

CWC-11

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QUE DOIT SUPPORTER UN DÉTAILLANT EN ESSENCE
OU EN CARBURANT DIESEL

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RÉGISSEURS : M. JEAN-NOËL VALLIÈRE, président
Me BENOÎT PEPIN
M. MICHEL HARDY

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STÉNOGRAPHES OFFICIELS

Dossier R-3499-2002
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procureur de la Régie

LES INTERVENANTS :

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procureur de Association des services de l'automobile
inc. (ASA);

Me ÉRIC BÉDARD
Me JEAN-FRANÇOIS HÉBERT
procureurs de Association québécoise des indépendants du
pétrole (AQIIP);

Me PIERRE TOURIGNY
procureur de CAA-Québec et Option consommateurs (CAA/OC);

Me PAULE HAMELIN
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Me CHRISTOPHER L. RICHTER
Me CHRISTIAN IMMER
procureurs de Les Entrepôts Costco (Costco);

Me STEVE CADRIN
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indépendante (FCEI);

Me ÉRIC DUNBERRY
procureur de Institut canadien des produits pétroliers
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Me SOPHIE PERREAULT
M. RENÉ LEMIRE
représentants de Pétro-Canada;

Me MADELEINE RENAUD
procureure de Produits Shell Canada (Shell);

Me CLAUDE TARDIF
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Me LOUIS P. BÉLANGER
procureur de Ultramar Ltée (Ultramar).

Dossier R-3499-2002
3 avril 2003
Volume 5

TABLE DES MATIÈRES

	PAGE
PRÉLIMINAIRES	5
PREUVE DE COSTCO	
PIERRE RIEL	
JOSEPH J. LETO	
INTERROGÉS PAR Me CHRISTIAN IMMER	7
CONTRE-INTERROGÉ PAR Me ÉRIC BÉDARD	
SUR LA QUALIFICATION D'HOMME DE MÉTIER DE M. RIEL	13
REPRÉSENTATIONS PAR Me ÉRIC BÉDARD	17
REPRÉSENTATIONS PAR Me CHRISTIAN IMMER	19
Me ÉRIC BÉDARD	27
Me CHRISTIAN IMMER	31
INTERROGÉS PAR Me CHRISTIAN IMMER	32
CONTRE-INTERROGÉS PAR Me ÉRIC BÉDARD	112
CONTRE-INTERROGÉS PAR Me IVANHOE CHALIFOUX	232
INTERROGÉS PAR Me PIERRE RONDEAU	235

and some of the provincial reports on energy.

52 Q. Okay. Now, if we can focus more specifically on the four items you mention at the bottom of your bio, Areas of Consulting Expertise Relevant to High Volume Retailing, just indicate to the Régie what the first study implied in terms of, what the scope of the study was and the type of work that was done?

A. We released a hypermart, a hypermart study in February of two thousand one (2001). Our objective in conducting that study was to put together a complete picture of the evolution of hypermarkets into high volume gasoline retailing in the U.S. marketplace, and the way this was prompted is we had done some consulting work for one of the oil companies, looking at hypermarkets and how they were evolving, and realized there was not much information out there on assessing this in any level of detail.

So, in February of two thousand one (2001), we released a pretty rigorous complete study addressing hypermarkets and gasoline retailing.

(10 h 45)

53 Q. Okay. And the second item, led the study conducted for NACS, could you indicate to the Régie what NACS stands for?

Mr. JOSEPH J. LETO :

A. That is National Association of Convenience Stores,

so it's a trade organization representing a pretty large share of the U.S. retailers.

54 Q. Okay. And I understand we will come back in your presentation on explaining a bit more what a convenience store -- I guess that's abbreviated to C-store, am I correct?

A. Yes.

55 Q. What that implies and what that model implies -- and I understand that the third item is simply about the same scope of work that you described for the first item, in areas of consulting expertise?

A. Yes.

56 Q. Okay. And finally, on the last topic, could you give us a bit of context into what this means, these studies you indicate at the last item?

