DECISION

IN THE MATTER OF a review of the maximum margins, maximum delivery costs and maximum full service charge conducted under the authority of Section 14(1) of the Petroleum Products Pricing Act (S.N.B., Chapter P-8.05)

June 28, 2011

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

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NEW BRUNSWICK ENERGY AND UTILITIES BOARD("BOARD"):

CHAIRMAN:	Raymond Gorman, Q.C.
MEMBERS:	Pat Darrah Connie Morrison Terry Totten
BOARD SECRETARY:	Lorraine Légère
COUNSEL:	Ellen Desmond

REGISTERED PARTICIPANTS:

Atlantic Convenience Stores Association	Brian Barnett
Accommodation Victoria Détaillant Irving	Benoit Bossé
Bathurst Mainstop Inc.	Stephen Ashe
Canadian Oil Heat Association, And Canadian Oil Heat Association/Clark Oil	William Gould
Clark Oil	Peter Clark
Cooke's Quick Mart	Jeff Cooke
Co-op Atlantic	Peter T. Zed, QC
Épicerie St. Charles Ltée	Roger Richard
Evans 2000	Heather Bird
Fundy Energy Ltd.	Jim Gould
Gateway Petroleum Global Fuels Inc. / Les Pétroles Global Inc.	Jamie Fox Guy Gaudet
Hunter's One Stop	Eldon Hunter

Irving Oil Marketing Limited	Len Hoyt, QC
La Station du Carrefour	Gilles Thibodeau
Magnetic Hill Esso	Jason Lutes
Murray’s Irving	Calvin Grant
Nashwaak Convenience	Lillian Canning
New Brunswick Department of Energy	Patrick Ervin
New Brunswick Korean Convenience Stores Association	Nick Pitre
Norton One Stop	Steven Frits
Notre-Dame Express (Esso)	Jim McDowell
Point Park Petro-Canada	Brian LeBlanc
Salisbury Gas and Convenience	Ted Nicholson
Scholten’s Group (Scholten’s Oromocto Ltd., 031019 NB Ltd.,Scholten’s City Limits)	James Scholten
Sunbury Drive Grocery Ltd.	Darren Brooks
Taylopr Petroleum	Ivan Douglas
Ultramar Ltd.	Warren Maynard
Village Convenience	Dale Dyker
Westmount Esso	Ronald Roy
XTR Energy Company Ltd.	Dave Duboit
Public Intervenor	Yassin Choukri, Q.C.

Introduction

This is a decision of the New Brunswick Energy & Utilities Board (Board) following a review of the maximum margins, maximum delivery costs and maximum full service charge with respect to motor fuels and heating fuels sold in New Brunswick. This review was conducted pursuant to Section 14(1) of the *Petroleum Products Pricing Act* (PPPA) which allows the Board, on its own motion, to conduct such a review to ensure that the margins, costs and charge are justified. Once a review is complete, the Board may order that the margins, costs or charge be adjusted.

The initial maximum margins, delivery costs and full service charge were set by the Minister of Energy on July 1, 2006. The Board conducted its first review under Section 14(1) in 2008 and, at that time, approved a half-cent adjustment to the maximum delivery charge for motor fuels. No other adjustments were made pursuant to the 2008 review.

The Board issued a public notice advising that it would be conducting its second review under Section 14(1) of the PPPA, with the intent to hold a public hearing on the matter. To assist with the review process the Board issued a Request for Proposals and subsequently engaged the services of an independent expert, Gardner Pinfold Consulting Economists Ltd. (Gardner Pinfold), of Halifax. Gardner Pinfold was directed to meet with industry stakeholders, conduct an analysis of the petroleum market and file a report (the Gardner Pinfold report) on the issues under review.

Gardner Pinfold's mandate also included gathering relevant financial information on the New Brunswick petroleum industry through questionnaires to petroleum retailers and wholesalers, as well as conducting interviews with wholesalers and heating fuel retailers. The questionnaires requested annual expense data for the years 2005 through 2009. The Board determined that retailer and wholesaler data filed with Gardner Pinfold, for the purposes of the review, would be deemed confidential.

