

INDUSTRY CANADA

**JULY 1999 GASOLINE PRICE INCREASES**  
A COMPETITION BUREAU EXAMINATION REPORT

**July 1999 Gasoline Price Increases**  
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**Synopsis**

*Responding to public concerns about gasoline pricing*

For Canadians, the cost of gasoline at the pumps has been a source of ongoing confusion and some concern. The reasons are many: retail prices fluctuate frequently and often significantly. Prices are posted large—as a means of competitive marketing—and are thus continuously in view. Price shifts are usually rapid and widespread, a pattern unique in the retail marketplace. Finally, the forces that drive gasoline prices are complex, involving international crude-oil inventories, national wholesale price discounting, and domestic retail competition.

To some Canadians, however, the explanation by gasoline retailers of particular price hikes have not been convincing to consumers. Concern about unfair pricing and suspicion of collusion among producers and retailers have sometimes resulted. This report follows one incident in which such concerns were immediately and widely expressed.

In July 1999, The Competition Bureau of Industry Canada received 243 consumer complaints about the increases in retail gasoline prices across the country in that same month. Consumers expressed concern about both the extent of the increases and the simultaneous rise in prices at all gasoline stations across various market areas.

In response, Bureau staff examined the July price increases to determine if there had been anti-competitive behaviour by any gasoline company. Relevant information from public sources on domestic and international crude-oil and gasoline prices was collected. Bureau staff conducted interviews with industry participants and reviewed the records of major oil companies in detail. The Bureau's task was to determine if an offence had been committed under Canada's *Competition Act*.

This report offers an analysis of those July price increases, details the examination itself, and presents the Bureau's findings.

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**Results in Brief**

*What the evidence shows*

**" There is no evidence of communication among the gasoline companies to coordinate a price increase."**

The evidence collected during the Competition Bureau's examination of the July 1999 gasoline price increases does not indicate that an offence occurred under the criminal conspiracy or price maintenance provisions of the *Competition Act*, or that an abuse of dominant position occurred under the civil provisions of the Act. On the contrary, the examination revealed that retail price increases in many gasoline markets across Canada in early July, and during the rest of the month, were the result of independent pricing decisions by gasoline companies.

The Bureau found no evidence of any communication among gasoline companies to coordinate a price increase. In fact, the review of company records revealed uncertainty on the part of gasoline companies about the reasons for the increases. Each of the gasoline companies interviewed set its own retail gasoline prices based on an assessment of market prices, operating costs and target margins.

The large price increase in some markets that occurred early in July 1999 was a response to the depressed nature of retail gasoline prices in the weeks prior to the increase, coupled with rising crude-oil and wholesale gasoline prices. Simply put, for many weeks gasoline had been sold to consumers at prices very close to cost in certain markets.

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**Introduction**

*Gasoline Price Regulation and The Competition Act*

While provincial governments have the authority to regulate retail prices, most provinces prefer to allow market forces to determine prices. For its part, the federal government has no jurisdiction to directly regulate retail gasoline prices, or even to determine the reasonableness of pricing, except during national emergencies.

The federal government's responsibility for gasoline pricing is through the *Competition Act*. The *Competition Act* is a federal statute designed to ensure that market forces are allowed to operate in a competitive environment. The Competition Bureau of Industry Canada is responsible for the administration and enforcement of the Act. This includes investigating possible violations of the criminal provisions of the Act—such as price fixing—and behaviour contrary to the civil provisions, such as abuse of a dominant position.

**"If the Competition Bureau has reason to believe that the Act has been violated, the Bureau must initiate an inquiry."**

Competition Bureau investigations begin with an examination to determine if issues have been raised which suggest activities that may be in violation of the Act. If the Bureau has reason to believe that the Act has been violated, the Bureau must initiate an inquiry.

Subject to judicial authorization, investigative tools available during an inquiry include:

- searching company offices;
- seizing documents;
- compelling production of documents and testimony under oath; and
- intercepting private communications.