A. The last bullet relates more to specific consulting work and topics we've addressed for companies in the market analysis, market strategy area, rather than, the studies we just talked about are what we call industry studies, we market them to all companies. The last bullet is more company-specific consulting work.

57 Q. Okay. Now, have you worked in the -- have you testified, sorry, as an expert witness before today?

A. Yes, I have.

58 Q. Okay. And have you testified more particularly in the Canadian setting?

A. Yes.

59 Q. Where have you testified in Canada, in what context?

A. I've provided expert testimony before the National Energy Board, addressing a crude oil pipeline project.

Me CHRISTIAN IMMER :

Okay. Alors, Messieurs les régisseurs, si vous permettez, je vais commencer avec la présentation de monsieur Leto et ensuite on va faire une brève présentation par monsieur Riel. Et monsieur Leto, je vais plus ou moins m'asseoir et lui laisser mener le show parce qu'il est bien en mesure de faire ça sans moi, donc je vais le laisser aller avec sa présentation.

Notre but est de faire une présentation d'à peu près quarante-cinq (45) minutes sur le document, en tentant de donner un peu de contexte à ce qui est indiqué dans le document.

60 Q. So, Mr. Leto, if you could proceed to make a brief summary presentation, hitting on what you believe are the important points of your presentation.

A. Thank you.

61 Q. Well, perhaps just before that, the presentation you will refer to is filed at Costco-4, so everybody is on the same page, I hope.

COSTCO-4 : "Evolution of the High Volume Gasoline
Retailer for Woods & Partners,
prepared by EAI, Inc. - January 20,
2003"

A. I guess probably the first matter to, I guess, to explain is the, the topic is the "Evolution of the High Volume Gasoline Retailer". And to that point, I guess one thing we would like to discuss through this presentation is that the evolution of the High Volume Retailers has been going on for quite some time in various forms, and that's one of the things we'd like to present here, is how the transition has been occurring from -- I'll call them, you know, lower volume traditionally pumping gasoline only stores to hybrid stores with convenience and other profit centres, in addition to gasoline, to the very high volume gasoline retailers. So that's the focus of this presentation.

As far as, I guess for purposes of definition on a High Volume Retailer, and there's -- excuse shifting around on nomenclature, but generally when folks talk about High Volume Retailers, they're generally referring to this class of gasoline retailers that, in U.S. numbers, push somewhere between two hundred (200) to a million (1 M) gallons of gasoline sales per month.

And there is the independent large chain retail stores that got into this business in the late eighties ('80s), early nineties ('90s). And then, in the mid-nineties (mid-'90s), early nineties ('90s), the, what we call the hypermarts, which is meant to define non-traditional gasoline retailers, the mass merchandisers, supermarkets, and discount chains that have gotten into gasoline retailing.

At least in the U.S., that phenomenon started in about the early nineties ('90s), mid-nineties (mid-'90s). And if you go way back in time, it's not something that's totally new, because Sears, Zayre's, a number of other types of store chains had gotten into the gasoline business in the U.S. twenty (20) years ago, faded out, it never got very large. So this phenomenon has been around for quite some time.

The difference between what occurred twenty (20) to thirty (30) years ago and today is it's not an isolated activity in the U.S. anymore, meaning the hypermarts getting into gasoline retailing. Our last count -- and we do try to maintain our study -- there's probably about fifty-nine (59) companies in the U.S. now in gasoline marketing that are in this category of non-traditional gasoline retailers -- again, the mass merchandisers, supermarkets, and department stores. These are, range from the large

Dossier R-3499-2002
3 avril 2003
Volume 5

PANEL COSTCO
Interrogatoire
Me Christian Immer

grocers, mass merchandisers such as Costco, Sam's, on our East Coast, BJ's, to the small regional grocer that might have ten (10) stores.

