PRINCE EDWARD ISLAND
Regulatory & Appeals Commission
Commission de réglementation et d'appels
ÎLE-DU-PRINCE-ÉDOUARD

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| **Date Issued:** | **August 31, 2022** |
| **Docket:** | **PMC21-01** |
| **Order** | **PC22-002** |

**IN THE MATTER** of a review of the minimum and maximum markup for heating fuel and motor fuel in the Province of Prince Edward Island, pursuant to section 27 of the *Petroleum Products Act*, RSPEI 1988, c. P-5.1.

# INTERIM ORDER

Panel Members:

J. Scott MacKenzie, Q.C., Chair
M. Douglas Clow, Vice-Chair
Erin T. Mitchell, Commissioner

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Allison MacEwen,
Director, Regulatory Services
Prince Edward Island Regulatory & Appeals Commission

# Background:

1. The Commission has been delegated broad powers to regulate the distribution and sale of petroleum products within the province of Prince Edward Island, pursuant to the *Petroleum Products Act*, ("Act").[1]

2. The Commission is granted the authority to determine:

    a. the price of heating fuel and motor fuel; and

    b. the minimum and maximum markup between the wholesale price to the retailer and the retail price to the consumer. [2]

3. The minimum and maximum markup is commonly referred to as the "margin". As required by the Act, the Commission determines both the wholesale margin and the retail margin for petroleum products.

4. In 2019, following an application from the Prince Edward Island Retail Gasoline Dealers Association, the Commission undertook a review of the appropriate retail margins for gasoline and diesel fuel. The Commission was not asked to consider any change to the wholesale margins, or to the retail margins for other petroleum products.

5. In December 2019, the Commission issued Order PC19-003 approving new retail margins for gasoline and diesel fuel effective January 1, 2020. In the Order, the Commission also stated that a complete review of the wholesale and retail margins for gasoline, diesel and furnace oil would be undertaken prior to December 31, 2021.

6. In June 2021, the Commission retained an independent expert, Kalibrate Canada, Inc. (formerly Kent Group Ltd.), to gather data, conduct analysis and make recommendations regarding the appropriate wholesale and retail margins for gasoline, diesel and furnace oil.

7. In November 2021, Kalibrate surveyed Prince Edward Island wholesalers and retailers requesting information relating to sales volumes, acquisition costs and operating costs. The deadline for responding to the survey was extended to January 2022 at the request of industry.

8. On July 20, 2022, Kalibrate submitted its report and recommendations to the Commission (the "Kalibrate Report"). Kalibrate recommends that:

    - the wholesale margins for gasoline and diesel be increased by 2.01 cents per liter;
    - the retail margins for gasoline and diesel be increased by 1.93 cents per liter; and
    - the furnace oil margin be increased by 1.63 cents per liter.

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[1] *Petroleum Products Act* RSPEI 1988, c P-5.1

[2] Ibid Sec. 27

9. The Kalibrate Report was shared with industry and made publicly available on the Commission website. Notice of the Report, including the recommended changes to the margins, was also published in local newspapers. Members of the public and industry were given the opportunity to make written submissions to the Commission. In total, the Commission received nine written submissions from industry and members of the public.

# Kalibrate Report:

10. Kalibrate was engaged as an independent expert to assist the Commission in determining the appropriate wholesale and retail margins for gasoline, diesel and furnace oil. Kalibrate worked directly with wholesalers and retailers to gather the relevant data needed to make informed recommendations regarding the appropriate margins.

11. Kalibrate considered two main factors in their analysis of the wholesale and retail margins: operating costs and acquisition costs. Kalibrate defines operating costs as the costs associated with wholesaling or retailing petroleum products. Any changes to the operating costs since the last margin review may impact a market participant's ability to maintain or generate a return.

12. The acquisition cost looks at the relationship between the acquisition cost of fuel and the benchmark price used in the Commission's pricing formula. Kalibrate explained that the price paid by a wholesaler or retailer is usually an agreed price differential (premium or discount) from the benchmark price. Any change in the price differential may affect the total available margin.

13. Kalibrate's analysis focused on changes in the operating and acquisition costs since the applicable margin was last reviewed. The retail margin for motor fuels was last reviewed in 2019, the wholesale margin for motor fuels was last reviewed in 2012, and the margin for furnace oil was last reviewed in 2017.

## Wholesale Margins for Gasoline & Diesel

14. The wholesale margins for gasoline and diesel was set at 5 cents per liter in 2012. Although no application was received to increase the wholesale margin, the Commission determined that it should be reviewed. As a result, wholesalers were asked to provide sales volumes, acquisition costs and operating costs for each year from 2011 through to 2021.