## July 1999 Gasoline Price Increases

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#### Gasoline Prices in Canada

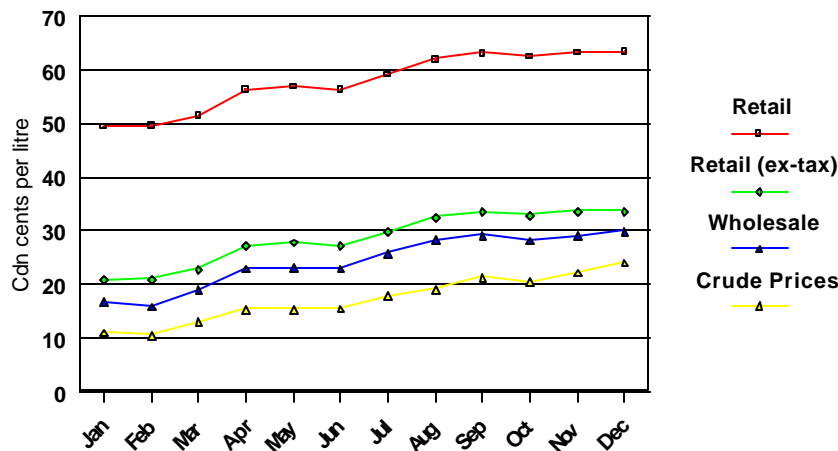
##### *Influences and trends*

The retail price of gasoline in Canada is influenced by both crude-oil prices on world markets, and competition in wholesale and local gasoline markets.

**“The price of Edmonton Par crude oil increased 61 percent from January to July 1999 - 15 percent in July alone.”**

World crude-oil prices increased steadily in 1999 following supply cuts by the Organization of Petroleum Exporting Countries (OPEC) and other oil-producing countries. As an example, the price of Edmonton Par crude oil, a type of crude sold in Edmonton, increased 61 percent from January to July 1999, increasing 15 percent in July alone. These increases, combined with greater-than-anticipated US demand, caused wholesale gasoline prices in North America to increase in 1999 as well. The average Canadian wholesale price rose 54 percent from January to July, with a 13 percent increase in July. Canadian retail gasoline prices (including taxes) increased 20 percent between January and July—5 percent in July alone. The US experience was similar, where average retail prices went up 21 percent between January and July 99, and increased by 6 percent in July.

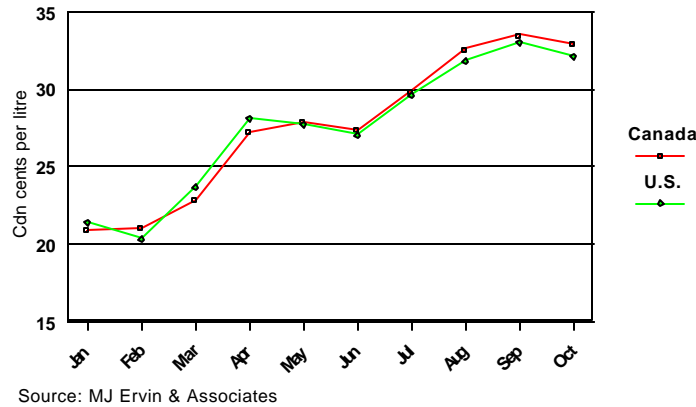
**Crude (Edm. Par), Wholesale, and Retail Price Comparison (Canadian Average, 1999)**  
**Chart 1**



Source: MJ Ervin & Associates

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**Canada and U.S. - 1999**  
**Average Retail Price Comparison (ex - tax)**  
Chart 2



### **The Canadian Crude-Oil Market**

*As the world market goes...*

The 19 crude-oil refineries in Canada are operated by 11 different petroleum companies. In the west, most refineries use domestically produced crude oil while eastern refineries use imported crude. Refineries in central Canada are able to use either domestic or imported oil.

Even when using domestic crude, Canadian petroleum companies use the world market price to calculate refinery costs. They do this because they could obtain that price by selling Canadian crude to other refiners on the world market. As a result, refineries in Canada are almost immediately affected by an increase in world crude-oil prices.

Crude-oil prices in western Canada are based on Edmonton Par (EP). The price of EP is in turn based on the price of West Texas Intermediate (WTI) crude, sold in Chicago. EP is priced to be competitive

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with WTI, taking into account transportation costs. In Eastern Canada, oil prices are based on the crude oil available in the North Atlantic, such as 'Brent Oil' from the North Sea.

