The application of the Competition Act
to
the current fluctuations in gasoline prices

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INTRODUCTION

In April 1994 the Honourable John Manley, Minister of Industry, referred to the Director of Investigation and Research ("Director") a letter from Mac Harb, M.P. (Ottawa Centre) which complained about the fact that retail gasoline prices in Ottawa were consistently 3 ¢ to 4 ¢ a litre higher than prices in Southern Ontario. Mr. Harb requested consideration of revisions to the Competition Act to better deal with the retail gasoline market.

This report responds to that request and provides information regarding the Act's application to the current fluctuations in gasoline prices in various markets in Canada. The conclusion reached is that the provisions in the legislation are adequate to deal with anti-competitive behaviour in relation to gasoline pricing and that amendments to deal with these issues are not required at this time.

GASOLINE COMPLAINTS

Allegations of retail gasoline price fixing from many different areas of Canada account for a large number of complaints under the Act. For example, in 1991, as a result of a campaign by some Ontario newspapers, the Bureau of Competition Policy ("Bureau") received more than 4,700 such complaints.

These complaints allege anti-competitive conduct typically based upon the following:

- that retailers in the same neighborhood charge identical prices;
- that prices move in unison, e.g. they rise together before a long weekend;
- that petroleum product price changes do not seem to track the cost of crude oil;
- that price differences between markets do not seem to be justified by cost differences.

HOW THE COMPETITION ACT APPLIES TO GASOLINE PRICING ISSUES

The Act empowers the Director to investigate allegations that prices have been set as a result of anti-competitive behaviour, such as described below. The magnitude of price changes, the absolute level of prices or the relation of retail prices to the cost of the product are not, in themselves, evidence of an offence under the Act.

Gasoline pricing complaints are reviewed in relation to the following provisions of the Act.

Section 79: Abuse of dominant position

This provision is designed to remedy situations where a single firm possesses or more than one firm jointly possess market power and engage(s) in a practice having the effect of substantially lessening competition. In the petroleum sector this provision could conceptually capture dominance or joint dominance by refiners "squeezing" margins between company owned stations and independent retailers which could have the effect of maintaining or increasing retail gasoline prices.

In 1992, the Bureau extensively examined an abuse complaint from a large independent retail gasoline chain. The complaint was to the effect that the major refiners in a market squeezed the margin available to their unintegrated customers in the following way: first, by raising their wholesale prices substantially during the period from late July to late November 1990; and second, by lowering retail prices in their branded stations from December 1990 until April 1991 to levels below the independent's product cost.

The investigation revealed that the margin squeeze resulted from the rapid price changes caused by the Persian gulf crisis and differences in inventory accounting practices between Canada and the United States. During the first period there was a buildup of high cost inventory in anticipation of a disruption of supply. In the second period, the U.S. invasion resulted in a drop in product prices in the United States, where the industry priced its inventory on a last in first out basis. Some Canadian independent marketers took advantage of these lower prices through imports. The Canadian refiners then lowered their retail prices to remain price competitive in those markets while maintaining wholesale prices high in accordance with their first in first out inventory practice. In summary, the margin squeeze was not caused by unlawful anti-competitive behaviour.

Section 50 (1)(a): price discrimination

Under the price discrimination provision, it is an offence for a supplier to make a practice of charging different prices to competitors in the same market who purchase similar volumes of products.

In 1992, the Bureau examined a price discrimination complaint from a large independent retail gasoline chain. The complaint was to the effect that the independent's supplier, a major refiner, discriminated against it by charging higher prices for gasoline picked up at the refinery than were charged to the independent's competitors. However, data obtained from that refiner showed that the independent paid 1¢ per litre more than its competitors but that this higher price was in fact part of a deal to repay the outstanding debt that it had contracted with the refiner.

The examination in some detail of the facts behind the allegations in the two complaints noted above gave no indication of a "general offensive" or co-ordination of anti-competitive acts on the part of the major petroleum companies to eliminate or discipline unintegrated marketers. In both cases, there was no evidence of an inappropriate exercise of market power nor was there a plausible case to be made of anti-competitive behaviour. An extensive amount of information was reviewed. The examinations were not constrained by inadequate investigative powers at the Director's disposal. Simply stated, the facts did not support a conclusion that unlawful activity had occurred.