As part of the review, the Board invited all petroleum wholesalers and retailers to attend an information session on the review process. This information session took place in

Fredericton on the evening of September 28, 2010. At that time Board staff and Mr. Michael Gardner, president of Gardner Pinfold, were available to answer questions and provide direction on the process that would be taking place. Participants were encouraged to cooperate with the independent consultant. They were also informed of their right to file evidence as part of the proceeding and to question the evidence filed by others.

A public hearing on the matter was scheduled for January 2011. At the request of several parties it was rescheduled to April 2011 so as to allow full and complete participation from petroleum retailers, industry stakeholders and the general public. The hearing was held in Fredericton from April 4 through April 6, 2011.

<u>Participants</u>

Thirty-one businesses and organizations registered as participants for this proceeding. In addition, the Attorney-General appointed a Public Intervenor to participate in this review pursuant to Section 49(3) of the *Energy and Utilities Board Act*.

Four of the participants filed evidence, namely:

- The Atlantic Convenience Store Association
- Co-op Atlantic
- The Scholten Group, and
- The Public Intervenor.

Several participants cross-examined witnesses and provided oral submissions at the conclusion of the proceeding. In addition, the Board received written submissions from Gateway Petroleum and the Canadian Oil Heat Association.

The evidence and submissions offered by the participants provided a wide range of views and opinions. Those intervenors operating businesses in the petroleum market sought an increase in the margins, both for motor fuels and heating fuels.

The Public Intervenor filed the report of MJ Ervin & Associates of Calgary (the Ervin report) and relied on the expert testimony of Mr. Michael Ervin. This report provided an analysis and critique of the Gardner Pinfold report, but did not offer any alternative recommendations.

The Gardner Pinfold Report

Gardner Pinfold filed its report in bilingual format with the Board on December 9, 2010. The report was amended on December 14, 2010, to reconcile minor differences between the English and French versions. Gardner Pinfold filed a further, revised report on February 21, 2011, which incorporated additional data received from retailers. In summary, the recommendations arising from the report of Gardner Pinfold were as follows:

	Wholesale		**Retail**	
	Motor Fuel	Heating Fuel	Motor Fuel	Heating Fuel
Maximum Margins	0	0	0.82	0
Delivery Costs	0	n/a	n/a	0
Full Service Charge	n/a	n/a	0.5	n/a

It should be noted that Mr. Gardner modified his opinion in his testimony at the hearing. When asked by the Chairman for his final recommendation as it relates to retail motor fuel margins, Mr. Gardner stated, at page 243 of the transcript:

> *"The ultimate recommendation would be a figure...in the range of .8 to .9 cents per litre."*

Issues

The issues before the Board in this matter involve a determination of whether an adjustment would be justified with respect to:

Motor Fuels

a. maximum wholesale & retail margins
b. maximum delivery cost
c. maximum full service charge

Heating Fuels (Heating Oil & Propane)

a. maximum wholesale & retail margins
b. maximum delivery cost.

Legislation

The following sections of the PPPA are relevant to this review process:

Maximum prices and margins

3*(1) The Board has authority*

(a) to set, and shall set the maximum wholesale and retail prices that a wholesaler and a retailer may charge for petroleum products, and

(b) to set, and shall set the maximum margin between the wholesale price to the retailer and the retail price to the consumer of petroleum products.

Components of the maximum price

4*(1) For each type of heating fuel and motor fuel, the maximum wholesale price shall be the sum of*

(a) the benchmark price, as established or adjusted pursuant to sections 10 and 11,

(b) the maximum wholesale margin, and

(c) applicable taxation.

***4**(2) For each type of heating fuel and motor fuel, the maximum retail price shall be the sum of*

(a) the benchmark price, as established or adjusted pursuant to sections 10 and 11,

(b) the total allowed margin, which is comprised of the maximum margin for a wholesaler and the maximum margin for a retailer, and

(c) applicable taxation.