*Last In First Out*

In adopting the Last In First Out (LIFO) accounting system in the early '90s, Canadian crude-oil refiners moved to a standard already used by their American and European counterparts. Under LIFO, the cost of the last crude oil purchased is used to calculate production costs for gasoline. A rise in crude-oil prices will almost immediately create a rise in production costs, which will in turn be passed onto refiners' customers in the form of higher wholesale gasoline prices.

The Canadian petroleum industry adopted the LIFO accounting system in response to an incident during the Gulf War. Canadian petroleum buyers sustained substantial losses when the high-priced crude they purchased at the outset of the conflict lost much of its value at war's end. By the time their crude had been refined and sold as gasoline, a successful resolution to the war seemed assured and crude oil and gasoline prices had dropped.

**Wholesale Gasoline Markets in Canada**

*American benchmarks*

**"Canadian wholesale suppliers use US benchmarks because they represent the cost of importing gasoline into Canada."**

Canadian wholesale gasoline markets are regional in nature, with identifiable markets well established in Atlantic Canada, Quebec, Ontario, the Prairies, and British Columbia.

To establish prices, Canadian wholesale suppliers use American benchmark prices for gasoline as a reference point. These benchmark prices follow the international price of crude oil and are affected by factors such as seasonal demand and inventory levels. Canadian wholesale suppliers use US benchmarks because they represent the cost of importing gasoline into Canada, not including transportation and other import costs. Together, the US benchmark and regional wholesale gasoline prices are a competitive starting point for Canadian wholesale prices and limit the power of Canadian refiners to set prices.

**Important Canadian Wholesale Selling Points**



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**and Referenced US Wholesale Markets**

Vancouver	Edmonton	Toronto	Montreal	Halifax
Seattle	Minneapolis	New York	New York	New York
	Grand Forks	Harbour	Harbour	Harbour
	Great Falls	Buffalo		
		Detroit		

In addition to surveying US wholesale prices, Canadian suppliers look to other supply-and-demand factors to set wholesale prices. Canadian wholesale suppliers must have competitive prices and be responsive to what their customers are willing to pay, as a price difference of less than a penny per litre can result in thousands of dollars of savings. This is a powerful incentive for some wholesale gasoline customers to switch suppliers. Canadian wholesale suppliers closely match their competitors' prices to reduce this incentive.

*Online price reporting*

The wholesale price of gasoline in Canada is available on Internet-based reporting services. These reporting services give the Canadian wholesale gasoline market the appearance of a retail market; the prices on the various services are not unlike the large street-level signs at gasoline stations.

The similarity in Canadian wholesale suppliers' prices according to the reporting services is somewhat misleading. The posted prices are not always the real prices paid by customers, who receive discounts for purchasing large quantities. As a result, Canadian wholesale gasoline suppliers are not always certain of the current wholesale price.

Price discounting can also occur when a wholesale supplier's inventory exceeds demand, although Canadian refiners who were interviewed said refinery production levels are now so closely aligned with sales needs that periodical product shortfalls in specific regional markets force them to import.

**Retail Gasoline Markets**

*Price and location*

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Supply-and-demand conditions in local markets—usually the size of an urban area—determine retail gasoline prices.

**"Gasoline retailers go to great lengths to promote the quality of their product; most Canadians accept that the gasoline available in this country is of a universally high quality."**

Canadian consumers are primarily concerned with two factors when they shop for gasoline —price and the location of the station. Gasoline retailers go to great lengths to promote the quality of their products. However, most Canadians accept that the gasoline available in this country is of a universally high quality. This leaves gasoline retailers with few differentiations to make them attractive to customers. As a result, there is a need to stay competitive—down to the penny. Retailers stay vigilant, and adjust their price points frequently, so prices are often identical or similar in a local gasoline market. Consumers and competitors are quickly informed of the lowest available price in a market with large street-level signs at gasoline stations.

*Types of gasoline stations*

The number and concentration of competitors in a local gasoline market has a substantial influence on the extent of price competition. Local gasoline markets lacking a retailer with a dominant market share tend to have the most price-competitive markets. In large urban markets, most stations selling major brands of gasoline are company-owned outlets run by an agent. Prices at these stations are set by the brand's corporate head office.