15. Three major wholesalers provided data to Kalibrate. The participants "*included a broadly representative mix of wholesale market participants*"[3] who accounted for greater than 90 percent of wholesale transactions in the Province. In Kalibrate's view, this represented a strong representative sample. As not all participants provided the requested data for all years, Kalibrate used data for the years 2013 to 2020.

16. Based on the data submitted by wholesalers, Kalibrate determined that the total operating costs for gasoline and diesel wholesalers increased, on average, 2.01 cents per liter

[3] Kalibrate Report page 19

between 2013 and 2020. Kalibrate recommends an equivalent increase in the wholesale margins for gasoline and diesel fuel.[4]

17. Kalibrate asked wholesalers to also provide their acquisition costs for gasoline and diesel from 2011 through to 2021. The acquisition cost would consider the contracted discounts or premiums relative to the Charlottetown rack price, being the benchmark price used in the Commission's pricing formula.

18. Only one wholesaler provided acquisition costs for all products for the entire period of evaluation. Kalibrate determined that this did not represent the majority of market conditions and would bias the overall results. As a result, Kalibrate was unable to value any change in the acquisition cost for wholesalers, and did not recommend any change to the wholesale margin due to the cost of acquisition.

19. Although "*not ideal*", Kalibrate recommends that the change in operating costs be considered and the change in acquisition costs be omitted due to a lack of representative data. Kalibrate therefore recommends that the wholesale margin for gasoline and diesel be increased by 2.01 cents per liter due to increased operating costs between 2013 and 2020. [5]

## Retail Margins For Gasoline & Diesel

20. The retail margins for gasoline and diesel were last reviewed in 2019, based on data up to and including 2018. The current minimum and maximum retail margins (6 cents per liter to 7 cents per liter for self serve, and 6 cents per liter to 10.5 cents per liter for full serve) came into effect on January 1, 2020.[6]

21. As part of Kalibrate's review, retailers were asked to provide sales volumes, acquisition costs and operating costs from 2018 through to 2021. In total, there are approximately 82 retail gas stations in Prince Edward Island.

22. Only six retailers, representing 39 retail gas stations, submitted data to Kalibrate. On a volumetric basis, this translates to just over 50 percent of the total retail consumption of gasoline in the Province. Kalibrate concluded that was an acceptable representative sample as it includes a "*reasonable majority*" of retail motor fuel transactions in Prince Edward Island.[7]

23. Based on the data submitted by retailers, Kalibrate concluded that the total operating costs for gasoline and diesel retailers increased by 1.93 cents per liter between 2018 and 2021. Kalibrate recommends an equivalent increase in the retail margins for gasoline and diesel fuel.[8]

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[4] Ibid page 23
[5] Ibid page 24
[6] Order PC19-003
[7] ibid page 25
[8] Ibid page 28

24. Although 39 retail gas stations provided information regarding their operating costs, only 14 retail gas stations provided data regarding their acquisition costs over the entire evaluation period. On a volumetric basis, this represents less than one-sixth of the total gasoline consumption in Prince Edward Island.

25. Kalibrate determined that the acquisition costs for the 14 retail gas stations did not accurately reflect the broader market. Due to the "*magnitude of missing information from other retailers*",[9] Kalibrate was not able to recommend any change to the retail margin arising from changes in acquisition costs.

26. Kalibrate recommends that the change in operating costs be considered, and the change in acquisition costs be omitted due to a lack of representative data. Kalibrate therefore recommends that the retail margins for gasoline and diesel fuel be increased by 1.93 cents per liter due to increased operating costs between 2018 and 2021.[10]

## Combined Margin for Furnace Oil

27. The margin for furnace oil is set differently than motor fuels. Instead of separate wholesale and retail margins, a combined maximum margin is set for furnace oil. Currently, the combined wholesale and retail margin for furnace oil is 21 cents per liter.

28. The furnace oil margin was last reviewed in 2017, based on 2016 data. As part of Kalibrate's review, wholesalers/retailers of furnace oil were asked to provide sales volumes, acquisition costs and operating costs from 2016 through to 2021.

