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IN THE MATTER of an Application by the Director of Investigation and Research under Section 105 of the Competition Act, R.S. 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 (the "Director")

Applicant

- and -

IMPERIAL OIL LIMITED ("Imperial")

Respondent

CONSENT ORDER IMPACT STATEMENT

Introduction to Consent Order Impact Statement

1. Rule 34(3)(b) of the Competition Tribunal's Rules of Practice requires a statement in support of the Director's Application for a Draft Consent Order (the "Application" and the "DCO"), which was filed on June 29, 1989. The purpose of a consent order impact statement is to demonstrate that the transaction under review, if fully implemented and incorporating whatever positive obligations and structural remedies that are set out in the proposed consent order, would not give rise to any

likelihood of a substantial prevention or lessening of competition in any relevant market in Canada.

2. Unless otherwise expressly defined herein, terms used in this Statement incorporate the meaning ascribed to them in the DCO.

3. Since the transaction entails the merger of two fully-integrated and nationally-represented petroleum companies, a significant number of product and geographic markets in Canada are potentially impacted by it. Following extensive investigations and discussions, the Director has included in the DCO certain divestitures and obligations which will ensure that competition in Canadian markets will not be lessened for the wholesale supply and retail marketing of gasoline as well as the Atlantic Region wholesale supply market in other petroleum products. This impact statement is designed to provide a comprehensive survey of the DCO's likely competitive effects in those relevant markets.

4. In the Application the Director stated that a principal concern in the downstream of the petroleum industry is the possibility that a concentrated domestic refining industry could limit the supply of gasoline that is available to independent gasoline marketers in wholesale markets.

5. As the RTPC indicated in its 1986 report Competition in the Canadian Petroleum Industry (see Application pp. 14-15), given that the refining industry must be concentrated because economies of scale result in relatively few refineries the best means of ensuring efficient and competitive gasoline distribution is for imported gasoline to have ready access to the Canadian market. When available in sufficient volume, the landed price of imported gasoline places an upper bound on the wholesale price that the domestic refiner can charge for gasoline to independents. Also in that environment and where independent marketers are competing with the refiner-marketers in retailing gasoline, the independent marketers will place an upper bound on the price the refiner-marketer may charge for gasoline at retail.

6. The Director recognized that service station location is an important feature of local rivalry at the retail level of the industry and that independent marketers when assured supply, will be able to compete by offering lower prices to compensate for any disadvantage their location may present to the consumer. However, there are areas where, due to the merger, Imperial would have a very large presence in a neighbourhood or community where insufficient competitors are present.

7. An important reason for seeking to increase the number of service stations available to independent marketers is to reduce the extent of refiner-marketer representation in the

retail stage of the industry. This objective follows from the Director's analysis of how vertical integration from refining to marketing could facilitate interdependent stability among the refiner-marketers.

I. Description of the Parties and the Transaction

8. A description of the parties and the transaction are set out in paragraphs 5 to 10 of the Application.

Investment Canada

9. The transaction was reviewable under the Investment Canada Act. The Minister responsible for the Investment Canada Act found the transaction to be of net benefit to Canada and granted his approval on February 23, 1989. The Minister responsible for Investment Canada, in making his announcement stated that his decision did not in any way affect the application of the Competition Act. As part of the approval process, Imperial made certain undertakings to Investment Canada, including an undertaking to reinvest through 1992 a minimum of 70 percent of its upstream cash flow before debt servicing in upstream operations in Canada, provided that economically viable opportunities exist. Imperial has also agreed to offer for sale to Canadian companies, over a period of five years, upstream assets of Texaco or Imperial, or both, having a minimum value of $550 million, and to sell a significant portion of those assets.

Trade Marks

10. As part of the transaction, Texaco Inc. and Texaco entered into an agreement pursuant to which Texaco assigned to Texaco Inc. all of its rights to the trade marks, trade name and logo of Texaco Inc., and Texaco Inc. provided a licence to Texaco to use the trade marks, trade name and logo during a phase-out period. Texaco is required to remove the name "Texaco" from its corporate name, commercial name and trading name by August 23, 1989. Texaco may continue to sell goods and services bearing the Texaco trade marks and to display the trade marks at automobile service stations and other marketing facilities until February 23, 1991. After that date Texaco Inc. is free to re-enter the Canadian market.

II. The Draft Consent Order

11. The proposed DCO follows an extensive examination by the Bureau of Competition Policy (the "Bureau") of the transaction commencing in late 1988. At that time, Imperial advised the Director of its intention to bid to acquire all the shares of Texaco. The Bureau's preliminary examination of both the upstream and downstream sectors of the industry identified a number of concerns in respect of the merger of the downstream operations of Imperial and Texaco, and the Bureau so advised Imperial in early January, 1989. On January 20th, 1989, the

parties to the merger publicly announced their intentions, and the Bureau's examination, then freed from the constraints of confidentiality that the parties had requested, thereupon entered a more extensive review. At the same time, the Bureau requested Imperial to provide certain undertakings because the Bureau had not had sufficient time to complete a thorough analysis of the competitive implications of the downstream aspects of the merger. As a result, Imperial undertook to divest certain downstream assets of Texaco if required by the Director and to hold separate the downstream operations of Texaco until the Bureau's staff and consultants had an opportunity to complete a full analysis of the competitive implications of this merger and recognizing the possibility of an application to the Tribunal for a consent order. On July 4 the Tribunal issued an interim order which superseded the previous hold separate undertaking.

12. The Bureau's analysis was based primarily on 1987 statistics which were the most comprehensive available at the time. Subsequently as they became available 1988 statistics were included in the analysis where materially different.

13. To ensure that the transaction will not be likely to prevent or lessen competition substantially, the DCO provides for the divestiture of certain assets of Imperial and Texaco as well as imposing obligations upon Imperial to supply gasoline to independent marketers in Ontario and Quebec.