Gas stations that display the brand of a major gasoline company but set their own prices are becoming less numerous in many urban markets. However, some of these dealers operate large gasoline stations and even have their own limited retail networks.

Local gasoline markets also include independent retailers who purchase their inventory wholesale and sell their own brand of gasoline. Some of these independent retailers are very large, but most are small, relatively low volume companies.

*Price cycle*

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Some large urban markets are characterized by price cycles where prices decrease to levels approaching cost, then increase. With gasoline stations in most large urban markets operating at margins (the difference between the wholesale and retail price) varying from 5 to 10 cents per litre, retail prices often drop to levels approaching the wholesale prices. This causes retailers to increase prices to more profitable levels. Then the cycle of competition continues.

**"Gasoline company officials who were interviewed said that if prices do not increase at most gasoline stations in a market by the evening rush hour, they can be expected to decrease further."**

The price cycle can result in sudden—and sometimes large—increases in retail gasoline prices, followed by a slow erosion. Gasoline company officials who were interviewed said that if prices do not increase at most gasoline stations in a market by the evening rush hour, they can be expected to decrease further. The rate at which retail prices increase is accelerated by the computerized pricing systems used by the major gasoline companies. These pricing systems allow for rapid collection of market prices and a quick reaction to price movements.

*Stable pricing*

Some urban gasoline markets, and many rural markets, have more stable gasoline pricing. In stable urban markets, retail gasoline prices are less responsive to changes in wholesale gasoline and crude oil pricing. It can take two months for a reduction in crude oil prices to be reflected in lower retail gasoline prices. Margins in most stable urban markets in Canada generally remain at less than 10 cents per litre. In rural markets, margins are often higher, but this is usually attributable to a lower sales volume per gasoline station; higher margins are needed to cover operating costs.

**End-User Prices for Petroleum Products (mid-month prices)**

Country	Price	Price (ex-tax)	Price	Price (ex-tax)
	July 1999 (US \$ per litre)		Aug 1999 (US \$ per litre)	
France	1.034	0.199	1.084	0.223
Germany	0.898	0.224	0.937	0.243

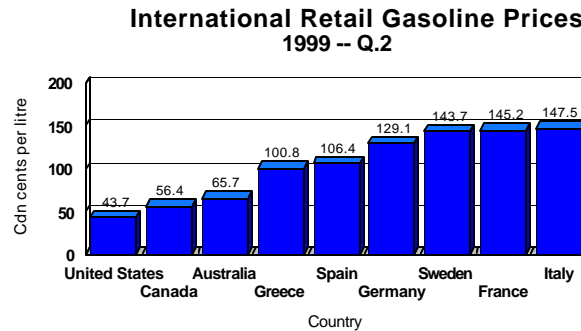
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Italy	1.051	0.278	1.087	0.292
Spain	0.792	0.264	0.826	0.283
UK	1.233	0.216	1.283	0.241
Japan	0.815	0.327	0.865	0.349
Canada	0.41	0.213	0.416	0.219
USA	0.314	0.213	0.34	0.239

*As world crude oil prices rose in 1999, price increases in Canadian retail gasoline markets were generally consistent with markets in other industrialized countries. Canadian prices on an ex-tax basis were lower than most industrialized countries and comparable with price increases in the United States. Source of data: International Energy Agency.*

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**International Price Comparisons**  
Chart 3



Source: MJ Ervin & Associates

### **July Price Increases and the *Competition Act***

The concerns expressed by consumers regarding the July 1999 gasoline price increases were reviewed under the conspiracy, price maintenance, and abuse of dominant position provisions of the *Competition Act*. The first two - conspiracy and price maintenance—are criminal offences. Therefore, the onus is on the Competition Bureau to prove the offences beyond a reasonable doubt in a court of law. The third—abuse of dominant position—is a civil provision. The Competition Bureau must establish the required elements of the provision before the Competition Tribunal, an independent, quasi-judicial body, on a balance of probability standard.

### **The Conspiracy Provision**

The conspiracy provision of the Act makes it an offence for a person to enter into an agreement or arrangement with another person to prevent or lessen, unduly, competition in the sale or supply of a product. The potential offences considered in the examination of the July price increases were an agreement or arrangement to fix prices or establish the amount of a price increase. To show an offence under the conspiracy provision the Bureau must prove before the courts that:

- two or more market participants, with market power, have entered into an agreement or

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arrangement to fix prices or increase prices, and that

- the agreement or arrangement would prevent or lessen competition unduly.

