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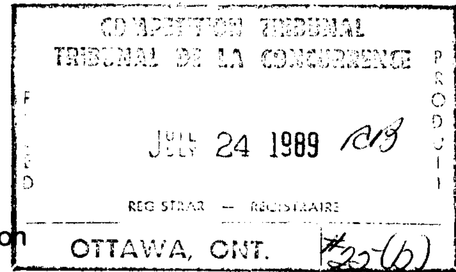
CT 89/

THE COMPETITION TRIBUNAL



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

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

BETWEEN

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

\- and -

IMPERIAL OIL LIMITED

Respondent

AFFIDAVIT OF WILLIAM T. STANBURY

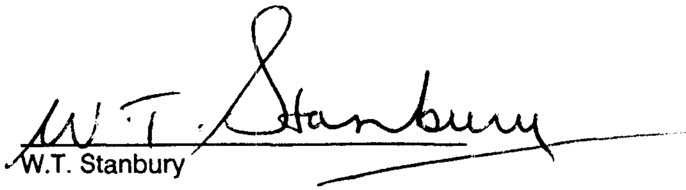
I, William T. Stanbury, of the City of Vancouver, in the Province of British Columbia in Canada MAKE OATH AND SAY AS FOLLOWS:

1. I am the UPS Foundation Professor of Regulation and Competition Policy in the Faculty of Commerce and Business Administration in the University of British Columbia and have been retained by the Director of Investigation and Research, Consumer and Corporate Affairs - Canada, to provide my opinion on effects on competition in the Atlantic region resulting from the merger of Imperial Oil Limited with Texaco Canada Limited, and on the efficacy of the Draft Consent Order submitted to the Competition Tribunal. Now shown to me and attached as Exhibit "A" to this my affidavit is a copy of my report.

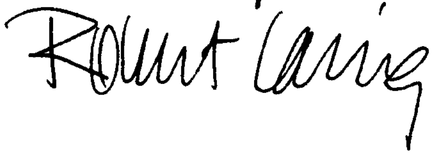
2. The contents of this Report attached as Exhibit "A" to this my affidavit and the opinions expressed therein are true to the best of my knowledge, information and belief.

3. I make this affidavit pursuant to Rule 42(1) of the Competition Tribunal Rules.

SWORN before me at the)
City of Vancouver, in the)
Province of British Columbia,)
this 20 day of July 1989.)



W.T. Stanbury



A Commissioner for taking Affidavits
for British Columbia

Exhibit A

Report of W.T. Stanbury

In Respect of the Takeover
of Texaco Canada by Imperial Oil

This is Exhibit A to the affidavit by
W.T. Stanbury sworn before me on
July 20, 1989

A Commissioner for taking Affidavits
for British Columbia

REPORT
of
W.T. STANBURY

IN RESPECT OF THE TAKEOVER OF TEXACO CANADA BY IMPERIAL OIL

I PROFESSIONAL BACKGROUND

1. My present title and position is UPS Foundation Professor of Regulation and Competition Policy in the Faculty of Commerce and Business Administration of the University of British Columbia. I obtained my B. Comm (Economics option) in 1966 from UBC (graduating with the gold medal), and my MA and PhD in Economics from the University of California at Berkeley in 1968 and 1972 respectively. At Berkeley I studied industrial organization with Prof. Joe S. Bain, a leading authority. I joined UBC in 1970 as an Assistant Professor and was promoted to Associate Professor in 1975 and to full Professor in 1981. My teaching responsibilities have included Policy Analysis, Strategic Management, Business-Government Relations, and Canadian Competition Policy (taught in the Faculty of Law).

2. Much of my research has focused on Canadian competition policy. In this field alone I have published over fifty articles or book chapters as well as being editor or author of several books. On several occasions I have testified before parliamentary committees considering new competition legislation, most recently in respect to Bill C-91 which became the Competition Act of 1986. I was a consultant to the Royal Commission on Corporate Concentration and prepared a research monograph published by the Commission. I have been retained by the Bureau of Competition Policy to provide expert advice in several other merger cases under the Competition Act.