One of the things that has made this business stick this time around is, is the barrier to entry has dramatically been reduced from twenty (20) years ago, and a lot of that is the result of Underground, U.S.T., Underground Storage Tank Program, which basically set a set of rigid standards on tank specifications and monitoring leakage. So that it made companies less fearful from getting into the gasoline retailing business.

And although, you know, we have not studied the Canadian market in detail, we have worked for companies in Canada, looking at the U.S. market with respect to this hypermart phenomenon. But, you know, we know there's at least four (4) companies that are classified as hypermarts aggressively pursuing gasoline in Canada.

We probably touched on most of these, this evolution of the high volume gasoline retailer, we probably pretty much stepped through, but in the States, we started with the attended server gasoline only business. Unfortunately, I'm old enough to remember those. We still have some of those around in the

Dossier R-3499-2002
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Volume 5

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States, by the way. There's at least two (2) states where you have to have an attendant at the gasoline site, you cannot have self-serve.

So those, actually, all of these businesses that we're talking about as far as evolution are still around. We now have a mix of stores representing each classification we show you here in this illustration. We moved almost simultaneously to more the self-serve pumper units -- these are mainly gasoline, you can pay at the pump. And then kind of overlapping that, more evolving with convenience stores with gasoline, these would be stores that offered snack food, cigarettes, and ultimately alcohol beverages, two thousand (2,000), you know, a fifteen hundred (1,500), two thousand (2,000) square foot store and up.

To what we are seeing today, the independent High Volume Retailers -- just to put those stores in perspective, they're often in the three thousand to five thousand (3,000 - 5,000) square foot range. They may have somewhere between eight and twelve (8 - 12) pumping units, MPD units, very high volume, very large store sales, different economy of scale.

There's four major High Volume Retailers in the U.S., and they're all privately owned, and they're growing

very rapidly. And their growth started back in the late eighties ('80s). And then, as we mentioned, the hypermarts with gasoline, I think we described what we're classifying in that category. And that's, among these categories, the hypermarts with gasoline are probably one of the fastest growing segments in the gasoline marketing, U.S. gasoline marketing business.

With these last two categories, a big part of their growth has been, you know, using the latest in technology. The sites are automated and often integrated with the main store. And the volume these stores tend to do is probably on the order, as we mentioned earlier, if I had to pick an average, they're on the order of two to three times the volume of a conventional convenience store type operation.

So we probably covered most of these retail models. Again, I mentioned the gasoline pumper unit -- at least in the States, some of these, a lot of these units are being, have been phased out for more modern convenience stores with gasoline operations. These generally would have a small kiosk sitting in the centre of the pumps, to basically conduct the transactions, and they would have a small selection of snacks.

Conventional gasoline-convenience store operations,

these sites, I mentioned, have four to six MPD units, and the convenience store size is in the range of two to three thousand (2,000 - 3,000) square foot, or they can be smaller. These stores are also going through quite a bit of transition in the States.

A lot of the convenience store chains, major oil company branded or owned, have been positioning themselves to look more like the High Volume Retailers, those four companies that we mentioned earlier -- those being, we'll mention them further, but Sheetz, WaWa, QuikTrip, Race Trac -- those are the four dominant High Volume Retailer companies in the U.S.

A little more definition on the High Volume Retailer, and I guess talking a bit about the mass merchandiser, of which we mentioned Costco, Sam's and BJ's are the dominant mass merchandisers in the gasoline business in the U.S. Their operations are quite unique, and so when we talk about some of these business models in gasoline -- and these are our observations from talking to these players, being on their sites, observing customers and how they react to these different businesses.

The mass merchandisers are quite unique in that most of the mass merchandisers pursue a gasoline only, you

know, "no frills", no ancillary businesses, it's a high volume, high-traffic though-put type operation, very much modeled as their core big box store business is modeled. You know, in their business I think they call it number of SKU's, a lot less product selection, a lot higher throughput traffic, and the customer always believes they're going to get a very competitive price, they do not have to shop.