14. The DCO provides that, in the Atlantic Region, Imperial will divest Texaco's Eastern Passage refinery together with the Ultramar/Texaco reciprocal supply agreement as well as four storage terminals, a number of company owned service stations, dealer-owned branded service station supply agreements, bulk plants and all contracts or customer lists associated with the foregoing.

15. The DCO further provides that Imperial will divest 9 other storage terminals outside the Atlantic Region.

16. The DCO requires Imperial to make available to independent marketers in Ontario and Quebec wholesale supplies of gasoline directly or indirectly from its Sarnia and Nanticoke refineries at its wholesale supply points in existence during the term of this provision.

17. The DCO also provides that Imperial will divest 543 retail outlets across Canada and, where branded dealers are involved, will offer to supply such dealers on an unbranded basis.

III. Overview of Canadian Petroleum Industry

18. An overview of the downstream sectors of the petroleum industry is set out in Appendix 2 to the Application.

IV. Competitive Impact in Atlantic Region

19. In the Atlantic region, there are few refiners, imports by independents are virtually non-existent and there is an absence of a significant number of independent retailers. There are few effective independent competitors to the refiner-marketers operating in most of the region. These refiner-marketers are, in order of retail gasoline market share, Irving, Imperial, Petro Canada, Ultramar, Texaco and Shell. Prior to the merger only Irving, Imperial and Texaco operated refineries in the Atlantic region, the others being supplied through supply exchange agreements. Irving, as a matter of record, does not supply independents. A fourth refinery is operated by Newfoundland Processing, but that refinery is restricted from selling petroleum products in the provinces other than Newfoundland.

20. After the merger, in the absence of the DCO, there would be two refiners, and five firms would account for 96% of the volume of gasoline sold under their brands at 98% of the stations in the Atlantic region.

21. In the Atlantic region, the DCO requires the divestiture of Texaco's Eastern Passage refinery together with the Ultramar/Texaco reciprocal supply agreement as well as the divestiture of all of Texaco's terminals in the region. Since these assets comprise Texaco's only refinery in the Atlantic region and all of its terminals, the transaction does not alter Imperial's capacity in the region at the refining and wholesale distribution level. The DCO requires the prior approval of these divestitures by the Director, who is to ensure that a prospective purchaser would not likely thereby substantially prevent or lessen competition. Therefore Texaco will be replaced by a new competitor and there will be no increase in the concentration of ownership of refining in the Atlantic region, and, to the extent reasonable and possible, effective competition will be maintained. The DCO therefore ensures that there is no likelihood of a substantial prevention or lessening of competition in the refining of petroleum products in the Atlantic region.

22. Pursuant to the DCO, Imperial will sell Texaco's Saint John (New Brunswick), Chatham/Newcastle (New Brunswick), Charlottetown (Prince Edward Island) and Long Ponds (Newfoundland) terminals. The terminal in Charlottetown will be offered for sale upon the condition that Imperial is able to

negotiate terminalling rights for up to three years and 25% of throughput capacity.

23. The Director would prefer that the purchaser of the Eastern Passage refinery also acquire the terminals. The DCO provides that the purchaser must to the extent reasonable and possible intend to operate the refinery and serve the domestic market. The purchase must not result in a substantial prevention or lessening of competition, and will be subject to environmental and employment undertakings. If the purchaser does not desire an assignment of the Ultramar/Texaco reciprocal supply agreement, the agreement would be retained by Imperial. If the purchaser did not require the above-noted terminals, they would be offered for sale as operating terminals or closed.

24. In addition, 197 retail gasoline stations will be offered for sale along with the Eastern Passage refinery and the terminals. The Director and Imperial have agreed that Imperial will retain Texaco's shares of Great Eastern Oil Limited which carries on business in Newfoundland and will retain 13 Texaco company-owned retail outlets in the Atlantic region.

25. It is presently uncertain whether the ultimate purchaser of the Eastern Passage refinery will require all of Texaco retail outlets, bulk plants, contracts and customer lists that will be offered for sale by Imperial. In the event that the

purchaser of the refinery decides not to acquire all of the retail outlets, bulk plants, contracts and customer lists, the Director would assess whether partial divestiture would alleviate his competition concerns.

Effective Remaining Competition in Atlantic Region

26. A survey of the Atlantic Region's larger centres where Imperial proposes to retain former Texaco service stations indicates that there will be a significant number of effective competitors remaining after the divestitures required by the DCO are fully implemented and that in none of the Atlantic region markets will Imperial's post-divestiture market share exceed 30%.

27. In the larger service station markets in the Atlantic Region where Imperial plans to retain former Texaco outlets, Irving Oil will continue to be the largest or a significant retailer of gasoline. Moreover, in each of the affected larger centres in the Atlantic region there will be at least four other significant retailers with substantial market shares following the full implementation of the transaction and the DCO. Since the purchaser of the Eastern Passage refinery and terminals will potentially stand in Texaco's shoes with respect to ownership of retail outlets (with the exception of the few retained by Imperial), there will be no likelihood of a substantial lessening of competition in any affected Atlantic region markets.

28. The evidence indicates that some competition exists in each of these affected retail areas, and this situation will persist following the full implementation of the transaction and the DCO. For example, in the largest centres there were substantial shifts in market shares between rivals over the period 1984 to 1987. This recent shift in market shares is indicative of a certain degree of competition. For example, Imperial and Ultramar (including Gulf) had the largest market shares in St. John's, Newfoundland in 1984, yet by 1987 Ultramar's market share had dropped six points (which amounts to a 20% decrease), and Imperial's share had also declined seven points (being 23%). Another example is the growth of the independent, Co-op, from 1984 to 1987 in Saint John, New Brunswick. During this period, Co-op's market share in Saint John increased by approximately 30%.

Government Regulation of Retail Gasoline Marketing

29. As set out in the Application, Nova Scotia and Prince Edward Island are the only provinces of Canada in which there is significant government regulation of retail gasoline marketing. Despite the existence of these regulations there is, nevertheless, some scope for price competition. Moreover, provincial regulators have not attempted to impose limits on the maximum or minimum installed capacity of gasoline retailers, leaving some scope for competition to persist.