*Competition Bureau findings*

**"...it is evident the prices charged by the major gasoline companies in the wholesale and retail gasoline markets in July were based on independent pricing decisions made in reaction to market forces."**

The Competition Bureau's examination revealed no evidence that the major gasoline companies had entered into an agreement or arrangement to increase or fix prices in the month of July. In fact, it is evident the prices charged by the major gasoline companies in the wholesale and retail gasoline markets were based on independent pricing decisions made in reaction to market forces. These companies continued to compete for customers in both the retail and wholesale markets.

*Wholesale Gasoline Prices*

There was a similarity in the wholesale prices of different suppliers. This similarity is not evidence of an agreement to fix prices, however, as posted wholesale gasoline prices are not what customers actually pay. The final transaction prices paid by many customers are usually lower than the published wholesale prices—they are discounted on volume purchases. The final price and terms are confidential, and the occasional differences in wholesale prices provides further evidence of the absence of a price-fixing agreement. The gasoline companies do attempt to track the wholesale prices of their competitors, but the companies did not have completely accurate information about the actual wholesale prices charged by their competitors.

**"Even though the companies use US benchmarks, their records show that they did not always achieve targeted wholesale prices."**

The similarity of the posted Canadian wholesale prices can also be explained by the fact that major

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wholesale suppliers in Canada use American benchmark prices in order to set their own prices. Despite this practice, company records show that they did not always achieve targeted wholesale prices. The fact that Canadian wholesale prices are based on those in the United States is further evidence that Canadian wholesale prices are difficult to control at all, tied as they are to the price of imported US gasoline.

Discounted wholesale prices, price variability over time, inconsistency in meeting targeted prices, and uncertainty about competitors' prices, indicate business conduct that does not suggest the existence of a price-fixing agreement. All the evidence that was collected indicates that each major Canadian wholesale supplier established its prices after its own independent assessment of supply and demand in regional wholesale markets across the country.

Canadian suppliers must also respond to competition in regional markets, and consider the supply requirements of their own retail networks. All our findings indicated wholesale gasoline prices were determined by the interaction of supply and demand conditions during July 1999.

*Retail Gasoline Prices*

In the examination of the retail gasoline market the Bureau sought evidence of a coordinated price increase across the country resulting from an agreement to fix prices.

New federal environmental regulations that took effect on July 1, 1999, require all gasoline sold in Canada to have no more than one percent benzene. Refiners incurred extra costs to produce the low-benzene gasoline, resulting in more expensive wholesale gasoline. One national gasoline company did attempt to implement a price increase on July 6, 1999, hoping to bring retail gasoline prices in line with increases in crude oil and wholesale gasoline prices in North America and cover the new environmental costs.

The attempt at a nationwide price increase was not a success. Other national companies failed to increase prices in all markets by the same amount during the week after July 6, 1999, and whatever increases were made did not last long in many markets. The variety of pricing patterns suggests there was no coordination among the different gasoline companies to increase prices. Once again, the analysis of company records and the interviews with company pricing managers revealed that, after July 6, 1999, each company made independent decisions on whether to increase prices based on local market conditions.

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**July 1999 Prices for Selected Markets**

	July 5	July 6	July 7	July 8	July 9	July 10	July 11
Vancouver	59.9	60.5	60.5	58.5	58.5	56.9	56.9
Edmonton	49.8	52.9	52.9	52.9	52.9	52.9	52.9
Regina	59.5	60.1	60.1	60.1	60.1	60.1	60.1
Winnipeg	56.5	57.1	57.1	57.1	57.1	57.1	57.1
Thunder Bay	54.9	54.4	61.9	60.9	59.9	59.5	58.9
Toronto	49.9	49.9	59.9	59.9	58.9	58.7	58.5
Montreal	60.9	65.9	65.9	64.9	64.9	64.9	64.9
Quebec City	63.9	63.4	62.9	62.4	61.9	61.7	60.9
Halifax	59.9	59.9	59.9	63.9	63.9	59.9	59.9

Source: Gasoline Company Records

*Toronto in detail*

The Toronto retail gasoline market sustained one of the most dramatic price increases of July 6, 1999—10 cents per litre—and was the source of the most complaints to the Competition Bureau. Before that increase, the Toronto market had exhibited a common two-week price cycle; prices had been dropping well before the weekend as retailers strove to attract business.

