sarnia capacity, was not very far distant from the amount required to be provided in the base year (i.e. inadequate provision for growth); (3) it was concerned that the ratcheting up and down, by reference to the amount of gasoline independents had bought in the previous year, had the effect of discouraging independents from using the import option and at the same time insulated Imperial from having to meet the import price.

With respect to this last, if the independents exercised the import option and did not purchase a certain volume from Imperial, Imperial would be required in the following year to make a correspondingly lesser volume available to the independents. This seemed to undercut the Director's objective of trying to establish an environment in which independents would both be able to take advantage of the import option (in order to discipline domestic prices) and at the same time be guaranteed competitive domestic supply (to ensure their continued viability).

## I) Terms of Supply Assurance - RDCO – Assessment

In response to the Tribunal's concerns expressed on November 10, 1989, the Director filed, on November 28, 1989, a revised draft consent order (RDCO). The revised draft consent order replaces the obligation to "make available" with a requirement that a certain volume of gasoline must actually be sold by Imperial to independents. Mr. Howard, counsel for Imperial, made the point that it was always Imperial's intention to sell and that the earlier formulation was not an attempt to be coy. While that may very well be true, in the context of a Tribunal order, as has been noted, terms have to be sufficiently precise and unambiguous so that they can be enforced by way of contempt proceedings should a party not comply with them. An intention to sell, where no obligation to sell is imposed, could not be enforced in this way.

Pioneer Petroleums still argues that a supply provision without some sort of price mechanism is ineffective. It is argued that an obligation should be imposed on Imperial to supply to independents "at competitive prices". What constitutes a competitive price, it is argued, could be determined as follows:

> 20A. Twice yearly an independent may make a report to the Director if it feels that Imperial has failed to price competitively and has, therefore, breached its supply obligations under the RDCO. That report shall contain audited statements covering the prior six month period showing the independent's best Canadian contract price and Imperial's final net price to the independent.
>
> 20B. If the report demonstrates that Imperial's pricing has not been within 20 points of the independent's best Canadian contract price at least 50% of the time, the Director shall apply to the Tribunal for a remedial order for breach by Imperial of its obligation to supply at competitive prices.
>
> 20C. Imperial will not be entitled to cancel an independent's contract or impose a penalty for the independent's failure to pick up product if it is not priced competitively. At Imperial's request an independent shall supply the Director with audited statements every six months showing that it has picked up

> product at all times when Imperial's prices were competitive. Imperial shall be entitled to cancel a contract for failure to pick up competitively priced product within one business day of notice of written prices becoming competitive.[59]

Pioneer notes that the provision it has suggested Is precise and enforceable, does not require routine monitoring by the Director or frequent appearances before the Tribunal, does not require the automatic reporting of prices to the Director, does not require competitive pricing on a daily basis, ties competitive prices to Canadian contract prices only and obliges a purchaser to pick up competitively priced product.

The price clause which Pioneer suggests is not one that would create a minimum price around which industry price would stabilize. At the same time, however, the Tribunal accepts the Director's argument that Imperial should not be required to sell at a "competitive price" which Pioneer defines. Competitive prices fall within a range. Imperial's marketing strategy is clearly one designed to attract customers who will enter long-term contracts at a fairly stable price (i.e., price related to crude price or other ascertainable indicia). Pioneer's purchasing strategy is not compatible with this. It purchases on the spot market at fluctuating prices.[60]

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[59] Pioneer Petroleums Comments on the Revised Draft Consent Order, dated December 6, 1989 at para. 24.

[60] Pioneer purchases on the spot market in Canada or the United States (Buffalo and Detroit) as price advantage dictates. With respect to its domestic purchases, at least, it holds a number of long term contracts for supply which do not specify a price (either by reference to crude prices or other determinable indicia). As is common in the industry, these variable price contracts stipulate a minimum volume of gasoline which the purchaser <u>must</u> purchase over a certain period of time (e.g., a year) and a maximum volume of gasoline which the purchaser <u>may</u> purchase over that

Pioneer's price clause seeks to require Imperial to sell to independents at a price which is close to the lowest spot market price at least 50% of the time.

The Director takes the position, which the Tribunal accepts, that it is sufficient to require Imperial to sell a certain volume. In order to meet its volume requirement, it must sell at competitive prices. It is not necessary to require that the sales be in accordance with the pricing formula established by Pioneer, as opposed to merely within a range of generally competitive market prices which an obligation to sell will indirectly require.

The revised draft consent order replaces the requirement that the supply be made available to independents on "reasonable commercial terms" (which no longer include Imperial's standard form contract) with a requirement that a volume of gasoline be sold to independents and if Imperial refuses to sell, in a specific situation, it will be required to satisfy the Director that the terms sought by the particular independent are commercially unreasonable. What is commercially unreasonable is probably as vague as what is commercially reasonable (a feature of the order about which the

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time period. Thus, a purchaser such as P:ioneer benefits from having several sources of supply because this enables it to purchase from the least expensive source at any given time. This can lead to total purchases from a given supplier for the time period in question (e.g., one year) falling below the contractual minimum ("underliftings") and the total purchases from another supplier over the period rising above the maximum contracted volumes ("overliftings"). According to Mr. Howard, as a matter of industry practice contracts are not cancelled when underliftings occur. There may be reluctance to renew the contract, however, if the underliftings are persistent and substantial. Pioneer has been able to negotiate contracts with some suppliers that do not even require the purchase of minimum volumes.

Tribunal was somewhat critical). In this regard there is no improved precision in the order. However, the addition of the Director as an arbiter in the process does improve the enforceability. There is a precise event (the Director's decision) upon which a contempt order could fasten. In addition, the reverse onus provision strengthens the obligation imposed on Imperial.

Imperial and the Director have adjusted the base year volume (subject to what is said below) to the total volume sold by Texaco and Imperial to independents in 1988 in Ontario and Quebec, adjusted by the estimated increase in industry demand in 1989: 1552 million litres. The volume to be made available in 1990 is estimated at 1594 million litres.

With respect to the 26.4% cap, when calculations are done it is clear that this is a reasonable limitation. Some of the figures are confidential. One starts by acknowledging that the growth in demand for gasoline is expected to be somewhat flat over the next several years (the National Energy Board projected 0.6% annual growth from 1986 to 2005). The actual growth during 1989 was in the neighbourhood of 2.7%. Using those figures as indicating a range within which industry growth might lie, it is clear that the Tribunal's initial concerns were not well founded; the cap which is proposed is not unreasonable.

The revised draft consent order does not contain the ratcheting up and down of the supply volume by reference to the volume of purchases made by independents during the preceding year. The volume to be sold to independents remains constant subject to adjustment for industry growth or decline. The obligation to actually sell a certain volume to independents, as opposed to merely offering to sell, creates a guarantee that the required volume will actually go to the independents.

At the same time, three new qualifications have been added to the terms of the order. Two new qualifications apply to the volume to be supplied to independents. The third qualification relates to the circumstances in which an independent will be entitled to contract with Imperial for supply. All the Tribunal members are not in accord as to the portent of these changes or the appropriate response of the Tribunal thereto. What follows with respect to these provisions reflects the views of two Tribunal members only.

The first qualification, relating to volume, states (subparagraph 21(4)):

> In order to recognize the flexibility incorporated in usual contractual terms and that domestic demand may be satisfied by the import of petroleum products, Imperial shall have complied with its obligation to sell gasoline to independent marketers under this Order in any supply year if the volume of gasoline actually sold to independent marketers is within ten percent (10%) of the volume required to be sold to independent marketers ....

It is to be noted that, despite the preambular explanation in this clause, the 10% latitude allowed to Imperial under the clause is absolute in nature. It is not conditioned on any event or events. In effect, it means that Imperial's obligation to sell 1594 million litres is really an obligation to sell 10% less than that.

Pioneer Petroleums comments on this change:

> The "ratchet down" clause in the DCO has been replaced by a provision in paragraph 19(4) [sic] saying that the volume sold in any year may be 10% less than the RDCO volume as adjusted for industry increases and decreases. That means that the volume which is committed to be sold in 1990 is really 1435 million litres rather than 1594 million litres. 1435 million litres is less than the original DCO volume. This provision is more severe than the ratchet down formula. Under this provision Imperial can accomplish a volume reduction in one year that would have taken several years under the DCO "ratchet down" formula. ... This provision also allows Imperial to minimize the impact that any gasoline imports will have on its pricing by permitting it to sell less to independents in years when imports are available.
> ... This provision runs contrary to the Director's reliance on the import option to constrain Imperial's post- merger pricing because it excuses Imperial from the obligation to sell in the face of competitively priced imports.[61]

Counsel for Imperial argues that the 10% volume clause is necessary because the obligation on Imperial has been changed from one requiring that gasoline be offered for sale to one requiring that it be sold. This argument is not convincing. In the first place, while the DCO only required that product be "made available" all the analyses by the expert witnesses of the effect of

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[61] Pioneer Petroleums Comments on the Revised Draft Consent Order, dated December 6, 1989 at para. 5.

that provision proceeded on the assumption that the volume would in fact be sold that it would enter into the wholesale market and be available for independents. More importantly, however, the clause is not expressed in the qualified terms which Mr. Howard's argument indicates it is designed to serve. It is expressed as an absolute volume figure and really makes subparagraph 21(1) ineffective.