Availability of Supply

30. The Bureau has examined the availability of wholesale supplies of gasoline and other petroleum products to independent marketers in the Atlantic region. The overall supply situation that will prevail is unchanged, and after the full implementation of the transaction and the DCO will ensure access on reasonable commercial terms to adequate supplies of gasoline. If some of the terminals are not acquired by the purchaser of the Eastern Passage refinery, they would be made available for sale to a purchaser who is likely to continue their operation. This is feasible in the Atlantic region because import supply is readily available and is a potential competitive strategy for new marketers lacking contractual commitments from local refiners.

Conclusions with respect to Atlantic Provinces

31. The best means available for ensuring that the merger does not substantially prevent or lessen competition in the Atlantic region is to sell the Eastern Passage refinery together with its terminal facilities. In addition, in order to ensure that the refinery or the terminal, or both in tandem, have access to retail outlets, Imperial is required to divest almost all the service stations it acquired through the merger. The DCO creates an opportunity for the introduction of a totally new participant into the downstream segment of the Atlantic petroleum industry. If 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 the supply structure to where it was before the merger.

V. Terminals in Central and Western Canada

32. Terminals in key locations are important to distributing large volumes of gasoline inexpensively. Although independently owned storage facilities exist in Central and Western Canada, they are not widely distributed throughout these regions. The DCO goes a long way to alleviating any concerns about a possible shortage of terminal facilities by requiring Imperial to divest nine terminals in Central and Western Canada. Some of these terminals are strategically located and are large. An independent wholesaler of gasoline operating one of these large terminals, with access to imports and with outlets at retail would be a significant competitive force in the vicinity of the terminal.

33. Imperial will divest six terminals in Ontario and Quebec and three terminals in Western Canada (all of which are currently owned by Texaco unless otherwise indicated): Baie Comeau (Imperial); Rimouski; Ottawa; Sault Ste. Marie; Sudbury (either Imperial or Texaco terminal); Thunder Bay; Calgary; Victoria; and Prince George. The terminals in Sault Ste. Marie

and Victoria will be offered for sale conditional upon Imperial being able to negotiate terminalling rights for up to three years and 25% of throughput capacity.

34. The Director in determining whether competition may be substantially lessened in any area in which Imperial and Texaco each owned a terminal considered whether there were other terminals owned by unrelated companies. The DCO ensures that there is no substantial lessening of competition in Central Canada in access to and availability of terminals by requiring Imperial to divest a terminal in Baie Comeau and Rimouski (Quebec), Sault Ste. Marie, Thunder Bay, Sudbury and Ottawa (Ontario).

35. As for Western Canada, the DCO requires Imperial to divest terminals in Calgary, Victoria and Prince George.

36. All terminals will be offered for sale publicly as operating terminals. All sales will be made at fair market value subject to review by the Director to ensure that any sale will not result in any substantial lessening of competition. Sales will be to financially sound purchasers and subject to environmental and employment undertakings. During the period a terminal is offered for sale, the terminal may be operated or mothballed in a condition such that the purchaser could operate the terminal upon completing the purchase. If after a reasonable

period of time, which shall not be more than one and one-half years in the case of the Sudbury terminal, and not more than one year in the case of the other terminals, a terminal has not been sold, Imperial may, with the Director's consent, close and dismantle the terminal. If, in the Director's opinion, Imperial has not exercised good faith best efforts in offering a terminal for sale, as provided for in the DCO the Director may direct a trustee to offer the terminal for sale upon reasonable terms for six months, following which Imperial may close and dismantle it if no sale is completed.

VI. Supply and Wholesale Marketing of Gasoline in Central and Western Canada

37. Texaco has no refining capacity in Quebec or west of Ontario, but has capacity surplus to the requirements of its marketing network in Ontario and the Atlantic region. Consequently, Texaco has entered into reciprocal supply agreements and processing agreements with refiners in regions where it has no refining capacity. Imperial has refining capacity capable of supplying all regions in Canada, although it too has entered into reciprocal supply agreements to reduce transportation costs. Outside of the Atlantic region, the only competitive issue in refining as a result of the merger is in Ontario/Quebec as Texaco has no refinery west of Ontario.

38. The following table lists the effective capacities of refineries located in Central Canada.

Ontario/Quebec Region Refining Capacity

Firm	Location	Total Capacity (b/cd)	Pre-Merger Share of Refining Capacity (%)	Post-Merger Share of Refining Capacity (%)
Petro-Canada	Montreal Mississauga Oakville	230,500	28.0	28.0
Shell	Montreal Sarnia	191,000	23.3	23.3
Imperial	Sarnia	123,500	15.0	28.0
Texaco	Nanticoke	106,400	13.0	-
Ultramar	St. Romuald	100,000	12.2	12.2
Suncor	Sarnia	70,000	8.4	8.4
Total		821,400	100.1	100.0

As outlined in the Industry Overview annexed to the Application there is excess refining capacity in Central Canada. The existence of this excess capacity is an effective deterrent to a refiner trying to drive up gasoline prices by restricting supply, since other refiners can easily and profitably increase production to make up the difference. Because of high fixed costs refineries are motivated to increase utilization.

39. Gasoline imports have gradually increased since deregulation in 1985. An increasing number of independent

terminal operators and independent marketers have turned to imported product as an alternative source of gasoline supply.

40. Every refinery domestic or foreign has a geographic area in which it can competitively supply gasoline. The size of that area is a function of the refiner's cost of acquiring crude oil, its cost of refining the crude oil, its cost of transporting the output of the refinery, and the delivered cost of imported refined products. Thus, the geographical size of the area in which each refiner can effectively compete is determined not only by its ability to compete with other local refiners, but also with its ability to compete with products imported into the region. A corollary of potential import competition is that local refiners cannot raise their price for gasoline above the price at the closest import supply alternative plus the cost of transport. There is evidence demonstrating a linkage between wholesale prices prevailing for gasoline in Central Canada and prices for foreign sources of supply with ready access to those regions, such as U.S. refining and terminal centres along the Canada-U.S. border.