II METHODOLOGY

3. The analysis and conclusions in this affidavit have been based on a careful review of the large number of documents submitted to the Bureau of Competition Policy in the course of the review of Imperial Oil's takeover of Texaco Canada. The principal documents include the following:

- The various documents supplied by Imperial Oil, Texaco Canada, and others,
- Kent market survey data,
- Legislation and regulations of Nova Scotia and Prince Edward Island relating to the distribution of petroleum products,
- Information obtained from various participants in the petroleum industry by the Bureau of Competition Policy,
- Information provided by the Director's staff, and
- RTPC's report, Competition in the Canadian Petroleum Industry, published in 1986.

4. In preparing this report I relied on several secondary sources rather than my own original research on the petroleum industry.

III ANALYSIS AND CONCLUSIONS REGARDING THE MERGER

5. My approach in this section is to state the principal findings and conclusions based on the assumption that Imperial Oil and Texaco Canada would fully integrate their operations under the banner of Imperial Oil. This report follows the application by the Director of Investigation and Research for a Consent Order under which substantially all of Texaco's assets in the Atlantic region are to be divested by Imperial Oil within 12 months. To appraise both the likely impact of the merger on competition in the Atlantic region, and the efficacy of the proposed remedy (see Section IV below), it is necessary to assume that the two firms would have completed the merger and integrated their operations.

A. Scope of Analysis

6. I conclude that it is appropriate for the purpose of analysis to consider the Atlantic region (Nova Scotia, New Brunswick, Prince Edward Island and Newfoundland/Labrador) as a distinct market area for refined petroleum products because interregional transfers by all four refiners in the region have accounted for only 4% to 6% of the region's total supply of refined products over the period 1985 to 1988. Virtually all of these transfers (86% of which consist of gasoline and diesel fuel) come from Quebec by marine transport. Two refiners are substantial exporters of gasoline, such sales being made into the U.S.

B. Overview

7. This merger should be of great concern to Canadians because it has occurred in an economically important industry that is already highly concentrated and, more importantly, the industry is, for the most part, subject to high entry barriers. While it is useful to disaggregate the downstream petroleum industry into refining, terminals, wholesaling and retailing, the previous statement applies equally well to each component. In short, the merger of Imperial and Texaco is likely to lead to a substantial lessening of competition in the Atlantic region.

8. The barriers to entry include economies of scale (particularly in relation to this small and scattered regional market), government regulations in two provinces, excess capacity, and the existence of large sunk costs. Not only would there be only three refiners in the region after the merger, but the five largest gasoline retailers would have over 95% of the market in volume and 98% in terms of retail stations. Further, with the exception of the distribution of fuel oil for heating, independent resellers are virtually non-existent in the Atlantic region. Yet such firms are the "life of trade" in other regions where they have even a modest share of a market for a refined product. Finally, with the exception of heavy fuel oil (used by industry) and light fuel oil (for residential heating), imports are not an important source of supply. In addition, only the five majors would have the terminals necessary to handle imports of gasoline, diesel fuel and light fuel oil.

9. A merger in a concentrated industry with barriers to entry is likely to lessen competition for

several reasons. First, it reduces the already small number of firms in the oligopoly which, being interdependent, must find a way to coordinate their behaviour so as to both avoid price wars and explicit price-fixing. Generally, firms in an oligopoly find it easier to coordinate their behaviour if there are fewer rivals and the products are homogeneous as are refined petroleum products. Oligopolists coordinate by acting on the recognition of their interdependence through price leadership, or conscious parallelism rather than by means of a conspiracy in restraint of trade such as those condemned in S.45 of the Competition Act. Second, if the firms do succeed in jointly restricting output and raising prices above those that would prevail in a competitive industry, there are barriers to prevent new firms from entering and offering a lower price or other advantage to customers.

10. While the analysis that follows focuses on each of the components of the downstream petroleum industry separately, it must be kept in mind that vertical integration is the dominant characteristic of the industry. Such integration is effected both by ownership (e.g., the majors own refineries, terminals and retail stations), or by relatively long term contracts (e.g., a large chain of independent retail gasoline stations obtains a five or ten-year contract to buy most of its gasoline requirements from a refiner or an independent terminal operator who imports refined products). Such vertical integration is driven by economic forces including large absolute capital requirements, economies of scale, limitations on storing crude oil and refined products, the continuous process technology of refining and its high fixed costs, and the high degree of sunk costs at all three stages of the downstream petroleum industry.