At the very least, to accomplish the purpose which paragraph 21(4) is said to serve, it should be revised so as to provide something along the lines of the following:

> Imperial shall not be in breach of this order if in any supply year its sales to independents fall short of the volume of gasoline required to be sold under this order, providing Imperial can demonstrate to the Director that such shortfall was the result of underliftings, by independents, which underliftings could not reasonably have been anticipated and which shortfall shall not in any event exceed 10% of the volume required to be sold to independent marketers pursuant to the other provisions of this order.

The second new qualification in the RDCO with respect to the volume to be sold to independents is that any volume sold to debranded stations (under the 5 year commitment to supply) will now be counted as part of the 1594 million litre volume. These previously had been excluded because the volume of gasoline being provided to those stations (i.e. Texaco and Esso brand stations) was not part of the volume supplied to independents, by Texaco and Esso, pre-merger. To the extent that the amount supplied to those

debranded stations is allowed to be counted as part of the supply to independents post-merger, it of course decreases the volume of supply available to the existing independents. This is contrary to what the Director asserts the supply provision was designed to accomplish: a volume of supply to independents which is no less than that which existed pre-merger, adjusted for industry growth.

Mr. Howard argued that this change was "relatively insignificant" -- that it only amounted to some 177 million litres if unbranded supply were taken up by all the "divested" stations. If the Tribunal is correct in thinking that the amount which will be taken up by debranded dealers may not be large then the change may not matter. If, however, all debranded stations were to avail themselves of this provision, the amount taken up (approximately 180 million litres plus whatever amount arises out of the 68 additional divestitures in Quebec) would not be, as counsel would have us conclude, insignificant. It is impossible to conclude, on the basis of the limited evidence before the Tribunal, whether the amount of gasoline which will be supplied to the divested stations, pursuant to the 5-year guarantee, will be a small volume or a large one. Consequently, the approach originally taken, of leaving this amount out of the calculation, is both the most practical and logical way of proceeding. It is also most consistent with the purposes of the supply provision.

The third qualification which has been added is a most peculiar addition. It is stated (in paragraph 27) that Imperial shall not be required to supply to any independent marketer

> who is in default as a result of non-payment under any existing processing or other supply arrangement with Imperial, Texaco or <u>any other gasoline supplier.</u>

The underlining indicates the words added to the RDCO provision that were not in the DCO.

It was recognized by counsel for Imperial, in the course of the hearing on December 7, 1989, that the underlined phrase in paragraph 27, which allows Imperial to refuse to supply an independent who is in default of payment with <u>any</u> supplier, was not essential.[62] What is more, it seems somewhat unreasonable. An independent may have a bona fide dispute with another supplier which may result in that independent being technically in default of payment with the supplier. Paragraph 27 as drafted would allow Imperial to refuse supply to such an independent even though the independent's refusal to pay the other supplier was justified. Furthermore, the condition is not necessary. Imperial can demand the normal credit and security guarantees which it is reasonable to require of any customer with whom it contracts. This should be adequate protection against financially shaky purchasers.

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[62] Mr. Howard stated that the provision was intended to address credit risk and that "we can find a way of dealing with that if that is still a concern." Transcript of December 7, 1989 at 102.

Two members of the Tribunal are of the view that these three qualifications should be deleted. The paragraph 27 change is somewhat capricious and in the general scheme of the whole order may not be of much concern. Nevertheless, the change has absolutely no relation to the concerns expressed by the Tribunal on November 10, 1989 which caused it to refuse to grant the consent order at that time. To have a change of this nature suddenly "pop" into a revised order is disturbing.

With respect to the volume changes, the whole thrust of the argument presented to the Tribunal, with respect to the DCO, was that the volume which was to be made available to the independent market was in fact going to go into that market. As Mr. Howard said at the opening of his argument on December 7, 1989, Imperial was not attempting to be coy by agreeing to "make available" as opposed to agreeing to sell. The Tribunal's comments of November 10, 1989 were directed at ensuring that the supply of a certain volume of gasoline to the independent market would be firmly established as an obligation, rather than expressed merely as an intention. The RDCO was filed to meet those concerns and to convert the "intention to make available" into a real obligation to ensure that the quantity is in fact sold to the independents. To find that as part of the response to the Tribunal's concern that the obligation to supply be firmly entrenched, the volume to be provided is itself diminished is disquieting.

Two members of the Tribunal do not find it acceptable that when it seeks to ensure that the obligation to supply is firmly established, it is at the same time met with a proposal for decreasing the required volume to be supplied to independents. This seems inconsistent with what the Tribunal understood to be the principles underlying the parties submissions on the DCO. It is inconsistent with what the Tribunal has been told would be the extent and effect of the supply provision. In addition, all the evidence adduced by the Director's and Imperial's witnesses with respect to the supply assurance provisions were based on the volume set out in the DCO, which did not include an absolute 10% diminution and did not include the amounts being supplied to divested stations as part of the supply volumes guaranteed to independents.

## IX Intervenors

There are fifteen intervenors listed in the style of cause. They all appeared before the Tribunal either by an individual representative or by counsel. There were in addition four other persons who sought leave to make representations to the Tribunal but who found the expense of personal appearance intimidating. Written representations from these individuals were accepted as part of the record on the understanding that those representations could only be given such weight as is appropriate to statements on which there has been no opportunity to cross-examine. The following persons filed written representations on that basis: Texaco Car Wash/Weyburn Lube'n Wash, Weyburn, Saskatchewan (Mr. Koptie); Haberman Minit Mart

Limited/Texaco Food Mart, Cranbrook, British Columbia (Mr. Haberman); Chartier Hotels Limited/Prairie Oasis Texaco, Moose Jaw, Saskatchewan (Mr. Chartier); and Trends Holdings Limited/Road Runner Lube & Tune, also of Moose Jaw.

**A) Status of Intervenors in Consent Proceedings**

Counsel for the parties argued that the Tribunal should not accord persons the right to intervene in consent proceedings on the same basis as such right is accorded in contested proceedings. Counsel noted that the intervenors had had an opportunity, under section 35 of the *Competition Tribunal Rules,* to file comments on the DCO, which comments had been reviewed and responded to by the Director and the respondent. It was argued that the concerns of the intervenors had been considered and they should not be given any further right of involvement in the proceedings.

The Tribunal found it difficult to accept that argument. The rationale for according an intervenor status in consent proceedings, when the order sought directly affects his or her interests, is even stronger than that which exists in contested proceedings. In contested proceedings, it is not known, at the time intervenor status is requested, whether the would-be intervenor will be adversely affected by the order eventually given. In consent proceedings that is not the case; the likely disposition of the issue is known and a would-be intervenor knows with certainty whether his or her interests will

be adversely affected if the order sought is granted. In such circumstances, it is very difficult, to refuse leave to intervene to a person who will be directly and adversely affected by a DCO without offending the rules of natural justice.

**B) Protracted Proceedings as a Result of Intervenor Involvement -- Right to Adduce Evidence**

There is no doubt that the involvement of the intervenors in these proceedings added substantially to the length of time it took to deal with this application. Without participation by the intervenors it is likely that the application would have been disposed of within two months of the date of its filing. Additional time was necessary to allow intervenors adequate time to prepare their evidence (expert and otherwise), to accord intervenors the time to adduce that evidence before the Tribunal and to enable the Tribunal to consider the evidence adduced and the concerns raised by the intervenors.