41. The Director's concern regarding the merger in respect of supply in Central Canada is that there is a likelihood to lessen competition substantially should surplus refinery capacity and/or the import option disappear. Forecasts suggest that refinery utilization rates will continue to climb and refineries

will be operating closer to full capacity in the mid 1990's. It is more difficult to forecast if the import option might be interrupted or interfered with. The Director investigated in detail Imperial's claim for efficiency gains associated with bringing the Sarnia-Nanticoke refinery complexes under common ownership and operation. These efficiencies are real and will result in a significant increase in capacity to produce gasoline. In light of these efficiencies the Director rejected any requirement to force Imperial to divest Nanticoke or Sarnia in favour of an assured supply remedy as set out in the DCO. The Director's conclusion parallels the findings of the RTPC (see Application pp. 13-15).

Assured Supply to Independent Marketers in Central Canada

42. Although imports of gasoline from the U.S. and elsewhere will continue to be available at competitive prices, and although there are other refiners and wholesalers with excess capacity left to supply gasoline to independent marketers, as an additional assurance to independents Imperial will make available 1511 million litres of gasoline for sale to independent marketers on reasonable commercial terms at all Imperial wholesale supply points in Central Canada. This amount represents the volume of gasoline supplied by Imperial and Texaco to independent marketers directly or indirectly from the Sarnia and Nanticoke refineries before the acquisition. The maximum supply provided for in the DCO also includes a share of

additional output associated with synergistic efficiencies from Nanticoke and Sarnia, plus an accommodation for market growth. The DCO enables independent marketers to enter into long-term supply contracts with Imperial of up to five years and thereby guarantee continued sources of supply of gasoline for ten years. With such assurances of long-term gasoline supply, independent marketers will be encouraged to open new retail gasoline stations. Consequently, the DCO ensures that competition will at the very least remain at the same level as before the acquisition and that there will be no substantial lessening of competition in the refining and wholesale distribution of gasoline in Central Canada.

43. The DCO has given Quebec and Ontario independent marketers access to gasoline from the refineries without requiring them to operate the refineries or take any of the risks associated with investing in a refinery. The supply guarantee assures supplies will be available to meet a large share of the independent marketers' requirements. Moreover, the one anti-competitive instrument available to refiners in present market circumstances is to restrict gasoline supply to independent marketers. Where independents are well entrenched in good locations throughout the region, the assurances of supply from the refineries removes any likelihood of a lessening of competition from the joining of the two refineries under common ownership.

44. The DCO provides that in the first three years from the date of the order, the Director may apply to the Tribunal to seek any remedy under the merger or other provisions of the Competition Act should the supply obligation under the order prove insufficient to offset the effects of the merger as a result of a material change in circumstances. In years four to seven, the Director is limited to applying to the Tribunal for a variation in the terms of the duty to supply conditions.

VII. Gasoline Retailing in Central and Western Canada

45. Canadian retailers of gasoline compete with respect to both price and non-price characteristics of their service station offerings. Motorists are, by definition, among the most mobile consumers in terms of their access to a broad range of retail suppliers. While industry data suggest that 70% of consumers tend to buy most of their gasoline within two miles of their homes, the willingness of a significant number of consumers to shop more widely effectively disciplines pricing in local trading areas in larger urban areas. Search activity is for many motorists a relatively costless by-product of other activities associated with work, commuting or leisure activities. Gasoline purchase frequency is about once per week in Canada. The overall results of these factors is that individual consumers are exposed to a large number of retail gasoline outlets during the period of

time when they may require refuelling. The many alternative sources available to price sensitive consumers ensure that price changes move both rapidly and pervasively through most large metropolitan areas and smaller centres.

46. In Canada, retail markets for gasoline vary widely in nature from large urban markets to medium-sized communities to small communities. The Director has accepted for purposes of this analysis that in large urban service station markets, the relevant geographic market is the whole urban community and adjacent suburbs where a high percentage of commuters reside. It follows that in smaller urban communities, the whole community should be viewed as constituting a single geographic service station market. In this Statement, urban areas, both large and small, have been chosen as the relevant geographic frameworks for assessing the likely competitive implications of the transaction and DCO.

47. Retail gasoline sales in larger urban areas for motor gasoline are surveyed by Kent Marketing Services Limited ("Kent"), an independent market survey firm which compiles data by reading meters on gasoline pumps at service stations and publishes statistics on urban and rural service station areas located throughout Canada ("Kent Areas"). The boundaries of the areas surveyed by Kent usually correspond to municipal boundaries. Kent takes pump readings at all service stations in

larger urban areas six times a year and at outlets in less densely populated areas four times a year. Kent's data are available for all Canadian communities with populations of 25,000 or more, and for many smaller communities. Kent data covers approximately 70% of retail gasoline sales in Canada.

48. Smaller urban and rural areas have been grouped into communities with populations in excess of 10,000 which are not surveyed by Kent (the "Non-Kent Areas"), and communities with populations of fewer than 10,000 people (the "Town Areas"). In most Non-Kent Areas, systematic annual data on each retailer's share of gasoline sales was available from public or private sources. Sales data are not required for the purpose of assessing the likely competitive impact of the DCO in Town Areas as the merged firm's likely competitive significance can be evaluated by reference to the proportion of Imperial outlets to total outlets that will prevail after the DCO is fully implemented. Acceptance of the Non-Kent Areas and Town Areas as appropriate geographic markets yields a conservative definition, in most cases, of a relevant market for the purpose of competitive analysis.

49. In order to ensure that there can be no likelihood of a substantial lessening of competition in any Kent Area, where Imperial's share would likely exceed 30% by volume after the merger and that the market share of independents exceeds 20%,

Imperial will divest service station sites so as to reduce its market share to 30%. The independents' presence is vital to address the Director's concern about the increased potential for the anti-competitive use of market power as a result of increased refinery concentration brought about by the merger (see Application p. 36).