29. In total, four furnace oil wholesalers/retailers submitted data to Kalibrate. Kalibrate estimates that this represents over two-thirds of the total furnace oil consumption in the Province. Submissions included all the requested cost data for 2016 through to 2020; however, the cost data for 2021 was incomplete. As a result, Kalibrate's analysis was based on the change in costs between 2016 and 2020.[11]

30. Based on the data submitted by furnace oil wholesalers/retailers, Kalibrate calculated the change in operating costs between 2016 and 2020 to be 0.72 cents per liter.[12]

31. Although only three participants provided data relating to the acquisition cost of furnace oil between 2016 and 2020, this represented approximately two-thirds of the Province's furnace oil consumption. Kalibrate determined that this was an accurate reflection of the furnace oil market in the Province, and that the change in acquisition cost could be considered in analyzing the furnace oil margin. Kalibrate calculated the change in acquisition cost for furnace oil to be 0.91 cents per liter between 2016 and 2020.[13]

32. Kalibrate recommends that both the change in operating costs and acquisition costs be considered when setting the combined margin for furnace oil. Kalibrate therefore

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[9] ibid page 29
[10] ibid page 30
[11] ibid page 31
[12] Ibid page 33
[13] Ibid page 35

recommends that the furnace oil combined margin be increased by 1.63 cents per liter, representing a 0.72 cent per liter increase in operating costs, and a 0.91 cent per liter increase in acquisition costs between 2016 and 2020.[14]

## Submissions from Industry & Members of the Public

33. The Commission received a total of nine written submissions regarding the Kalibrate Report and the recommended changes to the margins. All written submissions are publicly available on the Commission website.

34. The Commission received only one comment from a member of the public, who was opposed to any increase in the margins. The remaining eight submissions were made on behalf of motor fuel retailers, including submissions from the PEI Retail Gasoline Dealers Association, the Convenience Industry Council of Canada and the Canadian Energy Marketers Association.

35. Although the retailers generally support the proposed increase in the retail margins for gasoline and diesel, several retailers do not consider the increase to be sufficient to cover increased operating costs incurred in 2022.

36. According to the submissions, retailers have seen significant increases in operating costs in 2022, related primarily to staffing costs and increasing credit card fees associated with rising fuel costs. Three retailers submitted that although the margin increase will help, it will not completely offset the increased costs experienced in 2022.

37. Several written submissions, including those from the PEI Retail Gasoline Dealers Association, the Convenience Industry Council of Canada and the Canadian Energy Marketers Association, specifically asked that any retail margin increase apply to both the minimum and maximum margins.

38. The most comprehensive submission was jointly made on behalf of the Convenience Industry Council of Canada and the Canadian Energy Marketers Association. Notably, the organizations are of the opinion that:

    - Kalibrate has the industry knowledge and technical expertise to undertake the margin review;
    - The methodology used by Kalibrate (volume-adjusted change in operating costs) is fair and reasonable;
    - Kalibrate's finding that the volume-adjusted change in operating costs was 1.93 cents per liter between 2018 and 2021 "*generally reflects the operating experiences*" of some leading PEI motor fuel retailers; and

[14] Ibid page 36

- The recommended 1.93 cents per liter increase in the retail motor fuel margin for the period 2018 to 2021 is fair and reasonable.

## Decision:

## Wholesale Margins for Gasoline & Diesel

39. The review of the wholesale margins for gasoline and diesel fuel was undertaken on the Commission's own initiative. The Commission did not receive a request from wholesalers to vary the margins, and did not receive any submissions from wholesalers regarding the increase proposed by Kalibrate.

40. Subsequent to the receipt of the Kalibrate Report, the Commission had the opportunity to review a July 2022 report prepared by Gardner Pinfold Consultants Inc. for Service Nova Scotia and Internal Services. The report, entitled "*Assessment of Petroleum Product Benchmark Options to Support Price Regulation in the Atlantic Provinces*" (the "Benchmark Assessment Report"), is instructive and addresses a number of issues dealing with the benchmark price of petroleum products in the Atlantic Provinces, including the setting of wholesale margins.

41. In the Benchmark Assessment Report, Gardner Pinfold discuss the widening gap between the New York Harbour Mercantile Exchange price and regional rack prices since 2018. As the Commission tracks the New York Harbour Mercantile Exchange price on a daily basis, it is well aware of this widening gap.

42. Gardner Pinfold also discusses two additional concerns with regional rack prices: (a) regional rack prices do not reflect a highly liquid market that is not subject to manipulation; and (b) the actual prices are not published.

43. The Commission has determined that further investigation and analysis is required before making a determination on any change to the wholesale margin for gasoline or diesel fuel.

44. The Commission has engaged an independent consultant to conduct further analysis regarding the appropriate benchmark price for petroleum products in Prince Edward Island. As any change in the benchmark price may reasonably affect the appropriate wholesale margin, the Commission will defer making any change to the wholesale margins for gasoline and diesel fuel until the benchmark review is completed. In the interim, the current wholesale margin of 5.0 cents per litre shall remain in effect.