Section 45: conspiracy

This provision prohibits conspiracies to fix prices if competition is or is likely to be lessened unduly. Proof of an agreement is needed. The Crown must also show that the participants to an agreement have market power.

The existence of identical prices, alone, is not considered evidence of an agreement when there are plausible alternative explanations. In the petroleum products sector, the visibility of posted prices and the homogeneity of gasoline tend to result in identical prices in a given market. Prices usually move quickly in reaction to each other as retailers match their competitors' price changes. Price leadership/followership is not an offence under the Act.

The Bureau has never uncovered evidence of an agreement among the major petroleum companies despite close monitoring of developments in the industry and, between 1973 and 1986, the comprehensive petroleum inquiry and proceedings before the Restrictive Trade Practice Commission.

The Bureau's investigation of retail gasoline prices in various markets in Canada in 1991 together with the report of an industry expert, the Dean of the Faculty of Management of the University of Lethbridge, found no evidence of collusion or other anti-competitive behaviour among the majors. In a more recent inquiry no evidence was uncovered of communication of retail or wholesale gasoline prices among the major oil companies, nor was there evidence of agreement.

The Director considers this provision adequate. To date the facts have not supported taking action under this section.

Section 61: price maintenance

This is the provision that has been most frequently enforced with respect to the retail price of gasoline. The cases have involved unwarranted control of retail prices by a supplier. Under the price maintenance provision of the law, the court must find that there was an agreement, threat or promise used to influence upward or discourage the reduction of the price of another supplier (or retailer).

Over the years the Attorney General has won some cases and lost others. Each case has turned on the court's weighing of the evidence in that particular case and not any inherent defect in the law (see attachment).

There is currently a case before the courts in Ottawa involving charges against three regional gasoline retailers.

PRICE REGULATION

Neither the Director, nor any other federal government agency, has the authority to regulate prices. This is a matter that falls under the jurisdiction of the provinces. Prince Edward Island is the only province that currently regulates the prices of petroleum products.

COMMON CONCERNS ABOUT GASOLINE PRICES

Major petroleum companies refine crude oil and distribute it to their wholesale distributor divisions who in turn supply the retail market - both captive and independent. The rack or wholesale product price generally tracks the current price of oil in New York harbour or Chicago. The supply relationship between refiners and gasoline retailers ranges from consignment commission agents to independent branded dealers who purchase gasoline at wholesale and set their own retail prices. The nature of the arrangement determines whether the supplier may legally set the retail price.

Some complaints reflect a lack of knowledge of the relationship between retailers and their suppliers. There have been instances reported in the media of commission agents, who manage company-owned stations, complaining that they were pressured to raise prices. However, investigation revealed that the gasoline was owned by the supplier who, of course, is free to set the price it wants.

It is frequently observed that retailers in the same neighborhood charge identical prices and that prices move virtually in unison. This phenomenon may be the result of normal market forces. Given the visibility of posted prices, gasoline prices in the same market tend to move in reaction to each other, as retailers match their competitors' price changes. This often results in identical prices. While gasoline prices may be identical, it is important to recall that particular retail offerings - the bundle of services available at the site - can vary. Some sites only offer gasoline, with or without service, while others may provide a convenience store, a restaurant, a car-wash or other facilities.

It is also alleged that price differences between markets do not seem to be justified by cost differences. Price differentials between geographic markets may occur for a variety of reasons. For example, as with many other products, gasoline pricing is affected by local supply and demand conditions, the number and type of competitors in each market, differences in crude oil refining costs, differences in marketing, distribution and transportation costs, or the degree of rivalry among competitors in local markets.

Some Canadian cities close to major American sources of supply have frequently benefited from lower prices as a result of the influence of a lower-cost imported product. In some markets price wars erupt as retailers discount prices to increase their volume. The greater the distance between markets, the less likely it is that retailers will be influenced by pricing in the other market.