50. In Kent Areas where the market share of independents was less than 20% further scrutiny on a case-by-case basis was undertaken with attention devoted to the following competitive factors: (a) the strength of representation by national or regional integrated retailers in the market; (b) the strength of representation by independent retailers and evidence of growth in the number of independent outlets and market share by volume in recent periods; (c) evidence of shifts in market shares among the major classes of retailers over recent years; (d) the number of non-Imperial gasoline sites which are likely to operate after all divestments are implemented in the market; (e) evidence of recent retail entry by independents or other national or regional integrated retailers; and (f) evidence of reasonable availability of wholesale supply of gasoline.

51. In carrying out case-by-case assessments, particular weight was given to evidence of variation in market shares during recent time periods (indicative of significant price and non-price competition in the market), and emphasis was placed on the

competitive presence of the independents, as reflected in their most recent aggregate market shares and aggregate share of outlets in the relevant market. Further, in cases where the evidence did not disclose both a significant variation in market shares, and a significant and growing independent aggregate market share, Imperial agreed to carry out further divestitures in accordance with the following formula:

Independents' Share	Post-Divestiture Imperial Share
19.0 - 19.9%	29.0 - 29.0%
18.0 - 18.9%	28.0 - 28.9%
17.0 - 17.9%	27.0 - 27.9%
16.0 - 16.9%	26.0 - 26.9%
15.0 - 15.9%	25.0 - 25.9%
Less than 15%	25.0%

52. In the Kent Areas, sites to be divested are representative of the mix of Imperial and Texaco sites in that market with respect to relative proportions of company-owned and dealer-owned sites. In addition, in order to ensure that the maximum number of divested sites are acquired by operators who plan to maintain them as going concerns, at least 50% of the divested gasoline sites in each Kent Area where the independents' pre-merger share was less than 20%, will have 1988 sales equal to or greater than the independents' average sales per site in that area. This requirement is designed to ensure that a significant proportion of the divested sites possess substantial viability as continuing gasoline retail sites.

53. With respect to Non-Kent Areas, Imperial will divest a sufficient number of retail sites in each market so as to ensure that its post-divestiture share of sales does not exceed 30% of that market.

54. In recognition of the fact that towns and villages with less than 10,000 in population are generally part of broader geographic markets, the divestiture standard was based on the number of non-Imperial outlets remaining post-divestiture. Furthermore volumetric data was not available for all of these communities. With respect to communities with fewer than 10,000 in population, where there are up to three retail sites in the community, no more than one site will be an Imperial site. In the communities where there are 4 to 7 gasoline retaining outlets, no more than 2 sites will be Imperial sites post-divestiture. Finally, in communities where there are 8 or more sites, no more than 1/3 of the sites will be retained by Imperial.

55. The DCO provides that company-owned sites shall be offered for sale as operating gasoline sites and sold at fair market value subject to review by the Director to ensure that the sale does not raise material competitive concerns. In order to ensure that a sufficient number of sites will remain as operating gasoline sites in certain high priced real estate areas

identified in Schedule 9 of the DCO, the DCO requires that Imperial will offer to lease at least half the sites in these areas to the extent that actual bids would indicate that less than half the sites will remain as operating petroleum retailing facilities. Leases would be for 10 years at normal commercial terms. Imperial will offer to supply these sites on an unbranded basis.

56. In dealer-owned sites that are subject to divestiture the DCO requires Imperial to grant to such dealers an early termination option with respect to their existing supply agreements on three (3) months advance notice. Dealers will have the option to require Imperial to supply them for up to five years on an unbranded basis.

Competitive Analysis of Kent Areas

57. In the majority of the Kent Areas, a significant share of the market is accounted for by independent chains. The size of the independents' aggregate market share is competitively significant for two reasons: (i) the independents' aggregate share is a good indicator that entry is feasible and sources of wholesale supply are readily available to potential entrants; and (ii) a substantial presence by independents diminishes the likelihood of coordinated anti-competitive behaviour among refiner/marketers in the relevant market. For these reasons the Director considered that the independents' aggregate share of a

Kent Area should be the primary determinant of whether further divestiture of service stations below a post-divestiture share for the merged firm of 30% would be required.

58. The likely composition of the largest firms in each of the Kent Areas following the implementation of the transaction and the DCO varies from region to region within Canada. In Quebec, Imperial, Shell and Petro-Canada will continue to face strong competition from Ultramar. In Ontario Kent Areas, Sunoco and several large independents will maintain strong regional presences. In the Prairies, Turbo, Mohawk, Petro-Canada, Shell, the Co-op, Husky and Imperial are all present in the market. Finally, in British Columbia, Chevron is both a substantial refiner and marketer of petroleum products, and will continue to provide Petro-Canada, Shell, Mohawk, Turbo, Super-Save, Pay Less and Imperial with competition following the full implementation of the proposed transaction and the DCO.

59. An examination of likely post-divestiture competitive conditions in smaller Kent Areas indicates that competition will prevail following the full implementation of the transaction and DCO. For example, in many of the smaller Ontario markets examined, Petro-Canada would be the leading firm after the implementation of the transaction and the DCO.

60. Recent shifts in market shares in Kent Areas clearly demonstrate that rivals' market shares exhibit substantial volatility and that both price and non-price competition prevails in the markets examined. Given the competitive salience of independents' presence in service station markets, it is important to emphasize that their presence has grown in virtually all the Kent Areas since 1983 in both number of sites and market share. For example, in 1983 independents controlled 12.8% of retail sites in Toronto; by 1988, the Toronto independents controlled 17.4% of existing retail outlets. Moreover, the Toronto market is characterized by strong chains of independent outlets. During the period surveyed, Pioneer grew from 9 to 22 sites and Sunys grew from 2 to 21 sites.

61. An alternative way of analyzing Imperial's likely competitive position in Canadian service station markets after the DCO is implemented is in terms of the number of outlets associated with its brand as opposed to its volume of sales. The number of outlets a firm has associated with it may be a better indicator of competitiveness than its volume of sales for two reasons. First, since there is substantial excess capacity in the Canadian service station industry, virtually every gasoline outlet in Canada has capacity to sell more gasoline. Second, to individual motorists, it is the number of outlets (not the volume of their sales) which determines the choices open to him or her.