11. Vertical integration of refining/terminal operations and retailing by the majors, where concentration is high at both the refining and retail levels, affords them a greater opportunity to act in a coordinated fashion on the recognition of their interdependence. They find it easier to monitor the behaviour of rivals, including independent resellers. As the number of refiners is reduced, vertical integration makes it harder for a refiner to "shade" its wholesale prices because the market becomes more transparent and small independents do not have sufficient countervailing power to obtain secret discounts. In general, as the RTPC (1986) noted, vertical integration tends to result in more stable retail prices with less pressure on wholesale prices at the refinery level. There are, however, two potential constraints on the ability of refiners to obtain supra-competitive prices: excess refining capacity, and the availability of imports of refined products in substantial volumes on competitive terms.

12. In summary, when examining competition within each component of the downstream petroleum industry in the Atlantic region it is essential to understand the consequences of its linkages, whether by ownership or contract, to activities above and below that component.

C. **Refining**

13. The central characteristics of refining activity in the Atlantic are as follows:

(a) Pre-merger there were four refiners in the region: Imperial, Texaco, Irving and Newfoundland Processing. Post-merger there would be three.

(b) The Newfoundland Processing refinery at Come By Chance is subject to a 25-year restrictive covenant under which it can sell refined products for consumption only in Newfoundland. Irving Oil has a long standing policy of not supplying independent resellers. Thus, in three of the four Atlantic provinces majors without a refinery could get refined products from only two sources (Imperial and Irving) and independents would have only one source, Imperial. This structure is hardly conducive to effective competition.

(c) All four refineries have excess capacity. For example, Newfoundland Processing's refinery operates at less than 50% of capacity. The Irving refinery has considerable excess capacity.

(d) Post-merger, Imperial would also have control of Texaco's marine terminal adjacent to its refinery. Hence they would be able to control the use of this terminal by another company which could use it to import refined products which are easily available in the U.S. or Western Europe.

(e) There are high barriers to entry into refining in the region: demand is growing slowly; there is excess capacity; there are substantial economies of scale in refining such that the addition of a single refinery of minimum efficient scale would add one-third to the present amount of rated capacity in the region; a refinery embodies a huge amount of sunk costs, i.e., the equipment has no other uses; and environmental regulations are growing in stringency so approval of a new refinery (even if a site could be found) might well be difficult to obtain.

(f) In Nova Scotia and PEI wholesale prices of refined products are set by a provincial regulatory body (see section F below). In Nova Scotia the wholesale or rack price is based on the refiner's cost of Brent crude oil plus allowed refining costs plus a margin which includes profits.

D. **Import Option/Terminals**

14. The obvious alternative source of supplies of refined petroleum products for wholesalers and retailers consists of imports. However, imports have competitive significance only if (1) there are independent terminal operators from whom (or through whom) wholesalers and retailers can obtain imports, or (2) wholesalers or retailers are able to vertically integrate backward to buy or build their own terminal(s). In the Atlantic region these conditions cannot be met.

(a) All of the majors operating in the Atlantic region, except Shell, have at least one terminal. Ultramar has 16 terminals while Imperial has 9; Texaco has five and Petro-Canada has 2. Through these terminals they import gasoline (1.3% of net regional supply in 1988),

stove oil and kerosene (25.3% of supply), light fuel oil (8.0%) and diesel fuel (5.2% of net regional supply in 1988). See Table 1. However, with the exception of heating oil, very little of the imported refined products is sold to the few independent wholesalers and retailers in the region. See Table 2.

(b) There is only one independent terminal operator, Olco. It has one terminal in Nova Scotia and one in New Brunswick. However, Olco's terminals are used to handle heavy fuel oil (i.e., bunker fuel), and cannot also handle such "clean" refined products as diesel, heating oil or gasoline.

(c) In all five locations where Texaco operates a marine terminal, Imperial also operates one. The merger would greatly increase the concentration of terminal capacity in these areas (Halifax/Dartmouth, Charlottetown, Chatham/Newcastle, Saint John, and Long Ponds, Nfld).

(d) There are substantial barriers to new facilities-based entry into terminal operations: there is substantial excess capacity among existing terminals; suitable deepwater sites are very hard to obtain; environmental regulations restrict the number of sites available and increase capital and operating costs relative to existing terminals; the two largest independent retail gasoline marketers have less than 50 stations and there are few independent heating oil wholesalers; and the Atlantic market is small, growing slowly, and is geographically dispersed. Moreover, entry by acquiring an existing terminal may require large expenditures to meet increasingly stringent environmental protection regulations.