As is well known, the Tribunal originally interpreted the *Competition Tribunal Act* as not contemplating that intervenors could play a role in the calling of evidence or in the cross-examining of witnesses. It was the Tribunal's view that such a restricted role followed from the wording of the Act and because the Director was a public official charged with the duty of enforcing the competition legislation on behalf of the public. The Director did not support that view and the Federal Court of Appeal, in *American Airlines, Inc.* v. *Competition Tribunal,* held that the Tribunal's interpretation of the intervenors' role was too narrow. The Court of Appeal stated:

> It is evident from the purpose clause that the effects of anti-competitive behaviour, such as a merger that has the result of substantially lessening competition, can be widespread and of great interest to many persons. In these matters, Parliament has provided for the Director to serve as the guardian of the competition ethic and the initiator of Tribunal proceedings under Part VII of the *Competition Act;* but Parliament has also provided a means to ensure that those who may be affected can participate in the proceedings in order to inform the Tribunal of the ways in which the matters complained of impact on them. I would ascribe to Parliament the intention to permit those interveners not only to participate but also to do so effectively. A restrictive interpretation of subsection 9(3) could in some cases run counter to the effective handling of disputes coming before the Tribunal.
>
> ...[I]t would seem reasonable to assume that persons attaining intervener status under subsection 9(3) could be well-positioned to provide insights concerning them through argument and reasons based on facts. Moreover, they arguably could more effectively and efficiently prove these facts if they have the ability to lead evidence or cross-examine witnesses depending on the issue involved and the circumstances of the particular case.
>
> It seems to me that permitting interveners to play a role wider than simply presenting argument is also a fairer way of treating them. ...
>
> ... [I]f a wider role for interveners does lead to longer or more complex proceedings before the Tribunal, surely that is a necessary price to pay in the interests of fairness, which is expressly required under subsection 9(2).[63]

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[63](1988), [1989] 2 F.C. 88 at 98-99 (C.A.), aff'd *sub nom. Air Canada* v. *American Airlines, Inc.* [1989] 1 S.C.R. 236.

## C) Benefits of Intervenor Involvement

There can be no doubt that the participation of the intervenors, in this case and in others, gives the Tribunal access to information which it would not otherwise have. The Tribunal is able to test a DCO, which has been reached by agreement between a respondent and the Director, in a way that would not otherwise be possible. Intervenors seek participation in proceedings to protect their own personal interests. These motives may not be directly relevant to the competition issues which the Tribunal has to decide. At the same time, the information which intervenors bring, regardless of their motives, is often of a type that is directly relevant to the issues at hand. Intervenors point up defects and oversights m the DCO, some major, some minor. That this is so will be obvious from the changes made to the DCO as a result of the involvement of the intervenors in this case. Reference will be made to each intervenor, in the order in which they appear in the style of cause.

## D) Changes in DCO Resulting from Intervenor Representations

Comme nous l'avons souligné précédemment,[64] l'intervention du procureur général du Québec a permis le dépôt de preuves supplémentaires se rapportant aux difficultés inhérentes qui se posent lorsqu'on tente de faire coïncider le marché géographique de détail et le territoire des grands centres urbains. En outre elle a fait augmenter de 68 le nombre de stations-service à être dessaisies en vertu du projet d'ordonnance par consentement (POC).

Par ailleurs, le Tribunal regrette le retrait du procureur général du Quebec du fait qu'il était un intervenant efficace et que sa présence aurait pu susciter, au profit du Tribunal, un débat vigoureux sur le prix plafond qu'établissent ou n'établissent pas les prix d'importations sur les prix domestiques.

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Le procureur général du Quebec a fait valoir que les critères retenus par le Directeur (c.-à-d. la règle du 30-20% ainsi que les règles s'y rapportant) étaient inadéquats pour assurer la concurrence au Quebec. Cet argument tient a l'affirmation selon laquelle les limites d'un territoire urbain ne conviennent pas lorsqu'il s'agit de définir des grandes régions métropolitaines comme Montréal, Toronto et Vancouver. A Montréal, par exemple, le marché englobe 73 municipalités. Le procureur général du Quebec a reconnu qu'il est difficile de délimiter avec précision des marches se chevauchants, mais a proposé néanmoins que chacune des 73 municipalités qui composent le Grand Montréal soit considérée comme un marché local distinct. Impériale et le directeur ont affirmé que les critères qui avaient été établis et appliques au Quebec étaient identiques à ceux employés ailleurs et qu'ils étaient appropries et suffisants. L'avocat du procureur général du Quebec a annoncé, à l'ouverture de l'audience, qu'il ne lui était plus nécessaire de participer officiellement aux procédures, Impériale ayant consenti au dessaisissement de 68 autres stations- service au Quebec. Bien qu'Impériale et le directeur aient maintenu qu'aucun dessaisissement supplémentaire n'était nécessaire pour atténuer les problèmes sur le plan de la concurrence, Impériale a déclaré que, comme elle avait de toute façon l'intention de se dessaisir d'autres stations-service en plus de celles désignées dans la liste des dessaisissements, elle ne voyait pas pourquoi elle n'en informerait pas le procureur général du Quebec. Impériale était donc disposée à prendre l'engagement de se dessaisir de 68 stations-service supplémentaires au Quebec.

**Beacon Hill Service (2000) Ltd.,** an Imperial outlet in Fort McMurray, as has already been noted, argued that it would be fairer and better for competition if a nearby Texaco station was divested since it is a more successful outlet than Beacon Hill Service. It was argued that what Imperial was doing, under the guise of the DCO, was culling the combined Texaco/Imperial network. Mr. Merchant, the majority shareholder in Beacon Hill Service (2000) Limited, is concerned about finding a major supplier after his current supply agreement ends. He is also concerned about the potential need to repay Imperial monies owed to it when his present supply agreement is terminated.

Mr. Merchant's argument that his neighbour, the stronger Texaco station, should be divested is based on the assumption that the exercise which Imperial and the Director embarked upon, with respect to the identification of divestitures in the retail market, was far more precise and analytical, with respect to the needs of the competitive situation, than was in fact the case. As was noted above, it seems clear that in many areas no order respecting divestiture was really necessary. Mr. Merchant, in argument, himself recognized that a refusal by the Tribunal to order the divestiture of his station would not necessarily help his situation.

In light of the evidence before the Tribunal concerning the uncertainty of market boundaries, the questionable need for divestiture orders in certain areas, the lack of detailed market information concerning the Beacon Hill or the Fort McMurray market, the Tribunal could not insist that the change which Mr. Merchant seeks be made.

Mr. Merchant did obtain from Imperial the commitment that the rental agreement under which Imperial operates a card lock operation (an unattended outlet accessed by generally large volume customers) on the back part of his property would be terminated as soon as Imperial can find another site. Counsel for Imperial stated that Imperial would remove its Esso sign from the card lock in the event that Mr. Merchant found another supplier for the station. This was in response to Mr. Merchant's concern that the existence of an Esso sign on the back part of his property would hurt his chances of obtaining a branded supply contract for the station on the front part of his property.

The Atlantic Refining and Marketing Employees Association and the Atlantic Oil Workers' Union Local 1 adduced most of the evidence before the Tribunal, either directly or through cross- examination, which led to the review of and changes to the Atlantic region divestiture provisions described above.

The intervention of the Consumers' Association of Canada was more general in nature than that of the other intervenors. No evidence was called by that Association. While it is hard to attribute any specific changes to the DCO to that organization's intervention it played a reviewing and questioning role.

The intervention of **Pioneer Petroleums,** as appears from comments elsewhere in this decision, was vigorous and direct. The evidence adduced by that intervenor added much to the understanding of the Tribunal, particularly with respect to the operation of the import option as it exists between southern Ontario and the northern United States (the Buffalo/Detroit/Syracuse areas). As noted above, the intervention of Pioneer Petroleums led to certain changes in the DCO being made even before the end of the initial hearings: the deletion of the provision of the DCO which deemed Imperial's standard form contract to comprise reasonable commercial terms; the addition of a term respecting grade mix. Pioneer's representations with respect to the Ancaster, Ontario situation remain to be dealt with.

Pioneer noted that between Hamilton and Brantford, Ontario there is an 18 mile strip of highway where, after rebranding of the existing Texaco station to Imperial, Imperial will hold 53% of the market. It is argued that Imperial should be required to divest a station in that area. The Ancaster situation demonstrates the imprecision of the retail station divestiture rules. The Hamilton municipal boundary runs through this strip of highway. Half the stations on the strip are considered as part of the Hamilton urban market. The other half were not considered in the Director's analysis at all because they are outside an urban area. It is clear from the evidence that treating one-half of these stations as part of the Hamilton urban market is arbitrary for two reasons. Significant uninhabited areas of farmland and the escarpment exist between this strip of highway and the built-up area of Hamilton proper. At the same time, as was noted by the expert witnesses, highway markets are almost

impossible to define because of the transient nature of the customers and because of the difficulty of identifying the extent to which a highway "gasoline alley" overlaps with adjacent small communities. There are no real criteria that can be applied to demonstrate that the highway strip itself should be considered as a separate market. Given these factors it is not possible for the Tribunal to conclude that it must require divestiture of a station in the area in question in order to meet competition concerns.