62. Generally, a comparison of market share and outlet data shows that both Imperial and Texaco have above average volumes of sales per station; thus they show that on an outlet basis the industry is less concentrated than when viewed on a volume basis. Accordingly, consumers have a wider range of potential choices than is indicated by looking at percentages of actual sales. For example, in Montreal, Imperial and Texaco together accounted for 27.4% of sales in 1987, whereas, they only had a 19.5% share of total outlets associated with them during that period. In Toronto, the comparable figures are 28% and 25% for 1987.

63. The following tables show, by number of outlets and by percentage for each province, the pre-merger, post-merger and post divestiture situation with respect to Imperial and Texaco retail gasoline outlets in relation to the total industry.

IMPERIAL/TEXACO AND DIVESTED SERVICE STATIONS, OUTLET SHARES, BY PROVINCE

Province	Outlet Share Texaco (Before)	Outlet Share Imperial (Before)	Outlet Share Imp/Tex (After Merger)	Divested Stations %Texaco Stations	Outlet Share Imperial (After Divestment)
	(%)	(%)	(%)	(%)	(%)
Newfoundland	4.1	28.0	32.0	35.7	30.6
Nova Scotia	11.7	17.6	29.3	92.2	18.6
New Brunswick	7.5	15.5	23.0	98.7	15.6
Prince Edward Island	13.3	25.9	39.3	94.4	26.7
Quebec	10.4	10.9	21.2	15.1	19.7
Ontario	13.3	13.9	27.2	19.4	24.6
Manitoba	11.1	21.4	32.5	28.3	29.4
Saskatchewan	6.9	21.6	28.6	31.7	26.4
Alberta	11.4	19.0	30.4	21.9	27.9
British Columbia	8.0	20.3	28.3	13.2	27.3
Totals	10.5	16.1	26.6	26.8	23.8

(Source: Octane survey, September, 1988 and company documents)

IMPERIAL/TEXACO AND DIVESTED SERVICE STATIONS, BY PROVINCE

Province	Total Service Stations	Texaco Service Stations	Imperial Service Stations	IMP/TEX Service Stations	Divested Stations	IMP/TEX Service Stations (After Divestment)
Newfoundland	690	28	193	221	10	211
Nova Scotia	884	103	156	259	95	164
New Brunswick	1017	76	158	234	75	159
Prince Edward Island	135	18	35	53	17	36
Quebec	4918	510	534	1044	77	967
Ontario	5265	701	730	1431	136	1295
Manitoba	1080	120	231	351	34	317
Saskatchewan	1457	101	315	416	32	384
Alberta	1884	215	358	573	47	526
British Columbia	1886	151	383	534	20	514
Totals	19216	2023	3093	5116	543	4573

(Source: Octane survey, September, 1988 and company documents)

64. In virtually all the Kent Areas there will be, following the full implementation of the DCO, at least two or three firms of similar size, in terms of outlets, competing with Imperial. Even in those few Kent Areas where there will not be three similarly-sized competitors, there will still be vigorous competition. Consequently, there will be a significant number of retail supply alternatives in all larger urban areas after the proposed transaction and the DCO is fully implemented, and the continued presence of a diversity of alternative sources for

retail customers will preclude any likelihood of any substantial lessening of competition.

65. Independents have been expanding their aggregate share of Canadian sales and outlets during the most recent period for which data is currently available. According to an excerpt in Octane there was a 2.2% growth in Canadian retail outlets from August, 1987 to August, 1988. The Octane survey demonstrates that a disproportionate share of new outlets were opened by independents during the August-to-August survey period. Olco Petroleum, which operates in Ontario and Quebec, opened 26 new outlets. Sergaz Inc., a well-established Quebec independent, opened 24 new service stations during the 1987-88 period. Turbo, a regional refiner in the Prairies opened 18 new outlets during the survey period. The DCO will ensure that a substantial number of company-owned sites to be divested will remain as part of the existing stock of operating service stations which provide competitive alternatives to consumers in the relevant geographic markets.

66. The report of the Restrictive Trade Practices Commission in 1986 found that the number of service station outlets had been declining in Canada since 1974. The data for the period from 1984 to 1987 indicates that the trend identified in the report has changed to a certain extent. In Quebec and Ontario, where major brand outlets have declined in net terms

since 1984, there has been significant new entry by independents. In the Prairie and Pacific regions, there have been substantial net gains in outlets, again largely driven by the growth of independents.

<u>Entry into the Retail Gasoline Business</u>

67. There are relatively low barriers to entry into most Canadian service station markets in Central and Western Canada. When entry by new firms and/or expansion by existing firms is feasible, gasoline prices cannot persist at high levels even when the concentration of sales of existing sellers is relatively high. Moreover, if service station sites are usable for other purposes (as they normally are), the investor knows that exit is feasible -- perhaps with a capital gain on the land. Ease of exit makes entry easier because the risk of capital loss is diminished. This is especially important for individual entrepreneurs when they are ready to retire or move on to other ventures.

68. Ease of entry has continued to be a fact in most of the 21 largest urban markets surveyed by Kent. Kent identifies a net increase of 258 outlets (137%) by 19 of the more important independent marketers between the end of 1983 and the end of 1987. There was also a net increase of 30 outlets by the smaller independent marketers. During these years, total industry outlets in these Kent Areas actually declined by 111 units.

69. Gasoline retailers possess significant excess capacity and can readily accommodate switches in consumer demand by increasing throughput at lower and largely constant marginal costs. Because of excess capacity, shares of volume measure past consumer preferences whereas shares of outlets measure what consumers could do in the future if a firm were to try to increase prices above competitive levels.