**"...retail gasoline in Toronto was being sold at prices below the posted wholesale prices of major wholesale suppliers on July 5."**

A price increase had been attempted in Toronto around June 28, but it failed when one of the major gasoline companies, concerned with public sensitivity to price increases before long weekends, did not increase prices. Prices dipped to between one and three cents per litre below the posted wholesale prices after the long weekend, even while wholesale gasoline prices in Toronto continued to increase, reflecting the increase in crude oil and North American wholesale prices.

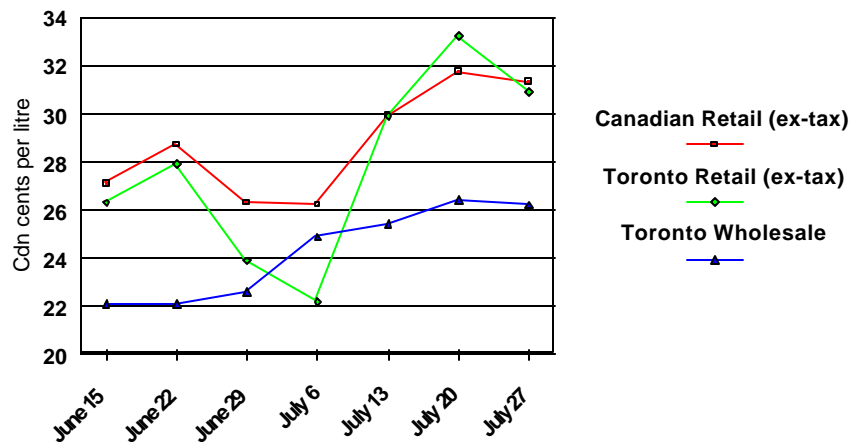
As the chart below shows, retail gasoline in Toronto was being sold at prices which were below the



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posted wholesale prices of the major wholesale suppliers on July 5. Note these prices may not have been below cost for all retailers because posted wholesale prices are discounted for some customers. This motivated most retailers to increase prices on July 6, 1999, following the lead of one of the major gasoline companies. This rise in Toronto gasoline prices, however, was short-lived. Prices started to drop two days after the increase, once again in step with a common price cycle in that market.

**Comparison of Weekly Average Retail and Wholesale Prices: Canada and Toronto, 1999**  
**Chart 4**



Source: MJ Ervin & Associates

**Toronto Area Price Cycle**

*Toronto area retail prices were 1-3 cents per litre below posted wholesale prices on July 5 which resulted in a large price increase on July 6, of 10 cents per litre.*

**"It is not unusual for increases or decreases to occur so rapidly that consumers, and even competitors, don't know which company changed prices first."**

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Many of the consumers who contacted the Bureau about the July 6 rise in retail gasoline prices in Toronto emphasized their concern that the increases occurred at the same time. A review of company records, however, revealed that prices did not increase at every gasoline station at the same time, but rather were staggered over the course of the day. In most gasoline markets in Canada, retailers try to imitate the price movements of competitors, subject to local market conditions. It is not unusual, therefore, for increases or decreases to occur so rapidly that consumers—and even competitors—don't know which company changed prices first. This is the normal pattern of competition in retail gasoline markets and does not raise issues under the *Competition Act*.

*One company's attempt to raise prices*

One major gasoline company tried to increase prices in multiple markets on July 6, 1999 following an assessment of its operating costs and market conditions. There was no evidence of communication by this company with its competitors to obtain an agreement to do the same. The evidence was to the contrary—the company that raised prices on July 6 was clearly uncertain about the reaction of competitors. Nor was the price increase successful in every market, further indicating there was no agreement on price.

*After July*

Retail gasoline prices continued to increase throughout the rest of 1999 in most Canadian markets, and mainly followed the usual pricing patterns that existed in most markets before the July increase. In those markets with pricing cycles, prices continued to rise suddenly then fall over time. In markets with typically stable prices, such stability continued after July 1999, although at higher levels reasonably attributed to increasing crude-oil costs.