**Claude Harnois Inc**. est un agent-grossiste pour les produits pétroliers Texaco dans une région située au nord-est de Montréal. Comme agent-grossiste, il recrute des stations-service pour Texaco. Une station-service ainsi recrutée achètera son approvisionnement en essence de Harnois et non de Texaco. M. Harnois a souligné une ambiguïté significative au POC. Le POC a été modifie suite à l'intervention de M. Harnois afin de bien préciser que "station-service appartenant à un concessionnaire" inclu les points de vente avec lesquels "Impériale, Texaco ou un agent-grossiste Texaco entretient des relations contractuelles, pour l'approvisionnement en essence ou l'utilisation de ses marques de commerce". Une autre station-service approvisionnée par M. Harnois, incluse par erreur dans la liste des dessaisissements, a été subséquemment retirée.

The **Attorney General of Newfoundland and Labrador** did not play an active role in the proceedings. A written submission was filed, questioning whether Newfoundland (Labrador) should have been treated as a separate market and all the assets sold independently of the other Atlantic assets to someone other than a major. Initially, the Attorney General did not adduce any evidence in this regard or appear before the Tribunal. On December 6, 1989, in response to the RDCO, the Attorney General filed affidavit evidence reflecting his position and counsel appeared before the Tribunal. As the Tribunal previously indicated, it regrets that the Attorney General did not take a more active role earlier. It was just too late, however, after the main hearings had been completed and after the RDCO had been filed, to open up the issues which the Attorney General raises. Thus the evidence filed by the Attorney General, while accepted as part of the record, must only be considered in that light.

**Petroles Ronoco** Inc. possède 8 points de vente au Quebec, dont trois sont loués à Texaco. Petroles Ronoco Inc. estime qu'Impériale aurait tout intérêt à transférer de la clientèle de ces stations-service à des stations-service Esso et à laisser se dégrader ces trois stations-service. II en résulterait une baisse de la valeur des stations-service propriété de Petroles Ronoco Inc. et une diminution de la concurrence. L'inclusion de ces trois stations- services dans la liste des dessaisissements a donc été demandée. Impériale, avant la comparution des témoins de Petroles Ronoco Inc., a informé le Tribunal que

les stations-service en question étaient du groupe des 68 stations-service qu'elle avait consenti à ajouter à la liste des dessaisissements au Quebec. 11 importe de signaler que les relations contractuelles entre Petroles Ronoco Inc. et Texaco étaient depuis un certain temps déjà troublées et que, selon toute probabilité, le motif déterminant de l'intervenant était la résiliation anticipée de ses baux.

The **City of Victoria's** intervention was motivated by one concern only: the divestiture of the Texaco (Imperial) terminal in Victoria should not be required to be on a going-concern basis. The terminal has a very visible and prominent location in the harbour- front area of the City. The City has for some time been trying to persuade Texaco (Imperial) to discontinue using the terminal facilities in that location. The Tribunal was asked to delete from the DCO the requirement that the terminal be sold as a going concern but not the requirement that it be sold. The City's request does not relate to competition concerns. It is not within the Tribunal's mandate to suggest the change requested by the City. As counsel for the parties indicated, the City has expropriation powers which it can exercise to require discontinuance of the terminal facilities, should it wish to do so.

**Lyn-Den Distributors** operates an Esso outlet in Ashern, Manitoba which is owned by Mr. and Mrs. Dennis Geisler. They do not want to lose the Esso branding which they presently have. Mr. Geisler does not believe that he can compete with the large, full- service Texaco station across the highway once it is converted to an Esso outlet. He submits that the Texaco station should be divested. He is concerned about finding another major brand supplier, which he believes to be necessary for success given his location and his other complementary business, a bakery and restaurant. He is also concerned that divestiture will require him to repay an improvement loan which he holds from Imperial. Loans are normally paid off at so much per litre sold and therefore they might never have to be paid as a lump sum if supply agreements are continued over a sufficiently long period of time. The same types of considerations apply in this case as the Tribunal indicated are applicable with respect to the Beacon Hill situation and which were dealt with above.

**Banff Bulk Fuels Limited** was represented before the Tribunal by Mr. I.J. Thomas. He operates a Texaco bulk station at Banff and a Texaco outlet in Dead Man's Flats, Alberta. He objected to the latter being debranded. He explained that the Texaco outlet serves partly as a satellite bulk operation which helps to make the Banff business viable, a state it failed to achieve under a number of previous operators. In response to these representations, Imperial and the Director agreed that another outlet in Dead Man's Flats should be divested in lieu of Mr. Thomas'.

Barron Hunter Hargrave Strategic Resources Inc. is involved in the exploration and development of oil and gas, strategic minerals and mineral processing. That company was interested in making an offer to acquire Texaco Inc.'s 78% share of Texaco (Canada). It would still like to do so. It intervened to argue that the merger should be rescinded because it gave Imperial too much market power. When counsel realized that the whole merger was not in issue, because the Director had approved it insofar as the upstream assets were concerned, counsel did not participate further in the proceedings.

Cook's Oil Company Limited intervened to press upon the Tribunal its concern about the continued viability of the Texaco successor in the Atlantic region. Cook's Oil is a wholesale marketer which supplies furnace, stove, gasoline and diesel fuel along the south shore of Nova Scotia. It owns four service stations in the Bridgewater area (three of which are Texaco branded) and supplies an additional eight Texaco stations in the Lunenberg area. Three of the Bridgewater area stations are to be debranded. At least one of the stations supplied by Cook's Oil will remain with Imperial. This particular station is, in the words of Mr. Cook, "the most prominent Texaco station on the South Shore" and has "high visibility" and "high traffic count". He is concerned about the loss of revenue to him from the loss of that station as one of his customers. The loss of that station, he also argues, diminishes the market share of the other stations supplied by him and makes them less competitive. He is also concerned about the loss of the Bowater Mersey Pulp and Paper Company account and federal and provincial government accounts. These are national accounts which were bid out of Texaco's Toronto head office.

Mr. Cook expressed concern regarding the identity of the purchaser of the Texaco Atlantic assets and argues, on behalf of both himself and other members of the Texaco Wholesaler Association of Atlantic Canada, that the Atlantic wholesale marketers should have the same opportunity for early termination as lessees of company-owned stations, and dealer-owned stations identified for divestiture in Ontario, Quebec and Western Canada. The dealer- owned stations must also be offered unbranded supply by Imperial.

> In the event that the ultimate purchaser of the Atlantic assets is a company which is not a company with a national recognition, then many wholesalers will need the opportunity to elect to continue or terminate on three months' notice their existing contractual obligations. These dealers as well would like to have a guaranteed supply of unbranded product from any subsequent purchaser for a period of five years. ...[65]

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[65] Notice of Request for Leave to Intervene of Cook's Oil Co., Affidavit of C. Cook at para. 13. The offer of unbranded supply was never extended to even the dealer-owned stations to be divested in the Atlantic. The right of early termination for lessees of company-owned and dealer-owned stations west of the Atlantic was clearly provided in paragraph 34 of the DCO. Subparagraph 3(ii) of the DCO was ambiguous and thus all dealer-owned stations, including the Atlantic, might arguably have had a right of early termination. In the RDCO, however, that subparagraph was amended to make it clear that none of the divested Atlantic stations would have such a right.

If their proposal were accorded to, it would of course hasten the disintegration of the Texaco network and increase the possibility that a prospective purchaser of the Atlantic region assets would not become a vigourous competitor to replace Texaco in the Atlantic region.

**The Texaco Retail Council, Halifax - Dartmouth Metropolitan Area** intervened to press upon the Tribunal its concern that Imperial was being allowed to retain "thirteen of the largest retail stations". That organization argued that this splitting of the retail network would over time reduce competition in the market place. It also argued that the prospective purchaser of the Texaco assets should be a company that can offer product, marketing, extensive credit facilities, business developmental support and financial stability comparable to that which had been provided by Texaco. These concerns are ones that have been noted above in the discussion of the Atlantic region asset divestiture.

## X Limitations on Variations to the Order

The Tribunal also expressed concerns, on November 10, 1989, about certain provisions of the draft consent order in which the Director seemed to be fettering his statutory authority to seek amendments or alterations to the draft consent order.

Section 106 of the *Competition Act* provides:

> Where, on application by the Director or a person against whom an order has been made under this Part, the Tribunal finds that
>
> (a) the circumstances that led to the making of the order have changed and, in the circumstances that exist at the time the application is made under this section, the order would not have been made or would have been ineffective to achieve its intended purpose
> ...,
>
> the Tribunal may rescind or vary the order accordingly.

The revised draft consent order contains the following clauses which purport to govern the Director's conduct in seeking variations of the order:

> 21.(5) In monitoring compliance with this Order the Director may, in his discretion, not apply for a variation of this Order or a further Order of the Tribunal as a result of a shortfall in volume in any supply year when he is satisfied that such shortfall has occurred because of a short term dislocation in the market ... .
>
> 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 [the supply assurance provisions] 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 [dissolution of the merger?].
>
> 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 provide 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. (underlining added)

Subparagraph 21(5) is completely ambiguous. It is not clear what it means. At first glance it seems to say that the Director may not apply for a variation as a result of a shortfall in volume arising out of a short-term dislocation of the market. The insertion of the words "in his discretion", however, nullifies that restraint. Such ambiguity is not appropriate in an order.