Backward Integration of Independents

70. New entrants in the market may expand to become large chains like Sunys in Eastern Canada and Pay Less on Vancouver Island. In turn, the larger chains have the opportunity to expand into the wholesaling sector (which may include importing supplies). Some examples of new entrants in the wholesaling sector are: Pay Less, Northridge Petroleum and Parkland in Western Canada, and Sunys, Comtrade and McAsphalt in Eastern Canada.

71. Most of these wholesalers started as retailers with one service station. With time, they took on additional agents and dealers who would sell products under the original retailer's brand name. In order to facilitate their wholesaling activities, some independents have obtained terminals to store their supplies. Examples of recent entrants to the terminal business

are Pay Less in the Pacific region and Olco in Ontario and Quebec.

72. Finally, independents have been known to expand into the refinery sector. Recent examples include Parkland Industries and Turbo.

Other Evidence on State of Competition in Kent Areas

73. On the supply side, retail gasoline businesses tend to have comparatively high fixed costs in comparison with other types of retail distribution. The retail gasoline business is distinguished by the very high level of specialized fixed investment required and these fixed costs have been augmented in recent years by land use and environmental regulations. Cost reduction is critical to competitive viability in the retail gasoline business, but the methods currently available to retailers to reduce their unit costs are constrained. In the past two decades network rationalizations and the growth of self-serve outlets in Canadian markets have helped reduce retailers' costs. Further reductions in retailers' costs per unit of sales will be primarily accomplished by increasing sales volumes. As a result, retailers are strongly motivated to sell more gasoline from each pump and to adopt pricing strategies and service offerings aimed at maximizing sales volumes.

Competitive Analysis -- Motor Gasoline Retailing in Non-Kent Areas

74. Generally, there are fewer companies involved in each of the smaller markets than were observed in the larger Kent Areas discussed in the preceding section. Moreover, there are greater variances in market shares among competitors in the Non-Kent Areas than those observed in the larger Kent Areas. Relatively larger disparities in market share are to be expected in small centres which can only support a limited number of service stations. In some small centres in Canada, a firm which has one or two more outlets than its next largest rival may appear to dominate the market.

75. Small communities by themselves may not be relevant markets from the standpoint of economic analysis. It will often be the case that there are a number of other retail sources available on nearby highways or in neighbouring towns and cities which represent alternative sources of supply for many residents. Further, rural residents are more likely to drive farther distances on a routine basis than residents of larger Canadian cities. This greater relative mobility of rural residents indicates that the geographic limits of less densely populated markets may be much broader than the municipal boundaries of the smaller communities.

76. As detailed information about market share variability and independent representation in Non-Kent Areas was not available, the 30% post-divestiture market share test was used. A relatively high proportion of outlets divested in Non-Kent Areas will be dealer-owned outlets because they tend to be more prevalent than company-owned outlets in towns and villages. In order to ensure that these outlets remain as effective competitive facilities in the local market, Imperial has agreed to offer wholesale gasoline supply to divested dealers on reasonable commercial terms on an unbranded basis.

Competitive Analysis -- Town Areas

77. For communities with populations of less than 10,000, a divestiture formula was used based on the number of non-Imperial outlets that would be likely to operate in the relevant market after the full implementation of the DCO. It was agreed that it would not be practicable in these markets to make reliable estimates of volumetric market shares on an outlet specific basis. As in the Non-Kent Areas, divested dealers who are unable to obtain an acceptable alternative source of wholesale supply will be offered supply by Imperial on an unbranded basis. This will ensure their continued competitive viability after the DCO is fully implemented.

VIII. LIKELY EFFICIENCY GAINS FROM THE TRANSACTION

78. The efficiency exception contained in section 96 of the Act recognizes that mergers, otherwise prescribed under the substantive provisions of section 92, may be permitted to proceed where they are necessary for the realization of economic efficiencies which are greater than and offset the anti-competitive effects of the merger. The transaction will permit the merged firm to achieve significant efficiency gains in the refining, marketing, distribution and retailing of petroleum products in Canada. The Director does not believe, however, that these efficiency gains are greater than or offset any likely substantial lessening of competition and, therefore, the remedies provided for in the DCO are necessary.

Retail Marketing

79. In retail marketing, the Imperial and Texaco organizations serve essentially the same markets with the same type of products. By merging, economies of scale and gains in efficiency can be attained through a rationalization of the retail sales workforce and the retail support workforce. A smaller workforce can now market the same volume. It is expected that all workforce reductions will be achievable over a period of 3 years, essentially through attrition. Imperial employs 470 in retail activities and Texaco 410. Through the merger,

organizational duplication can be eliminated, translating into a substantial employee workforce reduction.

80. Imperial can optimize its retail capital investment program to improve the productivity of its expenditure by avoiding costly duplications. For example, instead of building two service stations in a new development (one Imperial and one Texaco), only one higher productivity site could be built now and the freed resources (land, capital) could be used for other productive purposes.

81. Also, through the combination of the resources required to plan and execute these expenditures, economies of scale can be achieved. These resources represent savings in outside engineering and contracting services.

82. The merged Imperial organization can achieve significant economies of scale in advertising by supporting a single brand instead of two. In order to adequately advertise the larger Esso brand, it is not necessary to incur the pre-merger sum of the advertising expenses of both Imperial and Texaco.

83. In the retail area, the Imperial-Texaco merger will also create some losses in efficiency. Losses in efficiency

include one-time credit card conversion costs and one-time environmental clean-up costs.

Commercial Operations

84. In the commercial area, as in the retail area, gains in efficiency in sales and support workforce will be possible through the reduction in duplicate services. For example, there is no need for two sales representatives calling on the same customer. Additionally, there will be no need to staff duplicate product supply, crude acquisition and pipeline functions. The combined workforce of 460 would be substantially reduced largely through attrition.

Distribution

85. In many instances, Imperial and Texaco own terminals which are literally side by side, and which are not fully utilized. The divestiture of one of these terminals will allow the remaining one to be more fully, and thus more efficiently, utilized. Unit operating costs will be lower and inventory turns will be higher. Such terminal divestitures ultimately translate into lower unit distribution costs. The elimination of duplicate terminals will allow the rationalization of the workforce needed to operate the terminals and to support terminal operations. Similarly operating expenses such as maintenance and utilities are reduced as terminals are sold. The divestiture of duplicate terminals and the fuller utilization of the remaining ones will

allow the reduction of overall total inventories. Depending on the future operation of the terminals, some of these efficiencies may be off-set by the new owners.