Review by Board

***14**(1) The Board may, on its own motion, conduct a review of maximum margins, maximum delivery costs or the maximum full service charge to ensure that they are justified, and may order such margins, costs or charge to be adjusted after the review is completed.*

Considerations by Board

***1.1** The Board shall, when making a decision under this Act respecting prices, margins, delivery costs or full service charges, consider the fact that consumers should benefit from the lowest price possible without jeopardizing the continuity of supply of petroleum products.*

In addition the following sections of NB Regulation 2006-41 (the General Regulation), pursuant to the PPPA, are relevant:

Application for adjustment of maximum margins

***9**(1) Where an application has been made to the Board under section 12 of the Act for a change in the maximum margin that may be charged by a wholesaler or retailer, the Board shall consider the following:*

> *(a) whether, since the maximum margin was last set, an adjustment would be justified as a result of a change to*

(i) the costs of transporting heating fuel or motor fuel from New York Harbor or, in the case of propane, from Sarnia to the province,

(ii) volume of sales,

(iii) storage costs,

(iv) inventory turnover rates, and

(v) applicable levies and insurance costs; and

(b) any other factors that the Board considers relevant.

Adjustment of maximum delivery costs

11 *Where an application has been made to the Board to adjust the maximum delivery costs that may be charged by a wholesaler or retailer under section 13 of the Act, the Board shall consider*

(a) fuel costs,

(b) insurance costs,

(c) capital costs,

(d) volume of sales,

(e) in the case of an application for delivery costs that are particular to the applicant, the cost effectiveness of the applicant's operation, and

(f) any other factors that the Board considers relevant.

Review by Board

12 *Where the Board conducts a review under section 14 of the Act, the Board shall consider the same factors that apply under Section 9, in the case of a review of maximum margins, and under section 11, in the case of a review of maximum delivery costs.*

This decision will deal first with the margins, costs and charge that are appropriate for motor fuels. Heating fuels will be considered later in this decision.

A. <u>Motor Fuels</u>

1. Maximum Margins

When addressing whether the wholesale or retail margins are appropriate, the Board must consider the factors specifically enumerated in Section 9(1)(a) of the General Regulation. These factors include the cost of transporting fuel from New York Harbour (or Sarnia) to New Brunswick, volume of sales, storage costs, inventory turnover rates and applicable levies and insurance costs.

With respect to these specific factors, evidence was provided only on the cost of transportation. In its report Gardner Pinfold states, at page 24:

> *"The spread between NYH spot price and the Saint John rack price is often taken as a proxy for the transportation cost..."*

The Gardner Pinfold report notes that, while the price spread between the New York Harbour price and the Saint John rack price has widened by 0.3 cents per litre since regulation was introduced, a case to adjust the motor fuel margins was not made. The report states, at page 25:

> *"…the data do not provide a case to adjust motor fuel margins. The increase in the price spread between the NYH spot and the Saint John rack does not necessarily indicate a reduction in the overall marketing margin."*

No other evidence was provided on the factors specifically enumerated under section 9(1)(a).

Section 9(1)(b) of the General Regulation provides that the Board should also consider "any other factors that it considers relevant". In a decision dated December 19, 2008 the Board examined what "other factors" should be considered relevant with respect to making adjustments to the maximum margins and held, as follows (at pages 5 and 6):

> *"These 'other factors' relate to the cost structure of the industry and include matters such as: capital costs, maintenance costs, staffing levels, and the sharing of costs between the petroleum business and other businesses that are operated on the same location…In order to justify any changes to the maximum margins, the Board must be satisfied that the cost of*

> *operation has significantly changed in the period since the introduction of regulation."*

In the current review, intervenors did provide evidence relating to their cost structure. Gardner Pinfold received a number of responses to its questionnaires and had the opportunity to analyze the industry data. This data has allowed the Board to carefully consider the impact of certain costs. While the number of responses provided by industry may not have constituted a "statistically significant" sample size, any relevant evidence before the Board can be critically evaluated and given the appropriate weight.

In this case the evidence provided by intervenors and Gardner Pinfold, as it relates to the retail margin, was probing and convincing.