Paragraphs 28 to 31 are also ambiguous but for a different reason. It is clear, from the text of section 106 of the Act that the Director has implicit statutory authority to apply for a variation of an order, when the circumstances which led to the making of the order change and, as a result, the order originally given is ineffective. Paragraphs 28 to 31 of the RDCO are ambiguous because it is not clear whether those paragraphs are intended as a supplement to the Director's implicit statutory authority, flowing from section 106 of the Act, or whether they are intended as a restraint on that authority.

Counsel's argument also reflected this ambiguity. On the one hand it was argued that paragraphs 28 to 31 are merely additions to the Director's implicit statutory authority and, therefore, limitations on that additional authority should not concern the Tribunal. At the same time, it was argued that there should be no objection to the Director fettering his authority (i.e. his implicit statutory authority flowing from section 106) because he may, for example, grant certificates under sections 102 and 103 of the Act which effectively render a merger immune from challenge. He may decline to challenge a merger at all (section 97 of the Act), in which event, after three years, the merger is immune from challenge. The logic follows that if the Director can render a merger immune from challenge without any order of the Tribunal, consent or otherwise, having been granted, should he not also be able to limit his discretion to seek variations to Tribunal orders.

As noted, if Imperial's acquisition of Texaco had not been questioned by the Director, and if three years had passed, that merger could not have been subject to a "roll-back" on application by the Director. Equally, had an advance ruling certificate been given by the Director pursuant to sections 102 and 103, the acquisition would have been immune from future challenge by the Director, at least insofar as such challenge was based on "information that is the same or substantially the same as the information on the basis of which the certificate was issued. "

The question that remains unanswered is the extent to which, once a merger has been challenged, i.e., an application has been brought to the Tribunal by the Director, there is authority, therefore, for the Director to seek variations of any order given. In the present case, by agreeing to an order which contains a supply assurance for 7 to 10 years, has Imperial opened itself up to the possibility that the Director may apply at any time during those 7 to 10 years for a variation of the order, which variation might request not only changes to the supply assurance provisions but even a roll- back of the acquisition of the Nanticoke refinery?

As appears from the text of section 106 the jurisdiction to seek variations of orders is very broad and, at present, there is no jurisprudence governing its interpretation. As noted, there is no jurisprudence examining its relationship to section 97 (immunity if no challenge within 3 years of substantial completion) and sections 102 and 103 (advance ruling certificates). At the very least, however, it seems clear that the authority to seek variations under section 106 is only engaged when the circumstances which led to the making of the order are changed. That is, it seems doubtful that a variation order could be granted under section 106 if the changed circumstances were either facts which were known or which were anticipated at the time the original order, pursuant to section 92 or sections 92 and 105, was granted.

In this context it is then necessary to consider paragraphs 28 to 31of the RDCO. It seems clear that they superimpose on the Director's implicit statutory authority (flowing from section 106 of the Act) an express authority which is couched in both narrower and broader terms than the Director's implicit statutory authority recognized by section 106 of the Act. The authority granted by paragraphs 28 to 31 is narrower than the Director's implicit statutory authority because it is expressed to apply only when there is a "material change in circumstances ... <u>attributable</u> in whole or part to <u>the effects of the acquisition</u> of Texaco by Imperial." In the case of the Director's implicit statutory authority there is no requirement that the material change must relate to the effects of the merger. For example, changes in the world supply of gasoline available in the market because of government action, such as the imposition of trade restrictions, would not fall under the authority granted by paragraphs 28 to 31 (they could not be said to be attributable to the effects of the merger). Such changes might, however, if they were not anticipated at the time the order was given, trigger a variation to the order pursuant to section 106 of the Act.

While paragraphs 28 to 31 are narrower than the Director's implicit statutory authority, they are also broader. As noted, the Director's implicit statutory authority is limited to seeking variations to an order when

"the circumstances which led to the making of the order have changed". Paragraphs 28 to 31 do not carry this qualification. They refer to any changed circumstances which might render the DCO ineffective. Thus, paragraphs 28 to 31 confer on the Director additional authority to that which he otherwise would have. Those paragraphs do not constitute a restriction of the Director's implicit statutory authority recognized by section 106. They establish an additional avenue of review upon which the parties have agreed. With reference to such additional avenue of review, the Tribunal is not concerned about the restrictions which the parties have agreed will be placed upon it.

## XI Conclusions

There is much in the divestiture order, which the Tribunal is being asked to issue, which is cosmetic only. While the Tribunal is not prepared to refuse to sign an order because parts of it are cosmetic only, it does not want it to be thought that by so doing it is according greater importance to the cosmetic portions than they deserve. It does not want it to be thought that such aspects of the order are really driven by a need to meet competition concerns.

As has been noted, the Tribunal finds the divestiture provisions with respect to the retail markets to be of mixed value. There is no clear evidence that they were required in many situations. On many occasions they served only as a camouflage under which Imperial was able to pretend that the rupture of commercial relationships with particular station owners was

demanded by the Director or the Tribunal. While the general criteria which were established by the Director for divestiture in the retail markets could not be faulted for being careless of competition concerns, the application of those criteria, by allowing Imperial to choose the stations to be divested in each area, was less appropriate. The specific identification of the stations in the order creates an impression that the specific divestitures are the Director's or the Tribunal's choice when, in fact, this was not the case. The stations which appear on the divestiture list were chosen by Imperial. In addition, it is clear that in many instances the stations chosen were those which Imperial would have divested in any event because they are lower volume, less profitable stations.

At the same time, there is no doubt that the Tribunal could not refuse the order requested on the ground that somehow or other it failed to meet the test of eliminating the substantial lessening of competition which it is presumed will arise in the retail markets as a result of the merger. The Tribunal therefore is willing to grant the order requiring the divestiture of 346 retail gasoline outlets (outside the Atlantic region) identified in the confidential schedules 6, 7 and 8, as well as an additional 68 in the province of Quebec. These last are to be identified by Imperial with notice given to and approval respecting the divestiture subsequently obtained from the Director.

Another area of the order which is largely cosmetic is the required divestiture respecting terminals. It is almost certain that 7 of the 9 terminals listed in the divestiture list would have been closed without the requirement of the draft consent order. It would appear that about the only advantage the Director has "gained" by requiring their inclusion in a divestiture order is that Imperial has agreed to sell them without a restrictive covenant limiting their after sale use to non-petroleum storage purposes. It will be interesting to follow the future of these terminals to see if they are in fact maintained in use for petroleum storage purposes and play a competitive role in the industry. In any event, the Tribunal could not refuse to grant this part of the order on the ground that it was largely cosmetic only.

While it is the Tribunal's general perception that more attention than was necessary was paid by the Director to the retail markets throughout the country, it is also the Tribunal's impression that less attention than perhaps was necessary was paid to the Atlantic region. In that region the anti-competitive effects of the merger are clear and significant. The market at both the retail and wholesale level, pre-merger, exhibited significant uncompetitive characteristics, including provincial regulations in two provinces which create barriers to entry. The divestitures required of Imperial in this region do not encompass all the pre-merger Texaco assets. As is noted in the body of these reasons, there is a difference of view between the members of the Tribunal as to whether the provisions of the RDCO should be approved insofar as they relate to the Atlantic region. Two members of the Tribunal are not convinced that the provisions of the order sought will in all likelihood eliminate the substantial lessening of competition which it is presumed will arise as a result

of the merger in the Atlantic region. The third member is of a different view.

The two members of the Tribunal who are not prepared to sign the order, with respect to the Atlantic region, as it stands differ as to the appropriate disposition which should flow from that decision. One member is of the view that the appropriate disposition is to require Imperial to put all the Atlantic region assets up for sale, and thus leave in the hands of the market (i.e. prospective purchasers) the decision as to whether or not a more limited package of assets is viable in that region. The other member is of the view that the Director and Imperial should be given further opportunity to place before the Tribunal information concerning the identity, experience, financial resources and plans of the proposed purchaser with a view to demonstrating that despite the proposed division of the Atlantic assets, a vigorous and effective competitor will "step into Texaco's shoes" in that region.

The result, therefore, is that before approval of the Atlantic region terms of the RDCO will be given, either all the Atlantic assets should be offered together as a bundle or further evidence concerning the identity, plans, etc., of the proposed purchaser should be placed before the Tribunal to demonstrate that despite the division of assets, the terms of the RDCO will result, in all likelihood, in the elimination of the substantial lessening of competition arising out of the merger in that region.