RECENT MARKET ACTIVITIES

Natural Resources Canada reported that during August 1994, gasoline prices increased in many Canadian cities. The August increase followed several months of gradual price increases. Between the end of April and the end of August of this year, the Canada average ex-tax gasoline price increased 4.5¢ per litre; 3.7¢ of the gas price increase can be attributed to increases in crude oil prices.

During this period of time, the Bureau received numerous complaints about gasoline prices, all of which were examined to determine whether issues were raised under the Act. This review did not provide evidence of an offence under the Act.

Certain centres, for reasons described in the examples below, experience large fluctuations in gasoline prices. During these periods of fluctuation, it is not unusual for gasoline retailers to complain that prices are too low and that they are not making any profit.

For example, Montréal and the neighbouring areas frequently experience price wars which are the result of a combination of the presence of aggressive independent gasoline retailers in that market and occasional imports of offshore gasoline that bring downward pressure on local retail gasoline prices.

In Regina, until recently, consumers benefited from numerous price wars attributable to the large surplus of refining capacity together with the presence of aggressive independents in that market. However, gasoline prices increased this spring due partly to the decrease in available supply of product caused by the rationalization of refineries in Western Canada, and the reduction in the number of gasoline service stations.

In Ottawa, in August 1994, prices rose from 55.5¢ per litre to 58.5¢ per litre. This increase was widely reported in the media and resulted in complaints to the Bureau alleging price fixing or price gouging. Within 48 hours prices began to drop in the Ottawa region and these lower prices have been maintained. Observations of this kind of price volatility in a market are typical and consistent with a hypothesis of failed attempts to raise prices in the face of active competition.

CONCLUSION

The Bureau will continue to actively enforce the Act by closely monitoring developments in the marketplace and reviewing complaints (from consumers and those in the petroleum industry) to determine if there is evidence of anti-competitive activity.

In the Director's view, the provisions in the legislation are adequate to deal with anti-competitive behaviour in relation to gasoline pricing and amendments to the Competition Act are not required at this time to deal with these issues.

Consumers have an important role to play in addressing retail gasoline pricing. Those concerned about high gasoline prices should shop around and patronize gas stations that offer lower prices. This will reward the more aggressive retailer and put pressure on those who have higher prices to bring their prices down or risk losing business. Where consumers are concerned about the fairness of prices, they should demand an explanation from their gasoline supplier and seek a justification for the level of prices.

Petroleum product suppliers also have an important role to play in order to ensure a competitive and transparent marketplace. If suppliers are pressured to change their prices by a competitor or another supplier, they should inform the Bureau. Finally, as with any commercial enterprise, petroleum product suppliers should also be prepared to justify their prices to the consumer in terms of their costs, profits, and the general conditions of the marketplace.

Attachment

Price Maintenance (Gasoline and Heating Oil)

Convictions (and fines)

• May 1991 Perry Fuels Inc. $40,000 (Oshawa, Ontario), Perry Fuels Inc. agreed with a competitor not to reduce its prices on heating oil and threatened a competitor that it would initiate a price war if the competitor did not cease offering discounts.

• May 1991 Ultramar Canada Inc. $150,000 (North York, Ontario), Ultramar agreed with a competitor not to reduce prices on heating oil.

• February 1989 Shell Canada Products Limited $200,000 (Winnipeg, Manitoba). A marketing representative of Shell called a local Shell dealer and pressured him to raise his prices.

• June 1986 Sunoco Inc. $100,000 (Toronto, Ontario), Sunoco removed one of its dealer price supports because the dealer initiated price reductions.

• April 1984 Imperial Oil Limited $75,000 (Waverley, Ontario) Imperial refused to supply gasoline to an independent retailer because of the retailer's low pricing policy.

- October 1980 Arrow Petroleums Limited $7,500. (Ontario) Arrow attempted to influence upward the price of one retailer.

- September 1974 Petrofina Canada Ltd. $15,000.(Ontario). Petrofina attempted to influence upward the price of its own retailers.

- June 1972 Arrow Petroleums Limited $1,500. (Ontario). Arrow attempted to induce its dealer to maintain resale prices.