## Retail Margins For Gasoline & Diesel

45. The retail margins for gasoline and diesel were last reviewed by the Commission in 2019, based on data up to and including 2018. Kalibrate is recommending an increase of 1.93 cents per litre, based on increased operating costs since 2019. This represents an increase of approximately 30 percent over the current retail margin.

46. The Commission does not have an adequate explanation as to what operating costs increased, why those costs increased significantly over a three year period, or the process used by Kalibrate to confirm the reliability and consistency of the data.

47. Further, although Kalibrate discussed the impact of the COVID-19 pandemic on sales volume, there was no analysis regarding the possible impact of the pandemic on operating costs.

48. What, if any, impact the pandemic has had on operating costs is relevant to determining the appropriate retail margin. In New Brunswick, for example, as part of its retail margin review, Gardner Pinfold Consultants Inc. noted that 2020 wages and benefits increased over 2019 due, in part, to increased staff hours needed to meet safety requirements during the pandemic.[15] Gardner Pinfold also noted that it was possible that these costs may have been partially offset by government programs implemented to support businesses during the pandemic.[16]

49. The Commission is also concerned about the sample size used by Kalibrate, as only 39 of 82 retailers provided the requested data for the evaluation period. Without more information, including the geographic location of these retailers, the Commission is not satisfied that this is a representative sample of motor fuel retailers in Prince Edward Island.

50. The Commission has determined that further investigation and analysis is required prior to approving new retail margins for gasoline and diesel. In the interim, and pending a fulsome review, the Commission has determined that the minimum and maximum retail margins for gasoline and diesel shall increase by 1.0 cent per litre.

## Combined Margin for Furnace Oil

51. Currently, the Commission pricing formula for furnace oil includes a combined wholesale and retail margin of 21 cents per litre. As part of its review of the appropriate benchmark price of petroleum products, the Commission has engaged an independent consultant to provide recommendations on the appropriate margins for both retail and wholesale if the margins were to be separated.

52. In the interim, the Commission is prepared to increase the combined margin for furnace oil by 0.5 cents per litre. This interim increase of 0.5 cents per litre shall also apply to the margin for retail commercial diesel fuel.

53. In conclusion, the Commission approves the following retail margins for gasoline and diesel, and the following combined margins for furnace oil and commercial diesel fuel on an interim basis:

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[15] See report entitled *"Section 14 Petroleum Margin Review: Retail Motor Fuel and Heating Fuel"* prepared by Gardner Pinfold Consultants Inc. dated April 2022; New Brunswick Energy & Utilities Board Matter #0523.
[16] Ibid page 6, 10

| | Regular Gasoline | | Mid-Grade Gasoline | | Premium Gasoline | | Diesel | |
|---|---|---|---|---|---|---|---|---|
| | Min- | Max- | Min- | Max- | Min- | Max- | Min- | Max- |
| Self-Service Retail Margin | 7 | 8 | 7 | 8 | 7 | 8 | 7 | 8 |
| Full-Serve Retail Margin | 7 | 10.5 | 7 | 10.5 | 7 | 10.5 | 7 | 10.5 |

| | Furnace Oil Max | Commercial Diesel Max |
|---|---|---|
| Margin | 21.5 | 17.8 |

## Interim Order:

The Commission Orders as follows on an interim basis:

1. The wholesale margins for gasoline and diesel fuel shall remain unchanged at 5.0 cents per litre.

2. The minimum and maximum retail margins for gasoline and diesel fuel shall each increase by 1.0 cent per litre to minimum 7.0 cents per litre and maximum 8.0 cents per litre.

3. The combined furnace oil margin shall increase by 0.5 cents per litre to a maximum of 21.5 cents per litre.

4. The combined retail commercial diesel fuel margin shall increase by 0.5 cents per litre to a maximum of 17.8 cents per litre.

5. The interim margins approved herein shall be effective 12:01 a.m. on Friday, September 2, 2022, and shall remain in effect until otherwise varied by the Commission.

**DATED** at Charlottetown, Prince Edward Island, this 31st day of August, 2022.

**BY THE COMMISSION:**

*(sgd) J. Scott MacKenzie*

J. Scott MacKenzie, Q.C., Chair

*(sgd) M. Douglas Clow*

M. Douglas Clow, Vice-Chair

*(sgd) Erin T. Mitchell*

Erin T. Mitchell, Commissioner