With respect to the supply assurance provisions, which are designed to guarantee that a certain volume of supply will be available to independent gasoline stations in the Ontario and Quebec market, these are in general terms acceptable to all members of the Tribunal. There is a difference of view, however, as to whether the terms should be approved as they stand or whether certain changes should first be required. Two members of the Tribunal are of the latter view. The changes which the Tribunal requires in this regard relate to three changes which the parties made to the supply assurance provisions between November 10, 1989 and November 28, 1989 and which were filed with the Tribunal as part of the RDCO on the latter date. The provisions in question had not been part of the earlier draft; evidence by the parties' witnesses was not given in relation to them. Two of the new terms potentially lessen the volume of supply being assured to the independent market to 20% below that which the Director and Imperial had previously said was the appropriate volume which was to be assured to that market.

Two members of the Tribunal are not prepared to sign the order unless the volumes are returned to what was earlier indicated was the appropriate level. Part of this concern could be met by redrafting the shortfall clause so as to clearly allow shortfalls only when they arise out of unexpected underliftings by the independents. The third change in the earlier provisions, respecting when Imperial will be required to contract with independent purchasers, should also be returned to its earlier form.

Lastly, another provision added to the RDCO which was not m the earlier version (subparagraph 21(5)) and which describes the circumstances under which the Director may apply for the variation of an order, is completely ambiguous. It is not appropriate for inclusion in a Tribunal order.

**Summary of Conclusions**

1. The Tribunal is prepared to approve the RDCO filed insofar as the following provisions are concerned:

(i) divestiture or debranding of the retail outlets identified m confidential schedules 6, 7 and 8, being 346 in number;

(ii) divestiture or debranding of a further 68 retail outlets in the Province of Quebec which 68 shall be identified by Imperial and notice thereof provided to the Director within 12 months from the issuance of the order.

The terms and conditions on which such divestiture or debranding are to occur are set out in the RDCO and include a requirement that the debranded stations be offered unbranded supply for five years;

(iii) divestiture of the nine terminals listed in schedule 5, that is, terminals at Baie Comeau, Rimouski, Ottawa, Sault Ste Marie, Thunder Bay, Sudbury, Calgary, Victoria and Prince George, on the terms set out in the RDCO.

2. The Tribunal is prepared to approve the supply assurance provisions providing the following alterations are incorporated therein:

(i) removal of the qualification from paragraph 27 which allows Imperial to refuse supply to any independent who is in default of payment with <u>any</u> gasoline supplier (this does not preclude Imperial requiring normal credit security from independents but prevents Imperial from refusing to contract with an independent merely because that independent has a dispute with another supplier);

(ii) addition of a clause making it clear that shortfalls in volume which Imperial is to be allowed, pursuant to paragraph
21(4), are only permissible when Imperial can demonstrate to the Director that the shortfall occurs as a result of unexpected underliftings by independents (the reason Imperial gave for requiring the 10% latitude);

(iii) deletion of the volumes being supplied to divested Texaco and Esso stations so that those volumes are not counted as part of the supply being sold to independents (they had not been so counted in earlier versions of the supply provisions because, as Imperial explained, those stations were not previously part of the independent market and the volumes sold to them were not included in calculating the volume required to be provided to independents by the supply assurance provisions).

3. With respect to the Atlantic region, the Tribunal 1s prepared to approve the divestitures proposed only if either:

(i) all assets in the region are divested; or

(ii) additional evidence respecting the financial resources, expertise, experience and plans of the purchaser are presented to the Tribunal sufficient to demonstrate that the purchaser of the Texaco Atlantic assets will in fact be a vigorous competitor in the Atlantic region comparable to Texaco, the competitor it is replacing.

4. Subparagraph 21(5) should also be removed. It is completely ambiguous and potentially a source of protracted legal wrangling in the future over proper interpretation. The Tribunal is not prepared to approve such a provision.

**Dissenting Opinion (Dr. Frank Roseman)**

**Introduction**

There are several areas where the majority perceive problems with the RDCO that lead them to refuse to sign it. I do not share their view for the reasons set out below. Except where I explicitly differ, it should be understood

that the reasons of the majority reflect my own interpretation and understanding.

**Divestitures in the Atlantic Provinces**

The point of departure in evaluating the effect of the merger in the Atlantic is the alleged competitive harm flowing from the acquisition. The two negative changes in the competitive situation resulting from the merger that are identified in the Director's application and supporting material are an increase in concentration, particularly at the refining level, and the elimination of Texaco as a competitor. The same two effects are present elsewhere but competition is seen as much less vigorous in the Atlantic provinces than in other regions and the remedies m the RDCO are therefore most extensive in the Atlantic provinces. The immediate change in concentration and the prospects for success in replacing Texaco are related questions. The change in concentration can be measured by considering the shares held by Imperial and Texaco at the time of the acquisition; the success of the purchasers of the divested assets will affect concentration in the longer term. The short-run effect of the acquisition on concentration, with the RDCO, is trivial and does not represent a serious issue.

The RDCO should be evaluated, therefore, in relation to its success in creating a replacement for Texaco. This matter cannot be judged in isolation; it must be referenced to the overall standard of the likelihood of a substantial lessening of competition. When I consider this overall standard I find that the changes required by the RDCO result in a situation in which there may be some lessening of competition, but not to an extent that can be considered substantial. This conclusion is based on the view that the essential consideration -- whether the purchaser of the divested assets is likely to be a continued source of product at the refinery or wholesale level -- is satisfied. Most competitive concerns tie back to this question.

**Wholesale Supply: Immediate Effect of Merger and RDCO**

The long-term future of the refinery is bleak. It suffers from the twin problems of being much below minimum efficient scale, and of being located on tidewater so that its output can be replaced by shipments from other refineries. There is little reason to believe that it will be maintained in production when the need arises to make significant investments in it. However, the acquisition and the terms of the RDCO create an immediate threat to the refinery by reducing demand for its output from two directions.

Firstly, the assets retained by Imperial account for somewhat less than 18 to 20% of Texaco's retail sales. (The qualifier is necessary because the range was established before Imperial agreed to additional divestitures that reduced the volume represented by the retained assets.) It was also stated in argument by Mr. Pink that the Great Eastern Oil Company, in which Imperial is retaining the majority share ownership that it acquired from Texaco, distributes important quantities of heating oil. The quantities are unknown. Since significant quantities of heating oil were imported by Texaco to supplement the output from the refinery the loss of this volume may not represent any loss, or only a partial loss, to the refinery. The same applies to the loss of heating oil or diesel volume represented by the retention by Imperial of Texaco's national industrial and commercial contracts. One would expect, in any event, the retention of these contracts to have much shorter-term effects than is the case with the other assets. The important long-term problem for the purchaser of the assets will be to convince the commercial and industrial buyers to allow it to bid separately on the Atlantic Provinces business. Once again, the volume represented by the contracts is not known.

Secondly, the most important threat to the continued operation of the refinery is the fact that almost one-third of the refinery's output of gasoline is disposed of through an exchange agreement with Ultramar. What this means in effect is that Texaco is selling this large share of its gasoline output from the Eastern Passage refinery in Quebec without having to incur the cost of shipping to its markets there. Professor Stanbury states that it should be possible for the buyer of the refinery to find other buyers in Quebec and it

should be able to retain the exchange agreement with Ultramar. This is, m my view, another way of saying that other markets will have to be found to replace the assured market represented by the Texaco outlets in Quebec. Whether and where profitable markets might be found is an open question. The potential closure of the refinery is a negative feature of the merger that is not cured by the RDCO.

Whether the threat to the continued operation of the refinery raises a competition problem depends on whether the supply from the refinery can be replaced by an alternative competitive source. It is Professor Stanbury's evidence that importation of product would provide as much competition as does production from the refinery. This conclusion has not been contradicted. What has been raised is whether the import option is a practical alternative. A potential problem referred to was a possible shortage of product from offshore sources (particularly high octane gasoline). Sufficient capacity and the need of the terminal operators to have expertise were also raised as possible problems. Should a purchaser decide that it was going to rely on imported product to satisfy its requirements, none of these points can be taken seriously. If a temporary shortage of worldwide refining capacity is anticipated this would tend to increase the likelihood of the Eastern Passage refinery being retained in operation rather than its output being replaced by imports. It is difficult to believe that the blending of products by an importer is an exceptional kind of skill that the Tribunal must be concerned about. It is equally difficult to believe that a decision to rely on imported product (and not just to obtain occasional spot cargoes) could not be supported by supply arrangements that ensured product of adequate quality.