So that is basically what they've done in the store, and that's what they've taken out to the gasoline pumps. And they tend, the HVR's, the mass merchandise HVR's tend to locate in high-density urban market areas, a lot in the suburbs where there is still available land, but still, you know, high traffic, you know, good population base, or through traffic.

And just to put together, put in perspective the growth of the hypermarkets in the U.S. -- and this is dynamic, so some of the numbers, we released this to Woods & Partners prior to finalizing our industry study. So some of these numbers might deviate a little bit, but they're pretty close.

Number of hypermart gasoline operations, the first study we did -- which we released in February of two thousand and one (2001) -- there was approximately eleven hundred and forty (1,140) hypermart sites with

gasoline that we could define. And we did a pretty thorough job scouring where these sites were. As of approximately October two thousand and two (2002), there was a little over twenty-four hundred (2,400) sites. Fourth quarter last year, we estimated the hypermart additions, the hypermart entry into the gasoline business as averaging about sixty-two (62) sites per month. This is across all U.S. hypermarts.

So fairly, I guess to put it in perspective, it's almost like a mid-range oil company in the retail business. Collectively, the hypermarts look like, you know, a large major oil company with a lot of retail sites, it's that formidable now.

If you take our estimate of U.S. hypermarts with gasoline, and the independent High Volume Retailers that we mentioned earlier, collectively, there's a little over, we estimate about forty-four hundred and eleven (4,411) sites, and that's probably larger now.

To put that in contrast with the total retail outlets in the U.S., gasoline, gasoline with, always having gasoline, sometimes gasoline only, or gasoline with convenience stores, there's a little over a hundred and seventy thousand (170,000) sites in the U.S., as reported by NACS -- National Association of Convenience Stores.

In our projections for hypermart growth in the U.S., which we did back in two thousand (2000), two thousand one (2001), and that we consistently update, we're forecasting -- and I'll give you our more recent numbers to complement what we have presented here -- we're estimating the hypermart gasoline sites to grow to about six thousand (6,000), or the six thousand to seven thousand (6,000 - 7,000) site range by two thousand and seven (2007). So five years out, we expect them to add on the order of, what, about another four thousand (4,000), thirty-five hundred to four thousand (3,500 - 4,000) sites.

Currently, the site total in the U.S., with our survey and review of gasoline volumes these sites do, is five point eight to five point nine percent (5.8% - 5.9%) of the market, currently, the fourth quarter two thousand two (2002).

(11 h)

We're estimating that market share to grow to the twelve to sixteen percent (12% - 16%) range by two thousand and seven (2007). And the caveat there is that the twelve percent (12%) is just based on companies we know are already in the business, in the gasoline business, and they're growing their business. The sixteen percent (16%) is speculating on new entrants into the gasoline retailing business, of which, you know, there's a number of companies every

Dossier R-3499-2002
3 avril 2003
Volume 5

PANEL COSTCO
Interrogatoire
Me Christian Immer

year.

Again, with respect to the Canadian market, we know there are at least four companies that are classified as hypermarts that are in the gasoline business, or growing the gasoline business in Canada, and they are Loblaws, Safeway, Costco, and Wal-Mart. Wal-Mart is, in Canada, their arrangement is with Murphy. Murphy actually owns and operates the gasoline retail business, Wal-Mart provides them the land.

And Safeway is, our estimate of volume, Safeway is number 7 in gasoline volume among the hypermarts in the U.S. We estimate Costco is number 3, and Wal-Mart is number 1 in the U.S. market. So really three of the most formidable gasoline hypermart retailers are advancing in the Canadian market.

I'm not too metric litreate, I used to be when I was doing more engineering work, but bear with me. These are translated to litres, our volume forecasts, but taking our volume forecast for the U.S. market for hypermart sales in the U.S., it's about thirty billion (30MM) litres today, or fourth quarter two thousand two (2002). And by two thousand seven (2007), with the speculative category we were mentioning earlier that took us to the sixteen percent (16%) market share level, we expect it to hit