E. <u>Independent Wholesalers, Retailers</u>

15. As noted earlier, there are few independent resellers in the Atlantic region. This is atypical of every other region of Canada.

(a) Independents own only 50 of the approximately 2700 retail service stations and two firms account for 44 stations. The independents share of the market, for the region as a whole, is less than 5%. There are few independent wholesalers of any significant size, e.g., only three were large enough to have a contract of at least one year's duration with Imperial or Texaco.

(b) The data in Table 2 indicate that independents received from refineries only 2.8% of the region's net supply of gasoline, 1.7% of diesel and 18.9% of light fuel oil supply in 1988. Ignoring changes in the independents' inventories, these figures can also be interpreted as their collective share of the entire Atlantic market for each of these refined products. It is evident, therefore, that independents offer potentially significant competition only in the supply of fuel oil (for heating). (Note that light heating oil still accounts for 46% of residential heating demand in the Atlantic region. This too is quite different than the other regions.)

(c) Post-merger there would be only <u>two</u> suppliers of gasoline, diesel and light fuel oil to

independents. Table 3 indicates that Imperial (including Texaco) would account for 80% of independents' purchases of gasoline, and about 50% of diesel and light fuel oil. (This assumes they would lose no sales as a result of acquiring Texaco.) While Petro-Canada accounts for about one-half the independents' supply of diesel and light fuel oil, Petro-Canada obtains its supply of these products from Imperial's refinery in Halifax under an exchange agreement. Since independents have no direct access to imports or access through an independent terminal operator, their supply situation is highly precarious post-merger. Imperial and Petro-Canada would be in a position to seriously "squeeze" them if it was profitable to do so. In Newfoundland, independents are also able to buy from Newfoundland Processing's Come By Chance refinery which has a great deal of excess capacity.

(d) In Nova Scotia and PEI, fuel oil dealers, the only segment where independent resellers have made any headway in the region, must be licenced and the transfer of a licence must be approved by the regulatory agency. Further, the maximum price of fuel oil is regulated in Nova Scotia, and in PEI, both the minimum and maximum mark up is regulated by the Public Utilities Commission. In Nova Scotia, a wholesaler must operate its own storage facilities. All of these factors limit competition from independent wholesalers.

F. <u>Gasoline Retailing</u>

16. <u>Concentration</u>: Pre-merger, there were only six significant retailers of gasoline; together, they accounted for over 95% of sales volume and 98% of the number retail stations. Post-merger five sellers would have this very large fraction of the region's gasoline sales. This would result in a very high level of concentration. Moreover, the product is homogeneous - despite the large marketing efforts to create brand loyalty.

17. All of the significant gasoline retailers are either integrated regionals (i.e., Irving) or integrated national petroleum companies who compete with each other (except Irving) in the other regions of Canada. Only three of the six (pre-merger) had a refinery in the region. The rest obtained their supplies through exchange or supply agreements with Imperial, Texaco or Irving.

18. Although concentration has been high in retail gasoline markets in Atlantic Canada, the shares of individual firms in some of the largest cities have shifted noticeably during the period 1984 to 1987. Data for St. John's indicate that the market shares of both Imperial and Ultramar (including Gulf) fell by seven and six percentage points respectively. These changes amounted to a 23% and a 20% decrease respectively. Between 1983 and 1987 Texaco was able to increase its market share in St. John's and Halifax by some 18%. Such changes suggest that there has been some competition in urban gasoline markets and that Texaco was an effective competitor in the region.

19. <u>Independent Retailers</u>: Not only is the retail gasoline oligopoly highly concentrated, there is only an inconsequential "competitive fringe." Independents own only 50 of the about 2700 service stations and there are only two small chains with a total of 44 stations. It is hard to

overemphasize the role of independent wholesaler/retailers in increasing the intensity of competition in retail gasoline marketing. In general, they have emphasized lower price (including coupons, merchandise, etc.) as a marketing strategy. To support a low-price strategy they found ways of lowering the cost of distributing gasoline, e.g., self service gas bars which had both lower capital and operating costs (including labour and advertising). The RTPC (1986, p. 319) concluded that the enormous changes in the nature of gasoline retailing elsewhere in Canada were "goaded by the serious competitive threat of independent marketers which caused the integrated marketers to lower distribution costs to more competitive levels."