Under paragraph 96(2)(b) of the Act, the replacement of imports by domestic production is classified as an efficiency. The reverse should accordingly be considered an inefficiency where the result flows from the merger. In trying to determine what weight to give this consideration I ask myself what the effect would have been if the Director had succeeded in a contested application. The most extensive remedy that the Director could have obtained would be total divestiture of the Atlantic assets. This would not have cured the problem raised by the need to replace the Texaco outlets in Quebec with some other source of demand and the refinery would have been threatened in any event.

There is no evidence that the divested distribution assets are insufficient to support reliance on imports. Such evidence as there is from other parts of the country strongly suggests that the sales volume represented by the divested assets is adequate to support a large scale import operation. Therefore, at least in the short run, the divestitures can be concluded to cure the principal competitive concern, that if the refinery were closed and not replaced by a major import operation a source of product at the wholesale level would be lost.

**Wholesale Supply: Long-term Considerations**

The intervenors take the position that divestiture of only part of the acquired assets by Imperial threatens the long-term success of the purchaser. If they are correct and the future size of the network depends on its present size,

there is a danger that at some point even the import terminal would not be commercially feasible. They also urge that the characteristics of would-be purchasers must be carefully evaluated to ensure that they will be effective competitors.

Does the failure of Imperial to divest all the assets acquired from Texaco threaten the viability of a purchaser to an unacceptable degree? The retail market share retained by Imperial represented approximately 18 to 20% of Texaco's pre-merger volume. What is at issue is the effect on competitive vigour of replacing a firm with approximately 10% of retail sales (Texaco pre-merger) with one with approximately 8.2% (the purchaser of the assets).

The intervenors have also raised the concern that a potential buyer will not win acceptance in the marketplace and will therefore fail to hold the market share initially represented by the assets to be divested by Imperial. The Texaco Retail Council dealers state that by retaining high volume outlets the strength of the stations to be divested is weakened; in networks the total is more than the sum of the parts. This evidence has not been contradicted and is on its face reasonable. To the extent that this is an important consideration, it can be expected to be reflected m the price Imperial receives. The monies saved would be available to the purchaser to buttress the strength of the network if network synergy is really an issue.

The evidence regarding the desirable characteristics of a prospective purchaser is divided. The strong theme running throughout the intervenors' participation has been that in order for Texaco to be adequately replaced the buyer of the divested assets must be a strong, visible firm in the petroleum industry, one readily acceptable to consumers and dealers. Independents are not considered to meet this condition. There is the evidence of the past failures of independents to make much headway in the Atlantic Provinces which suggests that a purchaser without an established, widely-recognized reputation and its own credit card may not do well in the Atlantic provinces.

On the other hand, there is the view of Professor Stanbury that independents may provide the greatest competitive impetus, but not necessarily, since aggressive competitive conduct cannot be taken for granted. It is in the light of this and similar statements that I interpret Professor Stanbury's conclusion that competitive impact depends on who the purchaser is and what it does with the assets afterwards. He does not provide any criteria by which a purchaser who is likely to prove to be an effective competitor can be identified. Although Professor Stanbury states that determining an acceptable purchaser would be a matter of judgment for the Director, when his evidence is considered as a whole I do not find that he was of view that the identity of the buyer who would be an effective competitor could be determined beforehand. This must be distinguished from his view that some potential competitors might not be acceptable candidates because of their pre-existing market position. The most complete statement regarding the

importance of potential purchasers is probably contained in the following, which came near the end of his testimony:

> Q. But speaking only of the refineries at the moment. In terms of competition policy, would it be at all acceptable that this refinery could be purchased by one of the existing majors or by Irving Oil which, for purposes of the Atlantic region, I suppose, we could treat as a major?
>
> A. This is my opinion. I do not know what the Director's opinion would be. But I have not analyzed each one of the potential candidates inside or outside. As I emphasized in the affidavit, the potential impact on competition depends (a) on who buys it and (b) what they do with it. So, I will give you the extreme. Let us suppose you have Wild Cat independent buy them.
>
> Wild Cat independent could then simply follow a high margin, no price cut, no offer, no deals et cetera strategy and would be, for all practical purposes indistinguishable from the major, except for the name and they might not have the credit card.
>
> On the other hand, the Wild Cat could come in and start chopping price and trying to sign up a lot of stations very aggressively, the ones that are not being divested and any other stations, et cetera, as they come due, and could raise hell in the marketplace. Now, they are going to have to have some capital to be able to do that because I would suggest that the majors are not going to sit there and watch their market shares dissipate.
>
> You could imagine another world in which a major, not now in the region, might be approved by the Director and they might come in and, again, they might be aggressive for a while and expand the market share and might then stabilize. I do not know. It is a highly uncertain world. I do not know what the competitive strategy would be. I try to think of the range of possibilities, but I cannot be sure what anyone is going to do there.
>
> So, the Director will have to make a decision faced with the identity, together with what he thinks that individual corporation will do with those assets. And that is a judgment call.[66]

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[66] Transcript at 574-76.

I do not think that providing for Tribunal approval of a prospective purchaser will add anything since I do not see what criteria the panel hearing this matter might use. On what basis might one conclude that a potential buyer willing to pay the highest price is not likely to be the most effective competitor, assuming that it does not pose a competitive threat owing to its own, already high, market share? (A buyer who can anticipate an increase in its market power as a result of an acquisition may be willing to pay a higher price than others who do not anticipate such a result.) I seriously doubt that there is anything to be gained to balance against the costs that will be imposed on Imperial in the form of additional delay and the possible scaring off of potential purchasers.

This is not to say the RDCO should be silent on how divestiture occurs. Divestiture by Imperial of the specified assets would not, in my view, be acceptable if a totally piecemeal sale of assets were permitted. This would mean that Texaco could disappear without being replaced, its assets divided among the present competitors. The RDCO successfully addresses this unacceptable possibility since it requires that the assets be offered to a single purchaser. It is noteworthy, however, that had Texaco undertaken a similar piecemeal divestiture it is difficult to see how its sale of assets would have been subject to challenge, unless it were selling assets to a firm judged to have already an unacceptably high market share. Similarly, if Texaco had undertaken to sell the assets being retained by Imperial to Imperial and to dispose of the rest of the assets to other buyers, the only competition policy issue could be whether the other buyers were already too strong.

In sum, I find that there 1s reasonable assurance that the assets to be divested can support the continued existence of an independent source of wholesale supply. Although the future of the source is not assured, the level of uncertainty is unavoidable.

I would add that, in spite of my conclusion, I am very sympathetic to the view that all of the assets should have been included in the DCO. The fact that they were not appears to be the result of negotiations that leaned towards fine tuning with respect to the Atlantic provinces as well as in other areas, where it is often unclear that the divestitures would have any recognizable effect on competition and would not have occurred anyway as a result of rationalization of its acquired assets by Imperial. As described in the majority's reasons, the DCO certainly departs from the pattern found in the United States, where all retail outlets would normally be divested in areas where a competitive problem is recognized to exist. At least some of the threat to the refinery can be traced to a failure to accomplish this result in the Atlantic Provinces.

**Supply provisions**

Paragraph 27 of the RDCO, which deals with the credit- worthiness of customers is unnecessarily restrictive. Mr. Howard recognized that it was perhaps objectionable for that reason. It is not clear why the paragraph is in the RDCO. It does not in any way relieve Imperial of its obligations under the supply provisions. If anything, it implies an obligation to deal with all creditworthy customers that is not set out in the supply provision. In any event, given that paragraph 27 has no discernible connection with the essential conditions of the supply provision found in paragraph 21, that Imperial is required to sell specified quantities of gasoline to independents, I can see no ground for refusing to sign the RDCO with it present.

Subparagraph 21(4) allows for 10% flexibility in the quantities of gasoline Imperial is required to sell to independents. In my view, it would be totally against the spirit of the order should Imperial consistently sell 10% less than the specified quantities. While I would obviously not object to any clarification of the sub- paragraph that met the concerns of the majority, I do not see grounds for refusing the order on that basis.

Sales to formerly branded Texaco or Imperial stations who choose to buy from Imperial on an unbranded basis are to be included, under the supply provision in the RDCO, in the quantities to be supplied to independents. Under the DCO only sales to customers buying in excess of 20 million litres per year were to be counted as sales to independents under the supply provision. This change may conceivably have reduced the quantities that Imperial is required to supply to larger independents, i.e. those purchasing in excess of 20 million litres per year. Based on the available evidence it is doubtful that the change would produce much effect. Approximately nine dealers who were on the divestiture list had by the conclusion of the hearings, entered into supply contracts with other suppliers. In addition, none of the dealers who intervened displayed much interest in buying from Imperial on an unbranded basis.

If significant quantities of sale to individual dealers buying on an unbranded basis did occur, this would indicate that Imperial was offering attractive terms and would be a pro-competitive development. It is not one that should be inhibited, which would occur if Imperial felt that it was overly committed to supplying independents by being required to exclude the volume sold to single station independents from the quantities to be sold under the supply provisions.