SARNIA/NANTICOKE SYNERGIES

Refining

86. The Sarnia and Nanticoke refineries while different complement one another and significant efficiencies will result from joint operation. Significant supply efficiencies result from operating Sarnia and Nanticoke refineries as joint suppliers in a single combined supply system. With the combined operation, the pool of demands for both Imperial and Texaco can be allocated optimally to the refinery that is best suited, through its cost structure, to produce that type of product. In other words, each refinery operation would tend to specialize in the products it can produce most cost effectively. These production shifts are all operational in nature, with changes in production mix being routinely completed within 12 to 36 hours. In addition, with the combined operation, partially processed refinery streams would be exchanged between the two facilities via marine movements during open navigation. While one refinery's processing unit might be fully utilized or stressed, the other refinery's equivalent unit often has spare capacity. An optimization between the two facilities will take place, with the resultant yield of clean products (gasoline, distillate) from

a barrel of crude oil increasing and the unit costs decreasing. With the combined operation resulting in a lower cost structure, a significant additional volume of unleaded gasoline can be economically produced versus the volume from a stand alone operation of the two refineries. The additional gasoline produced would either displace imports or would be exported.

Reduced Unplanned Production Costs

87. Each year Imperial makes spot purchases of gasoline and distillate to cover unplanned production shortfalls. With a second refinery as part of the supply system, some of the support volume could be obtained internally at reduced cost.

Reduced Investment at Sarnia

88. Regulatory authorities in Canada have started the process of reviewing the quality specifications for diesel fuels with the objective of limiting the emissions of various pollutants resulting from the combustion process in diesel engines. If regulations substantially similar to those being adopted in the U.S. are adopted in Canada, then Canadian refiners will have to invest in new facilities to produce low sulphur diesel for on-road use. Continued sales of regular sulphur diesel for off-road use would be permitted. With the merged operation permitting optimal use of the two refineries in Ontario, Imperial will have the opportunity to meet the

requirements for low sulphur diesel with reduced investment costs.

Capital and Inventory Efficiency at Toronto Terminal

89. Common ownership of the two Ontario refineries will decrease capital requirements at the Toronto terminal for product transshipped into the Trans-Northern Pipe Line.

Other Efficiency Gains

90. The Imperial-Texaco merger will allow a significant increase in efficiencies at the head office level. Head office support staff of the combined entities can be lower than the sum of the individual entities. There is no need for two separate financial accounting, refinery engineering, planning and systems organizations; nor is there a need for two separate management organizations. The combined workforce can be reduced substantially from a present combined total of approximately 1450 largely through attrition.

IX. CONCLUSION

91. In the draft DCO the Director is seeking remedies to the merger that address his concerns as presented in his Application. In Atlantic Canada unless the divestitures are implemented there will be a substantial lessening of competition in the downstream sector. In the rest of Canada, given the potential uncertainties of excess refining capacity and the import option, the DCO includes a supply obligation and divestitures to eliminate any likelihood of a substantial lessening of competition. The Director submits that the provisions of the DCO achieve a high degree of protection for competition and Canadian consumers.

92. The DCO addresses the nub of the competition issues:

(a) In the Atlantic Provinces the Order returns the market to substantially the same structure that prevailed before the merger.

(b) Across Canada, Imperial will make available fourteen terminals of which many are large marine terminals. Many of these terminals are well located among the St. Lawrence and the Great Lakes. Thus in one move, the marine terminal facilities that will become available potentially to independent marketers

will strengthen significantly the access of independent marketers to the import option and their ability to compete in the market.

(c) The DCO ensures that the largest refinery complex in Ontario must, for at least seven years and at the option of the purchaser as long as ten years, continue to supply, directly or indirectly, independent marketers in Ontario and Quebec. The supply required to be provided by the DCO includes present volumes, a share of additional output associated with synergistic efficiencies from Nanticoke and Sarnia, plus, an accommodation for market growth. After the implementation of the DCO, independent marketers will be assured a larger volume of supply than before the merger. Prior to the merger, independent marketers had no assurances that Imperial and Texaco would have renewed or offered supply contracts in the event that refinery utilization rates increased. Independent marketers are better off under the DCO because it binds Imperial to supply far more gasoline due to the allocation of 26.4% of the increased production resulting from the joining under common ownership of the Nanticoke and Sarnia refineries. In effect, the DCO requires Imperial to channel to the independent marketers part of the efficiency gains from combining the two Ontario refineries. Finally, a formula in the DCO governs the rate of increase of the independent marketers' supply call on Imperial in relation to the market's growth.

(d) Five hundred and forty-three service stations are to be divested. Many of the service station sites to be divested are located in concentrated urban markets where independents are under represented.

93. The DCO also strengthens the independents. The DCO achieves this effect by imposing certain conditions on the station sites that Imperial will be divesting. Under the terms of the DCO, Imperial must include in the divestiture package a number of company owned stations as well as dealer owned stations, with an average volume roughly equivalent to that of the independents in the relevant market. Many of these stations are in prime locations and will, after divestiture, remain active service stations.

94. To the extent that there is a shortage of prime station locations, DCO increases the opportunities for independent marketers to acquire prime locations that would otherwise not be available.

95. The DCO reverses any anti-competitive impact that the merger would have had. Indeed a strong argument may be advanced that competition will be at least as well protected after the merger with the DCO than before the merger. These pro-competitive effects are being achieved without significant private or social cost.

96. The Director therefore submits that the provisions of the DCO will remedy any actual or likely substantial prevention or lessening of competition in the supply of petroleum products at wholesale and retail in Atlantic Canada, and in the supply of gasoline at wholesale and retail in Quebec-Ontario and in Western Canada.