**The Price-Maintenance Provision**

It is an offence under the price-maintenance provisions of the *Competition Act* for a supplier "to attempt by the use of an agreement, threat, promise or any like means, to increase prices upward, or to discourage the reduction of prices, by another supplier of a product." The Competition Bureau must prove there was an attempt to influence prices; it is not necessary to show that prices were actually changed.

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Most of the Bureau's court cases against the gasoline industry have involved the price-maintenance provision. Since the 1970s, 11 cases have been brought to court, resulting in eight convictions.

**"The evidence collected in this examination did not indicate any communication between gasoline suppliers with a view to attempting to increase retail gasoline prices in July 1999."**

An offence under the price-maintenance provision is similar to one under the conspiracy provision in that there must be an attempt by one supplier to use an **agreement**, threat, promise, or any like means to influence another supplier to increase prices or to stop price discounting. The evidence collected in this examination does not indicate any communication between gasoline suppliers with a view to attempting to increase retail gasoline prices in July 1999. The one company that did attempt to increase retail gasoline prices at its company-owned stations across Canada on July 6, 1999 seems to have made no attempt whatsoever to coordinate the increase with its competitors. The evidence shows that each company examined made independent pricing decisions on July 6, and subsequently throughout July.

**The Abuse-of-Dominant-Position Provision**

Section 79 of the *Competition Act* is designed to remedy situations where one or more firms are using a position of dominance to substantially lessen or prevent competition. Before a remedial order may be obtained under this section, the Competition Bureau must satisfy the Competition Tribunal that:

- one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business;
- the dominant firm or firms have engaged in or are engaging in a practice of anti-competitive acts; and that
- the practice of anti-competitive acts has had, is having, or is likely to have the effect of preventing or lessening competition substantially in a market.

**"A finding that one or more parties jointly control a market requires**

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**evidence of some communication and coordinated conduct between the parties."**

The first element considered in an abuse-of-dominance case is control. A finding that one or more parties jointly controls a market requires evidence of some communication and coordinated conduct between the parties. The Competition Tribunal has determined that *control* is synonymous with *market power* - the ability to set prices above competitive levels for an extended period of time. Market power requires a large share of the market, barriers to entry and, in the case of joint control by more than one firm, some form of coordinated behaviour to facilitate control of the market.

None of the major gasoline companies in Canada has a market share significant enough to be considered dominant. Combined, however, their share is large enough to warrant further examination in most wholesale and retail gasoline markets. Consequently, joint control by the major gasoline companies was considered in the examination of whether the July 1999 price increases could have been the result of anti-competitive conduct.

**"The July 6 price increase was started by one gasoline company making its own pricing decision."**

The evidence does not support any accusation that major gasoline companies either coordinated the July price increases or even communicated an intention to increase prices. The July 6 price increase was started by one gasoline company making its own pricing decision. Neither does any evidence show any attempt by that company to ensure through communication with competitors that they too would increase prices.

Other major gasoline companies made their own subsequent pricing decisions based on local market conditions. As a result, prices increased in some markets, remained the same in others, and decreased in a few.

There was no coordinated pattern of price movements across the country. The first element of the abuse-of-dominant position—market control—was not met, so there are no grounds on which to apply to the Competition Tribunal for a remedial order under this provision.

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**Conclusion**

**"Given the lack of evidence of anti-competitive behaviour, it is apparent that the July 1999 price increases, while dramatic, were the result of normal market forces."**

The Competition Bureau's conclusion is that the July 1999 retail gasoline prices were the result of supply and demand conditions. No evidence was discovered of communication or coordination among the gasoline companies regarding price fixing. On the contrary, a review of company records revealed uncertainty about the reasons for the increases.

The July price increases, although sudden and occurring almost simultaneously in some markets, were a correction of low retail gasoline prices in the weeks prior to the increase, and a response to rising crude-oil and wholesale gasoline prices.

Increasing retail gasoline prices in Canada after July 1999 can be attributed to increasing crude oil prices on world markets, which caused wholesale gasoline prices to rise throughout North America. Given the lack of evidence of anti-competitive behaviour, it is the conclusion of the Competition Bureau that the July 1999 price increases, while dramatic, were the result of normal market forces.