ISLAND REGULATORY AND APPEALS COMMISSION INTERROGATORY

In the matter of: **An Assessment of the Petroleum Products Benchmark and Margin Review Report prepared by Gardner Pinfold Consultants Inc. ("GP")**

Gardner Pinfold Consultants Inc. Response

Submitted: **July 4, 2023**

IR 1.

In recommendation #5, it was concluded that 5.0 cpl margin for secondary wholesalers is just and reasonable.

a. What expenditures were included in your review that attributed to the 5.0 cpl conclusion?

GP response: Secondary wholesalers were asked to submit operating costs incurred in carrying out in supplying retailers with motor fuels covering the period 2012-2022. We included a reporting template that provided guidance on the scope of the data requested. To simplify reporting, It included three categories: fuel delivery (terminal to retailer), administration, and "support" (to be specified but not quantified). The support included: marketing (cards, loyalty, discounts, promotions, etc), repairs and maintenance, allocated fixed costs).

b. Please provide a table which represents the wholesale expenditures similar to Table 2: Annual operating costs for all motor fuel outlets reporting, 2018-21.

The table below sets out the wholesaler data provided. As noted in the report, data for the full reporting period were not available because of entry and exit of wholesalers. But in any event, with just three of six secondary wholesalers reporting, and these accounting for just 35% of provincial sales volume, the results, in my opinion, could not be considered representative of industry costs.

		2017		2022
Delivery	**$**	**638,796**	**$**	**788,605**
Administration	**$**	**771,684**	**$**	**529,658**
Support	**$**	**2,854,468**	**$**	**3,430,108**
	$	**4,264,948**	**$**	**4,748,370**
Volume (litres)		**75,370,004**		**82,857,879**
Cents per litre		**5.66**		**5.73**

IR 2.

In recommendation #6, it was recommended the Commission may wish to issue guidance to industry clarifying the scope of wholesale activities it deems are covered by the wholesale margin under the existing pricing formula that relies on the rack price as a benchmark price.

a. If the Commission continues to use the rack price as the benchmark, please provide a list of the expenditures typically included in the rack price as compared to a list of expenditures typically included as part of the wholesale margin.

   The rack price is the refiner's selling price. It would cover all capital and operating costs needed to produce refined products (including the delivered cost of crude oil), plus the cost associated with transporting products from refinery to terminals and the cost of operating those terminals. The rack price would also include the refiner's profit margin. This description would apply in both unregulated markets and in regulated markets using the rack price as the benchmark price.

   The list of expenditures covered by the wholesale margin in a regulated market would depend on what benchmark is used and how the regulatory framework may define the relevant costs.

   - **With the rack price as benchmark, the wholesale margin would capture all costs from the rack forward. The rack is the point where the secondary wholesaler takes ownership of the product. From this point, the margin would cover all costs (including profit) needed to meet secondary wholesaler obligations under its supply contracts with retail outlets. These costs are identified in my response to IR 1.**
   - **With NYH as benchmark, the regulatory practice in the Maritime Provinces for quantifying the wholesale margin is to take NYH as the starting point for cost calculations and carry this through to delivery to (and support for) the retailer. The primary wholesaler (refiner) would account for transportation costs to and operation of the marine terminal, while the secondary wholesaler carries the costs identified in my response to IR 1.**
   - **The legislation that establishes the regulatory framework in New Brunswick[1] and Nova Scotia[2] each provide a working definition of the wholesale margin as the difference between the benchmark price and the selling price to retailers and provides guidance on the factors to be considered by the regulator in adjusting the wholesale margin. For New Brunswick, Regulation 9(1)(i) directs the EUB to consider (i) the costs of transporting heating fuel or motor fuel from New York Harbor as well as other specified costs/factors including any "… that the Board considers relevant". For Nova Scotia, Regulation 17 (4) gives the Board wide discretion in determining the factors to be considered in calculating the wholesale margin, including (b) (i) the distance from the refinery gate to the boundaries of a zone.**

[1]Regulation 8(1) https://laws.gnb.ca/en/ShowPdf/cr/2006-41.pdf
[2]Regulation 17(3) https://novascotia.ca/just/regulations/regs/ppprice.htm#TOC3_20

IR 3

In recommendation #7, a wholesale margin is broken out from the existing margin for both furnace oil and commercial diesel.

a. Please explain the difference between the wholesale margin in recommendation #5 which states the margin is for secondary wholesalers as compared to recommendation #7 which does not differentiate between primary and secondary.

   Conceptually, the wholesale margin is the same (though the amounts differ) insofar as it applies to a company supplying itself. From this perspective, both motor fuel suppliers and fuel distributors can be considered secondary wholesalers. Recommendation #5 applies to secondary wholesalers of motor fuel who buy from a primary wholesaler to supply their own outlets as well as third party retail outlets. Because their controlled outlets are an integral part of their business, they do not make a distinction between the wholesale and retail components of the overall marketing margin (13 cpl). Similarly, given the Commission's view that the Act requires a wholesale margin for heating oil and commercial diesel distribution, this margin would be available to distributors as buyers from a primary wholesaler. The margin amount differs because of differences in the underlying activity the margin is meant to cover.

b. What type of organization will be allowed to charge the 3 cpl wholesale margin in your recommendation?

   The wholesale margin would be available to licenced distributors of furnace oil and commercial diesel.

IR 4

If the Commission determines the rack price is the appropriate benchmark going forward, what steps would you propose the Commission follow to determine if costs related to the clean fuel standards are being passed through as an additive to rack, and how we might calculate the cost?

Refiners operate subject to a wide range of regulations addressing product specification, safety, transportation, environment, etc. Each requirement adds to the costs refiners try to recover through product prices to maintain margins. The ability to pass on costs through higher prices would depend on the competitive environment, specifically, the cost structures and pricing strategies of other refiners supplying the same market. In other words, simply because one or more refiners face higher costs in a particular market it does not follow that they will be able automatically to recoup some or all those costs by increasing prices. It could depend on the pricing strategy of the low-cost supplier. Alternatively, competing refiners may seize the opportunity to expand market share by holding down prices.

Regulators in the other Maritime Provinces have addressed the CFR issue by adopting a carbon cost "adder" approach which involves specifying an amount that is incorporated into the transportation fuel pricing formula when determining the maximum retail price. This amount would flow through fully to the suppliers' rack price to offset their compliance costs. These costs are not known (except by the companies themselves) and consequently a proxy value is used. In New Brunswick the EUB will determine the weekly adder using a formula-based approach linked to the import value of renewable diesel (a preliminary assessment suggests an initial adder in the 8.0 cpl range).[3] In Nova Scotia the UARB is basing its approach on the CFR maximum credit price of $300, resulting in a 3.74 cpl increase for gasoline and 4.17 cpl for diesel.[4]

Having a CFR adder specified by the EUB and UARB, with that adder intended to flow automatically through to the respective Saint John and Halifax rack prices, could provide the Commission with a basis for determining the extent to which the Charlottetown rack price is being influenced by CFR costs. This would require monitoring the rack price movements over a period of months. This is not a perfect approach given the range of factors influencing rack prices, but in the absence of direct input by the companies in question it is difficult to see how these costs could be identified with confidence.

---

[3] https://filemaker.nbeub.ca/fmi/webd/NBEUB%20ToolKit13

[4] https://uarb.novascotia.ca/fmi/webd/UARB15