(a) <u>Maximum Wholesale Margin</u>

With respect to the maximum wholesale margin, very little evidence was provided. As indicated above, Gardner Pinfold examined the cost of transportation but did not recommend any adjustment to the maximum wholesale margin. None of the other parties to the proceeding filed evidence related to this issue.

The Board finds that the current maximum wholesale margin of 6.0 cents per litre is justified and therefore no adjustment is necessary.

(b) <u>Maximum Retail Margin</u>

The evidence filed by intervenors addressed two primary factors that affected the cost of their retail operations, namely (i) changes to wages and benefits and (ii) changes in credit card expenses. Similarly, Mr. Gardner testified that these two factors have impacted the existing retail margins.

The Board finds these factors to be relevant for the purpose of this review and will deal with each factor separately in this decision.

(i) Wages and Benefits

With respect to the issue of wages and benefits, Mr. Gardner testified that, over the period under review (2005-2009), wage and benefit costs for retail motor fuel dealers had increased by up to 25 percent. These cost increases were driven, in large part, by legislated increases in the provincial minimum wage. Using the Statistics Canada profile of retail gasoline outlets for New Brunswick, Mr. Gardner determined that wages and benefits represented more than half of the total operating expenses for this business segment and had impacted the retail gasoline margin. In the February 21 revised report, that impact was calculated to be approximately 0.65 cents per litre.

Mr. Ervin, testifying on behalf of the Public Intervenor, critiqued Gardner Pinfold's recommendations. Mr. Ervin noted there was substantial variability in the wage data examined by Gardner Pinfold, with some dealers experiencing wage increases in excess of 100% during the period examined, indicating that wage increases were not strictly related to petroleum sales. Additionally, it was noted that no adjustments had been made to account for increased petroleum throughputs at retail motor fuel outlets.

Co-op Atlantic also provided evidence on the issue of wages and benefits and this evidence addressed, in part, the concerns of the Public Intervenor. Co-op Atlantic included volumetric and expense data from twelve of the company's retail motor fuel sites. The sites selected were identified by Co-op Atlantic as being representative of "gasoline-only" operations, that is, sites with a limited number of non-petroleum goods and services available for sale. On the issue of wages and benefits Co-op Atlantic's pre-filed evidence, based on its experience since July 1, 2006, supported an increase to the retail margin for motor fuels of 0.68 cents per litre.

The Board accepts that wages and benefits have increased since July 2006. The Board also accepts that wages and benefits have a significant impact on the retail margin and, accordingly, this is a factor that should be consider in determining whether or not an adjustment to the maximum margin is justified.

(ii) Credit card expenses

Credit card use impacts the retail margin in three ways: the credit card fee, the price of the fuel and the proportion of transactions paid for with a credit card. The impact that credit card fees have on the profitability of retail petroleum dealers was a matter of significant concern in this proceeding, particularly with respect to the proportion of transactions paid for with a credit card.

Gardner Pinfold examined the changes in the fees that motor fuel retailers paid to credit card providers on an annual basis. The revised report concluded that the total cost had increased by an average of 31 percent, having an effect on the total operating cost of 3%. While Mr. Gardner referred to, and relied on, the results provided by Statistics Canada, he also testified that these results were likely understated.

In his testimony Mr. Ervin expressed concern about the data used in the Gardner Pinfold report, noting that there was a high degree of variability in the data over the years and across sample sizes. As with wages and benefits, Mr. Ervin pointed out that the data used by Gardner Pinfold did not distinguish between credit card costs for petroleum transactions and those for non-petroleum transactions.

While the Ervin report challenges the methodology used by Mr. Gardner, the report also states, at page 6:

> *"We don't question that credit card fees (as well as other card fees) are a major concern to the retail petroleum industry and should be examined under any review of operation costs in the context of maximum allowable margins".*

The evidence of Co-op Atlantic is helpful in this regard, relying on data arising from its "gasoline-only" sites. Co-op Atlantic argued that, based on their experience, increases in credit card expenses had affected their costs and reduced their margins. In their view, an increase to the maximum retail margin of at least 0.15 cents per litre was justified.