20. Although there are few independents in the Atlantic region, they have shown an ability to win market share. For example, in Saint John, Co-op's share increased by 30% between 1984 and 1987.

21. The independents elsewhere in Canada pushed the retail sector to reduce the total number of outlets and increase the volume per station - thus increasing the productivity of labour and capital. When the U.S. border was open to the import of U.S. gasoline in 1985, independents in Ontario were the first to use this option to ensure that the domestic refiners' price didn't exceed the landed cost of imports.

22. Barriers to Entry: There are substantial barriers to entry into the retail gasoline business in the Atlantic region. First, there is substantial excess capacity. Second, there are higher regulatory barriers to entry in Nova Scotia and PEI. Third, there are very few domestic refiners from which an entrant could obtain supply. Post-merger, there would be only one in Nova Scotia, PEI and New Brunswick and in Newfoundland there would be only two if the entrant was an independent. (Majors could also obtain supply from the Irving Oil refinery in Saint John.) Fourth, a new firm would find it all but impossible to import gasoline because there are no marine terminals owned by an independent that are capable of handling "clean" products such as gasoline. As a result of the very limited sources of supply, a major entrant into retailing would probably have to enter at two stages, i.e., creating or acquiring a marine terminal to import gasoline, and buying or building a retail network. Finally, given the high level of concentration in individual urban (or rural) markets is high, hence entry on a substantial scale would likely provoke an aggressive competitive response from existing firms.

23. Excess Capacity: There appears to be substantial excess capacity among service stations in the region. Evidence filed with the Director, based on Kent Survey data for eight urban areas in the region, indicates that 37% of stations sold less than one million litres in 1987. Almost three-quarters of the stations in these urban areas sold under two million litres which is well below an estimate of the average for stations in 16 Ontario cities (2.2 million litres p.a.). Given that the stations for which size data area available in are in large urban areas, it seems reasonable to believe that in smaller towns and rural areas the average volume would be even smaller. Given that capital investment and running costs are less than proportionate to station capacity, it seems

reasonable to conclude that most service stations in the Atlantic operate at inefficiently small volumes.

24. **Provincial Regulation**: Nova Scotia and PEI engage in extensive direct regulation of both the wholesale and retail petroleum distribution. In Nova Scotia, under the Gasoline and Fuel Oil Licensing Act, the Board of Commissioners of Public Utilities regulates the wholesale and retail distribution of gasoline and fuel oil (defined to include stove oil, furnace oil, bunker, heavy fuel oil, propane). The purpose of the legislation is to "ensure at all times a just and reasonable price or change in price of gasoline or fuel oil to consumers and licensees..." The legislation is enormously detailed as a review of some of the key provisions indicates: (i) Every wholesaler or retailer of gasoline or fuel oil must obtain a licence. Retailers may only purchase supplies from licensed wholesalers. (ii) In determining whether it will issue a retail gasoline licence, the Board is to take into consideration "the public interest, convenience and necessity..." (iii) Retailers are prohibited from giving, directly or indirectly, merchandise to customers, unless the cost of such merchandise is included in the wholesale price of gasoline. (iv) The Board has the power to set prices or increases in the price of gasoline and fuel oil. Licensees shall not exceed the price (or increase) set by the Board. The Board may change prices at its own initiative or upon the request of the provincial Cabinet, with or without a hearing. Individuals may also apply for a change in a price and a public hearing will be held. The test to be met by an applicant for a change in price is whether the proposed price is "just and reasonable." (v) The maximum retail price of gasoline is not to be more than 4.6 cents per litre above the wholesale price also set by the Board. (vi) When a retail gasoline licence is to be transferred, the proposed licensee must satisfy the Board "that he can furnish services and facilities reasonably adequate" as required by the public convenience and necessity test. (vii) A retailer is required to "keep his outlet, including pumps, signs, lights and other facilities in good repair, fully serviced, painted and in a clean and tidy condition;" provide "separate washrooms for male and female members of the motoring public and keep them in a clean and sanitary state...," and "provide pump island attendants for the dispensing of gasoline." Further, in Nova Scotia a wholesaler must operate their own storage facilities, such as terminals, in the province in order to obtain the necessary licence.

