

## **BACKGROUNDER**

### **COMPETITION BUREAU CONCLUDES EXAMINATION INTO GASOLINE PRICE SPIKE FOLLOWING HURRICANE KATRINA**

#### **Background**

As a result of an unprecedented spike in Canadian gasoline prices following Hurricane Katrina and an unusually high number of complaints from consumers, the Competition Bureau (the Bureau) began an examination to determine if increases in wholesale and retail gasoline prices in the Fall 2005 stemmed from a breach of the *Competition Act* (the Act). In particular, the examination focused on whether the price increases resulted from anti-competitive behaviour among the integrated gasoline refiners/retailers or whether major changes to North American supply of wholesale gasoline resulting from the hurricane caused the increases.

#### **Summary of the Bureau's findings**

The Bureau's general findings are summarized below.

- In seven selected cities in Canada and the United States, the data show that prices increased in both countries for a period of 45 days.
- While gross refining margins in these cities during September 2005 increased significantly, those margins have since fallen to pre-hurricane levels.
- The wholesale price of gasoline in Canada tracks the spot price for gasoline in the U.S., specifically the New York Harbour spot price;
- The New York Harbour spot price follows crude oil costs. However, it also fluctuates due to supply and demand conditions and uncertainty in the market for gasoline. In the aftermath of Hurricane Katrina, supply and demand conditions coupled with a lack of immediate data from the affected region caused the U.S. spot price to deviate from crude oil costs.
- There was no evidence that the price increases were the result of a conspiracy among North American gasoline refiners.
- The Bureau found no evidence that anti-competitive behaviour caused the price of gasoline to spike in the aftermath of Hurricane Katrina.

#### **What did the Competition Bureau find?**

The Bureau found that the major reasons for the price shock were uncertainty over supply caused by a lack of data immediately following Hurricane Katrina, the closure of several refineries in the Gulf Coast region, and damage to pipelines that supply oil from the Gulf Coast to other refineries in the U.S. According to the Energy Information Administration in the U.S., 10% - 15% of total U.S. gasoline production was halted as a result of the hurricane.

The supply interruption broke down the normal relationship between crude and wholesale prices<sup>1</sup>. With a lack of refined product available to North America, prices increased dramatically even though the cost of crude did not change. Price increases are a normal outcome when supply is reduced and demand remains constant. Market forces increase the price in response to a shortage of gasoline. At significantly higher prices, consumers will consume less gasoline, which will reduce the likelihood of shortages.

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<sup>1</sup>Historically crude oil accounts for approximately 75% of the pre-tax price of gasoline.

In addition, historical data suggest that estimated gross refining margins are similar between Canada and the U.S. Right after Hurricane Katrina, there were short-lived differences between the two countries. Statistical analysis showed there was a lag on wholesale prices and gross refiner margins between selected Canadian and northern U.S. cities. However, the prices and margins quickly re-adjusted and converged to similar levels after mid-September. If Canadian refiners were engaging in an anti-competitive fashion, we would expect to see a protracted major deviation in wholesale prices and margins between Canada and the U.S. The data did not support an allegation of a co-ordinated practice of anti-competitive acts.

### **Why did prices in Canada increase if we were not hit by a hurricane?**

Retail prices for gasoline in Canada reflect wholesale costs. Just as there is a worldwide market for oil, there is a similar market for refined gasoline. Generally world prices are similar and fluctuate based on crude oil costs. In North America, refined gasoline is traded at regional spot prices, which may differ due to local supply and demand conditions. Refiners in Canada and the U.S. then base their wholesale prices on these spot prices. For example, most refiners in Eastern Canada tend to follow the New York Harbour spot price.

Following Hurricane Katrina, supply conditions on the east coast of the U.S. deteriorated and spot prices increased dramatically, which caused Canadian wholesale gasoline prices to rise. If Canadian wholesale prices had been much lower than American wholesale prices, Canadian refiners would have exported their gasoline to the U.S. This could have possibly resulted in Canadian shortages of gasoline.

### **Why doesn't the Bureau take action against price gouging?**

Businesses are generally free to set their own prices at levels the market will bear. Individual gasoline retailers taking advantage of tight supply to increase their prices would not raise issues because price gouging, or charging high prices at times of actual or anticipated excess demand, is not contrary to the Act. High prices are a concern under the Act when they are the result of anti-competitive conduct.

### **What are the characteristics of the Canadian gasoline industry?**

Canada is a net exporter of crude oil and gasoline. According to the U.S. Energy Information Administration<sup>2</sup>, Canada accounts for 3% of the world supply of oil. Canada is a price taker for crude oil and gasoline. This means that Canadian producers take the price on the open market and do not directly influence the world price of gasoline independently.

There are three types of wholesalers in Canada: national refiners (i.e. Petro-Canada, Esso, Shell), regional refiners (i.e. Irving, Ultramar, Chevron) and importers. Canada imports a small amount of gasoline primarily from Europe and South America.

Prices in Canada and the U.S. increased this year due largely to increasing costs of crude oil. The increase in crude oil prices reflects increased demand for oil from emerging markets such as China and India, as well as a growing U.S. economy. Traditionally, the price of crude oil is the primary determinant of gasoline prices. However, in times of uncertainty, major changes to supply and demand conditions in the U.S. can cause the price of gasoline to deviate from crude oil costs.

### **Why did prices increase so quickly before Hurricane Rita?**

In the days prior to Hurricane Rita, there were reports across the country of line-ups at gasoline stations as consumers anticipated the shortages and price increases previously experienced in Hurricane

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<sup>2</sup> The Energy Information Administration is an American Government agency responsible for the collection and publication of information regarding oil, gasoline, other petroleum products, and electricity.

Katrina's aftermath. On September 22, there were several reports that prices had crossed the \$2 mark. The Bureau found that the spike in prices resulted from retailers responding to a large increase in demand based on consumer fears of a potential shortage and price increases. These price increases were not sustained, and all increases had eroded in 24 - 48 hours of the initial spike. There was no evidence to suggest that prices were coordinated or fixed by retailers.

### **How did the Bureau conduct its examination?**

The Bureau examined the impact of Hurricane Katrina on the price of gasoline and analyzed information from publicly available resources including the U.S. Energy Information Administration. The Bureau compared Canadian cities to neighbouring U.S. cities, and examined the differences in wholesale prices and refiner margins. The Bureau also analysed the indicators of Canadian wholesale gasoline prices, which included an analysis of the U.S. spot price. The results of its investigation did not suggest that there was cross-border co-ordination to increase the price of gasoline. The data showed that the prices are consistent with market conditions following the hurricane.

### **How can I find out more about the Competition Bureau?**

For more information on the Bureau's role and activities concerning gasoline and other petroleum products, please visit the [gasoline portal](#) on the Bureau's [Web site](#) ([www.competitionbureau.gc.ca](http://www.competitionbureau.gc.ca)). The portal contains frequently asked questions, information on Bureau activities, a consumer pamphlet and basic facts on the Bureau's role with respect to gasoline price complaints.

Competition Bureau

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