Similarly, other intervenors provided anecdotal evidence that increased use of credit cards has impacted on their costs and retail margin.

The Board accepts that there has been an increase in credit card expenses since the adoption of petroleum regulation. This is a factor that should be considered in determining whether or not an adjustment to the maximum margin is justified.

Continuity of Supply

While the Board is convinced that there have been changes in the cost structure to the retail motor fuel industry, any change must be considered in light of Section 1.1 of the PPPA. The Board must balance the interests of industry with those of the consumer. As indicated in Section 1.1, consumers should benefit from the "lowest possible price without jeopardizing the continuity of supply of petroleum products".

The issue of "supply" was addressed in detail by the Atlantic Convenience Store Association (the ACSA). In its evidence, the ACSA provided a list of motor fuel retail sites (many of which were located in rural areas) which had closed in New Brunswick since 2005. A number of reasons were suggested for these site closures, including the fact that renewing infrastructure was too costly.

The ACSA argued that the rate of closure for motor fuel retail sites in New Brunswick was higher than in the other regulated jurisdictions of Nova Scotia and Prince Edward Island and that the high rate of site closures is jeopardizing the continuity of supply of petroleum products, particularly in rural areas.

While the number of retail sites has declined over the past several years, this does not necessarily suggest that the "continuity of supply" is jeopardized. Gasoline retailers will continue to enter and exit the petroleum business for a variety of reasons. The structure of the industry will also change over time. The changing nature of the marketplace does not, in and of itself, jeopardize the "continuity of supply".

As part of its evidence, the ACSA provided a report that examined the Economics of the Nova Scotia Gasoline Market. At page 52, the authors of this report state, as follows:

> *"Volumes in many rural communities are inadequate to support all the stations competing for the business. Some will go out of business. In most areas, this means consumers will have fewer choices, not that they will have no choice. The areas most likely to lose stations are communities over-supplied with service stations, not more isolated areas."*

Low volume petroleum retailers are likely to find the industry more challenging in a fixed margin environment. However, at the same time, many dealers do not take advantage of the full margin available under regulation, citing the need to stay price competitive with other retailers. With gasoline and motive fuel volumes remaining stable since the introduction of regulation, the Board is not convinced that "supply" is jeopardized in the current environment.

The Board has carefully considered and weighed all of the evidence that has been provided on the issue of retail motor fuel margins. The Board does recognize the changing nature of the cost structure and the impact these costs have had on the retail market. Balancing those factors listed in Section 1.1, the Board finds that an increase of 0.9 cents per litre is justified and adjusts the maximum retail margin from 5.0 cents per litre to 5.9 cents per litre.

2. Maximum Delivery Costs

The PPPA allows wholesalers to recover the cost of delivering motor fuel within New Brunswick from a site used by the wholesaler to an outlet used by a retailer. This cost is separate from the maximum price of motor fuel and does not form part of the wholesale or retail margins. Only the maximum delivery cost is regulated under the PPPA.

When addressing whether the delivery costs are appropriate, the Board must consider the factors specifically enumerated in Section 11 of the General Regulation. These include fuel costs, insurance costs, capital costs, volume of sales, the cost effectiveness of an individual operation (if appropriate) and any other factor the Board may consider relevant.

In its report, Gardner Pinfold examined freight charges for delivering motor fuel within New Brunswick and recommended that the current maximum delivery cost of 2.5 cents per litre was justified and need not be adjusted. No other party presented evidence or made argument for a change in the maximum delivery cost.

As indicated earlier this cost was, in fact, adjusted following the 2008 review. No evidence in this review suggested that a further adjustment was required. The Board finds that the maximum delivery cost of 2.5 cents per litre is justified.

3. Maximum Full Service Charge

The PPPA allows motor fuel retailers to charge a full service premium for dispensing fuel. In 2006 the Minister set this premium at 2.5 cents per litre.