25. In Prince Edward Island, the retailing and wholesaling of virtually all refined petroleum products is subject to the Petroleum Products Act which is administered by the provincial Public Utilities Commission. The extensiveness of the legislation can be illustrated by the following provisions: (i) Both retailers and wholesalers must be licensed. The criteria for obtaining a retailing licence is "public convenience and necessity" as judged by the PUC. In granting a renewal of such a licence the Commission must also give due consideration to the quantity of petroleum products sold in the previous year and to the service which the outlet renders to the community in which it is situated." (ii) The PUC "has general supervision of all wholesalers and retailers with

respect to pricing of petroleum products, including the authority to regulate the timing and frequency of wholesale and retail price changes." No retailer or wholesaler can deviate from the price in effect on April 15, 1987, unless ordered by the commission. Price changes "wholly attributable to changes in taxation" are not regulated by the PUC. Those who apply for a change in the regulated price must "prove that the proposed price change is just and reasonable." (iii) The PUC may fix the minimum and maximum markup between the wholesale price to the retailer and the retail price to the consumer of any petroleum product sold in the province. (iv) Retailers are required at all times (among many other things) to "provide pump island attendants for the dispensing of gasoline at manned and split service outlets" and to provide "trained console operators to control the dispensing of gasoline at self and split service outlets."

26. In addition, New Brunswick has recently enacted legislation imposing constraints on prices similar to those applied in Nova Scotia.[1] It has not yet been fully proclaimed in force, however.

27. In general terms, the effect of Nova Scotia and PEI's regulation is to restrict entry and maintain existing methods of gasoline marketing. By controlling methods of distribution (e.g., in Nova Scotia a service station must have two service bays and provide attendants to dispense gasoline), regulation prevents the use of the highly efficient, self-serve gas bar method of operation. While the trend in other provinces is toward a higher fraction of self-serve and split-serve, gas-only operations, Nova Scotia law prevents this efficiency-driven rationalization of service station capacity. Both provinces set the maximum price at the gas pump. In practice, the maximum markup (presently 4.3 cents/litre in Nova Scotia - higher than the competition-determined margin elsewhere) has also become the minimum. Control over the transfer of wholesaling and retailing licences potentially restricts entry by independents who want to acquire a number of retail sites to form an efficient-sized chain of stations. The regulators in Nova Scotia raise service station costs by requiring them to provide two washrooms on each site.

28. **Retail Margins**: It has been observed by Oil Buyers Guide that provincial regulation in Nova Scotia and PEI has strengthened both wholesale and retail prices giving rise to the best margins in Canada. Retail markets have been further stabilized by the large presence of Irving Oil and the virtual absence of independents.

29. Monthly data collected by the federal Department of Energy, Mines and Resources for 1988 indicates that in Halifax the retailers margin (based on full self serve prices) was 4.6 cents/litre

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1. See Gasoline Diesel Oil and Home Heating Pricing Act, S.N.B. 1987c. G-3.1.

every month - exactly as required by provincial law.[2] In St. John's the margin varied from 3.9 to 4.3 cents/litre, in Charlottetown it varied from 3.6 to 4.0, while in Saint John it varied from 3.7 to 4.5 cents/litre. By comparison, the retail margins (again, excluding coupons or free merchandise) in several other cities were as follows:

- Montreal 3.4 to 3.8 cents/litre
- Toronto 2.7 to 3.6
- Winnipeg 2.2 to 3.6
- Regina 3.1 to 3.8
- Calgary 2.8 to 4.0
- Vancouver 2.8 to 3.6

These data reinforce the conclusion that retail margins are higher and more stable in Atlantic Canada. For several other cities, the high end of the range is the bottom end of the range for the Atlantic cities.

30. Further, weekly data collected by EMR from April 1988 to May 1989 for regular unleaded gasoline at self-serve outlets indicated that for four Atlantic region cities (Charlottetown, Halifax, St. John's and Saint John) retail prices (excluding taxes) were much more stable than even the Canadian average. The contrast between any of these cities and Toronto, Winnipeg, Calgary and Vancouver was particularly marked. Moreover, throughout the period, retail prices in the four Atlantic cities were almost always two to five cents per litre above the Canadian average and even more above the cities where prices were far less stable.