The requirement to sell that was included in the RDCO but was not present in the DCO results in a clearer, more enforceable supply provision. It also creates a greater obligation on Imperial. It is perfectly reasonable for the Director and Imperial to have negotiated other changes that counterbalance Imperial's increased obligation under the RDCO.

In summary, it is unlikely that the change in the definition of sales to independents results in a significant effect. To the extent that there would be any effect, it cannot be concluded that it would be anti-competitive.

I would add that the supply provision attempts what is, in my view, the most difficult task that an order on consent can hope to accomplish: the curing of a change in structure with a behavioural requirement. Given the Director's reasons as to why the supply provision is necessary, it should accomplish its purpose adequately.

Subparagraph 21(5) is confusing and, to the extent that I understand it, redundant. Through it Imperial appears to be seeking assurance that the order will not be blindly enforced. However, it does not advance Imperial's cause since, under it, the Director properly retains his jurisdiction to determine when he will enforce the order. Accordingly, I agree that subparagraph 21(5) should be deleted.

**Comment**

The RDCO identifies a large number of divestitures. In the event an order is issued, it will be very difficult for scholars and commentators to determine, even in the first instance, how the structure of the industry was affected by the order. Accordingly, the Director has a responsibility to inform the public in his annual report with regard to who obtained the supply contracts of the dealer-owned stations and who purchased the divested assets. This would be a modest task with the cooperation of Imperial.

**Dissentin Opinion Re: Appropriateness of Deferring a Decision (Chairman)**

As noted, there is a difference of view between the members of the Tribunal as to the appropriateness of deferring a decision on the Atlantic situation until information respecting the identity, expertise, experience and plans of the purchaser is placed before the Tribunal. Two of the Tribunal members are of the view that such a requirement would be cumbersome and would place the Tribunal in the position of making a decision when it had no adequate evidence on which to base that decision. What follows under this subheading should be read as being the view of one member of the Tribunal only the Chairman. The views of the other two members on this issue are set out in the separate reasons which have been filed.

Imperial takes the view that a retention of jurisdiction would not be appropriate because it would involve a prolonged process of further hearings and would be unduly cumbersome for a proposed purchaser. In addition, Imperial maintains that it is important that the Director retain the discretion which he has under the Act not to reopen the whole issue yet again.

With respect to the first argument, it is not convincing. There is no need for further prolonged hearings, providing the purchaser is clearly one who meets the criteria established. What is more, paragraph 8 of the draft consent order contemplates that when Imperial disagrees with the Director as to the appropriateness of a proposed purchaser, Imperial may bring the issue to the Tribunal. There is no concern in that context about additional prolonged hearings.

> 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. (underlining added)

With respect to the second argument, the Director takes the position that he has an obligation under Parts VIII and IX of the Act to review the sale transaction and "that a function of the Director, as envisaged by the statutes is that he should be reviewing and exercising the approval right."[67] The criteria applicable pursuant to Parts VIII and IX of the Act are, of course, quite different from those identified in the course of these proceedings as the reasons for requiring review of the identity, experience and plans of the purchaser. The statutory obligation imposed upon the Director requires him to ensure that the acquisition by a proposed purchaser is one that does not have an anti-competitive impact. The reason identified in the Tribunal proceedings for seeking a review is to ensure that the purchaser is one who will likely continue as a viable and vigorous competitor in the Atlantic region. Retention of jurisdiction by the Tribunal in such a case does not preclude the Director's exercise of his statutory obligation. The Tribunal's review would only operate after the Director had approved the prospective purchaser unless, of course, the initiative for the review came from Imperial pursuant to paragraph 8 of the draft consent order.

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[67] Transcript of December 7, 1989 at 9.

I have no doubt that in most circumstances approval by the Director of a proposed purchaser is the appropriate safeguard. I do not see the Tribunal's role as being one of approving purchasers of assets. The Director has the expertise. When all the assets in the region are required to be divested no question would likely arise as to whether a divided portion could provide as the base for as vigorous and vital a competitor as existed pre-merger.

As has already been noted, the circumstances in this case are unique. Instead of Imperial being required to divest all the Texaco assets in the Atlantic region -- a region in which the pre- merger market situation is admitted by everybody to have been highly uncompetitive -- a division or "whittling away" of those assets is contemplated.

Asking that the identity of the purchaser, its financial resources, its experience and expertise in the industry and its plans be disclosed to the Tribunal IS a means of allowing the parties to adduce further evidence in order to tip the balance in their favour and demonstrate that the solution they propose does indeed meet the required test.

**<u>Concurring Opinion Re: Appropriate Disposition for the Atlantic Provinces (Madame Marie-Helene Sarrazin)</u>**

**Divestitures in the Atlantic Provinces**

It is certainly not possible for me to conclude as the Director has done that "in the Atlantic Canada, the Draft Consent Order effectively re-

establishes the market structure that existed pre- merger"[68].

Nor could I conclude that a degree of divestiture, in the case of an uncompetitive pre-merger market situation, short of full divestiture of all the assets in that geographic area, meets the required test or falls within the acceptable range of remedies designed to meet the post-merger situation.

Given the pre-merger situation in the Atlantic, a highly uncompetitive one with high concentration coupled with the loss of a vigourous competitor, the degree of risk which should be tolerated by subdivision of the assets is very low. Anything short of restoring in so far as possible the pre-merger market situation has to be assessed very critically.

The cumulative effects of the evidence presented before us created a strong doubt in my mind. A doubt which led me to determine that I could not conclude that the merger, as conditioned by the terms of the RDCO results in a situation where the substantial lessening of competition which it is presumed will arise from the merger has in all likelihood been eliminated.

I am of the opinion that the appropriate remedy in a situation such as that existing in the Atlantic region is to get as close as possible to restoring the pre-merger market situation knowing that in all reasonableness it will never be achieved in full and that the optimal solution is not the objective.

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[68] Notice of application at para. 42.

We were told very convincingly that the market "is the best judge of a particular combination of the assets that should be purchased".[69]

The suggestion of divesting all the assets up front rather than as a fallback situation was made in the comments delivered by the Tribunal on November 10, 1989.

As an answer in the RDCO, the Director retained the right to require the divestiture of additional assets.

Mr. Addy commented: "I think we respond to that concern [that all the Atlantic assets should be divested] and we are leaving it up to the purchaser rather than pre-judge [whether that is] necessary or not. When the market speaks in the bidding process, we will know for sure whether those assets are necessary." [70]

Mr. Pink in his response said: "We should offer up all assets as a whole package and then let a purchaser decide whether or not they want the whole package"[71]. He goes on to characterize the process of getting approval for further divestiture as convoluted one.

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[69]Transcript at 464.

[70]Transcript of December 7, 1989 at 7.

[71]Transcript of December 7, 1989 at 58.

I agree with Mr. Pink that m this matter it would be an unduly complicated process and I am of the opinion that where the market can be efficient we should let it be and not intervene. The approach which the Director is taking is to prejudge the market.

One cannot pretend that asking that all the assets in the Atlantic region be divested is the best solution but without further evidence it falls within the acceptable range.

**Tribunal to Retain Jurisdiction**

As a result of the position which I have set out above, it is not surprising that my view is that the Tribunal should not retain jurisdiction. All the Atlantic assets should be divested and they should be sold as a bundle. The market, that is the eventual purchaser, would decide what mix of assets is the most viable in the Atlantic region.

Secondly, if jurisdiction is retained, a judgment call will have to be made as to whether or not any proposed purchaser is suitable. The Tribunal cannot pretend it has the expertise to make that decision unaided. I would most likely require the opinion of experts and this could entail additional hearings. As Mr. Howard says ''additional evidence and additional intervention might well affect the enthusiasm of potential

purchasers to embark upon the acquisition of the Atlantic assets''.[72]

This type of review might be warranted and called for in other matters on other occasions. But I am not convinced that at this point in time m these proceedings, it should be undertaken. I am not prepared to see the Tribunal impose on the parties an obligation to present further evidence with respect to a potential purchaser.

On the other hand, I am not prepared to see the Tribunal refuse to consider further evidence, if the Director and Imperial choose this avenue to help eliminate the doubt which exists.

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[72]Transcript of December 7, 1989 at 26.

**Conclusion**

It is my opinion that, without further evidence, the appropriate disposition for the Atlantic Provinces is that all of Atlantic assets should be divested.

Concerning the retention of jurisdiction over the approval of the purchaser, I oppose this requirement. I do not think, in this case, that that is a proper disposition but I will leave it to the parties to decide if they want to choose that route.

DATED at Ottawa, this 26th day of January, 1990.

SIGNED on behalf of the Tribunal by the presiding judicial member.

B. Reed