In its analysis Gardner Pinfold determined that, owing to higher wage and benefit costs for motor fuel retailers, the current full service charge was not justified. Based on the increase in wage and benefit costs, Gardner Pinfold recommended a 0.5 cent per litre adjustment, raising the maximum full service charge to 3.0 cents per litre.

No other evidence was presented on this issue although several witnesses questioned the efficacy of setting a cap for full service, as few stations provided full service. Co-op Atlantic and the Public Intervenor both addressed the issue in final argument, recommending that the Board advise government to lift the price cap for those stations that provide full service.

In light of the evidence filed in this matter, the Board adopts the recommendation of Gardner Pinfold and finds that an increase of 0.5 cents per litre is justified and adjusts the maximum full service charge from 2.5 cents per litre to 3.0 cents per litre.

B. <u>Heating Fuels</u>

Furnace oil and propane are regulated as heating fuels under the PPPA. As with motor fuels the Board only sets maximum prices for these products. The New Brunswick heating fuel market is, however, much smaller than the motor fuel market in terms of volumes of product sold and in the number of companies involved. For example there are fewer than forty retailers marketing furnace oil and propane for home heating in New Brunswick, whereas there are more than 400 retailers marketing motor fuels to New Brunswick consumers. Nonetheless, the legislative standards for reviewing the maximum margins and delivery costs for heating fuels are the same as those for reviewing motor fuels.

Gardner Pinfold sent questionnaires to the 35 furnace oil retailers operating in New Brunswick and conducted interviews with the two primary propane marketers in the province. Based on the limited number of questionnaire responses from heating oil dealers Gardner Pinfold had insufficient data to make any recommendations regarding the wholesale margin, retail margin or maximum delivery cost for heating oil. Accordingly no adjustments were recommended.

Similarly, in the case of propane, Gardner Pinfold received no operating cost data from industry and, accordingly, found no basis for adjusting wholesale or retail margins.

Although no other party filed evidence regarding heating fuels, the Canadian Oil Heat Association did file a submission with the Board regarding the state of the furnace oil marketplace since the adoption of price regulation in 2006. The submission asserted that the wholesale and retail margins set in 2006 were inadequate and recommended the deregulation of prices for furnace oil.

The Public Intervenor addressed heating fuels only in final argument stating, at page 517 of the transcript:

> *"...that there be a review by the Province of New Brunswick to address the concerns of these (home heating fuel and propane) sectors as regards the original settings...to see if there is any upward or downward adjustments that should be made."*

For purposes of this review under Section 14(1) of the PPPA the Board must operate within the existing legislative framework. As there was insufficient evidence filed on the issue of heating fuels, the Board makes no adjustment to the margins or delivery costs for heating fuels and propane.

Decision

After careful review of the evidence and consideration of the arguments from the participants the Board makes the following findings and orders:

1. Motor Fuels – Retail Margin

   The Board finds that an increase of 0.9 cents per litre to the current maximum retail margin for motor fuels is justified and orders that, effective June 30, 2011, the maximum retail margin for motor fuels shall be 5.9 cents per litre.

2. Motor Fuels – Maximum Full Service Charge

   The Board finds that an increase of 0.5 cents per litre to the current maximum full service charge is justified and orders that, effective June 30, 2011, the maximum full service charge shall be 3.0 cents per litre.

Finally, the Board heard several submissions from parties requesting that the review process be streamlined in the future. Intervenors submitted that a process should be developed that would allow for the collection and analysis of data while having a more efficient, less costly hearing. The Board will work with the New Brunswick petroleum industry in the coming months to explore a more streamlined process for conducting future reviews under Section 14(1). In any future review the Board would encourage all stakeholders to provide data to the Board, or its consultants. It is in the interest of all participants of the New Brunswick petroleum industry to present data which allows the Board to make an appropriate determination on changes in retail and wholesale costs.

Dated at the City of Saint John, New Brunswick this 28th day of June, 2011.

Raymond Gorman, Q.C., Chairman

Pat Darrah, Member

Constance Morrison
Constance Morrison, Member

Terry Totten, Member