IV ASSESSMENT OF THE PROPOSED REMEDIES

31. Under the Draft Consent Order (DCO) filed with the Tribunal by the Director of Investigation and Research on June 29, 1989, Imperial Oil would be required to divest itself of substantially all of Texaco Canada's assets in the Atlantic region. Imperial would retain only Texaco's shares in the Great Eastern Oil Company (which supplies dealer-owned stations in Newfoundland with Texaco brand products), and 13 Texaco company-owned service stations. This means that Texaco's Dartmouth refinery (together with the Ultramar exchange agreement), five marine terminals (including the one adjacent to the refinery), 74 company-owned gasoline retailing sites, and 123 dealer-owned service station agreements are to be divested.

32. It is clear that the scale of the divestitures is almost equivalent to the total divestiture of Texaco's assets in the Atlantic region. However, the effect of the DCO, if approved by the Competition Tribunal, depends upon who purchases these assets and what they do with them after the purchase. For example, if all the assets to be divested in the Atlantic region are purchased by

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2. The courts in Nova Scotia have observed that the maximum dealer margin has tended to become a uniform retail margin - hence price competition appears to have ceased. See Apex General Supplies Ltd. and Board of Commissioners of Public Utilities (1978) 86 D.L.R. (3d) 661 (N.S.C.A.).

an independent reseller (or as a joint venture by two or more independents), this would create new entry and foster competition for several reasons. First, the economic logic of the industry requires vertical integration of refining, terminalling and retailing either by ownership or by means of fairly long-term contracts. By divesting virtually all of Texaco's Atlantic assets as a bundle, the DCO greatly increases the odds that a rival at least as effective as Texaco will take the latter's place.

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. The entrant would have a viable chain of retail sites and instantly obtain almost 10% of the region's retail gasoline sales.[3] 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. Despite the regulation in Nova Scotia and PEI, they are free to reduce prices in order to try to increase their sales and market share.

34. Third, since the general strategy of independents is to compete on price by using lower-cost methods of distribution, the purchaser of the divested assets could well inject more competition into what has not been a highly competitive market. A buyer who is not one of the majors or a regional refiner or marketer is more likely to take advantage of the higher retail margins in the Atlantic region. The Texaco network of retail stations appear to be of above average efficiency, yet they too have excess capacity. Hence a low-price, low cost strategy seems attractive, although the independent buyer has to reckon with the financial and marketing resources of the majors who are well established in the region.

35. In the Gemini case, the Competition Tribunal stated that "the object of a consent order is to eliminate the substantial lessening of competition which the Director alleges will result from the merger" (p. 68). If the Tribunal accepts the DCO there is no doubt that this objective will be met with respect to the Atlantic region because of the extensiveness of the divestitures, and the fact the Director must approve the purchaser(s) of the divested assets.

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3. While the Nova Scotia and PEI authorities would have to approve the transfer of service station licences to the independent, this should be far easier to obtain than trying to enter by building the same number of new stations.

Table 1

Imports Into the Atlantic Region, 1987 and 1988
($000m^3$)

	1987 Imports	1987 Net Cdn. supply	1987 %	1988 Imports	1988 Net Cdn. supply	1988 %
Gasoline	102	2812	2.4%	73	2898	1.3%
Stove Oil & Kerosene	66	244	27.0	37	146	25.3
Light Fuel Oil	--	1267	--	113	1406	8.0
Diesel Fuel	292	1740	16.8	101	1933	5.2

Source: National Energy Board data provided to Bureau of Competition Policy.

Table 2

Sales to Independent Resellers in Atlantic Canada, 1987 and 1988
($000m^3$)

	1987 Amount	1987 Net supply	1987 %	1988 Amount	1988 Net supply	1988 %
Gasoline	110	2812	3.9%	80	2898	2.8%
Diesel	27	1740	1.6	32	1933	1.7
Light Fuel Oil	261	1267	20.6	266	1406	18.9

Source: National Energy Board and data provided by refiners to the Bureau of Competition Policy.

TABLE 3

CONFIDENTIEL
CONFIDENTIAL

TABLE 4

CONFIDENTIEL
CONFIDENTIAL