DECISION

IN THE MATTER OF a review of maximum retail margins, delivery costs and full service charge for gasoline and other petroleum products conducted under the authority of subsection 14(1) of the *Petroleum Products Pricing Act*, S.N.B. 2006, c. P-8.05

(Matter No. 338)

May 5, 2017

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

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NEW BRUNSWICK ENERGY AND UTILITIES BOARD:

Chairperson:	Raymond Gorman, Q.C.
Vice-Chairperson:	François Beaulieu
Members:	Michael Costello
	Patrick Ervin
	John Patrick Herron
Counsel:	Ellen Desmond, Q.C.
Chief Clerk:	Kathleen Mitchell

INTERVENERS:

Atlantic Convenience Stores Association:	David Knight
Canadian Oil Heat Association:	William Gould
	Peter Clark
Irving Oil Marketing G.P.:	Len Hoyt, Q.C.
Scholten Group:	Jerry Scholten
	Chris Scholten
Public Intervener:	Heather Black

A. Introduction

[1] The New Brunswick Energy and Utilities Board (Board) has conducted a review of maximum retail margins, maximum delivery costs and the maximum full service charge for motor and heating fuels (petroleum products). This review was conducted pursuant to subsection 14(1) of the *Petroleum Products Pricing Act*, S.N.B. 2006, c. P-8.05 (Act).

[2] In accordance with the *General Regulation – Petroleum Products Pricing Act*, New Brunswick Regulation 2006-41 (Regulation), the Board must consider whether adjustments to each of the maximum retail margins, maximum delivery costs and the maximum full service charge are justified as a result of changes from the time when they were last set.

[3] The last retail margin review was conducted in 2013 resulting in the Board approving:

(a) An increase of 0.5 cent per litre to the retail margin for motor fuels resulting in a total maximum retail margin of 6.4 cents per litre; and

(b) An increase of 5.2 cents per litre to the retail margin for furnace oil, resulting in a total maximum retail margin for this petroleum product of 18.2 cents per litre.

[4] The Board engaged an independent consultant, Michael Gardner, President of Gardner Pinfold Consulting Economists Ltd. (Gardner Pinfold or Mr. Gardner), to prepare a report relating to the maximum retail margin, maximum delivery cost and the full-service charge under review, and to make recommendations as to whether any adjustments are required.

[5] As part of this review, meetings with motor fuel and heating fuel retailers were organized at various locations in New Brunswick. The meetings were held in order to introduce Mr. Gardner and to inform industry participants of the nature and scope of the review process and to encourage participation at the hearing. The objective of the meetings was to encourage industry to provide operating cost data through a survey and also to participate and file evidence as interveners.

[6] Following these meetings Mr. Gardner prepared, and circulated, a survey to petroleum product retailers. In his report dated October 2016 (Gardner Pinfold Report), response data was analyzed and compared against various market indicators. His findings and recommendations were based

mainly on the survey results. Various factors were used to derive recommendations for adjustments to the retail margins and delivery costs.

[7] Three of the interveners filed evidence in this matter: the Atlantic Convenience Stores Association (ACSA), the Scholten Group, and the Public Intervener.

B. Legislation

[8] Several provisions of the Act are relevant to this review process, including the following:

> **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.
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> **Components of the maximum price**
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> **4**(2) For each type of heating fuel and motor fuel, the maximum retail price shall be the sum of
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> (*a*) the benchmark price, as established or adjusted pursuant to sections 10 and 11,
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> (*b*) the total allowed margin, which is comprised of the maximum margin for a wholesaler and the maximum margin for a retailer, and
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> (*c*) applicable taxation.
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> **Maximum delivery costs**
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> **5**(1) The Board has authority to set, and shall set the maximum delivery costs that may be charged by a wholesaler to a retailer for the delivery of a type motor fuel or by a retailer to a consumer for the delivery of a type of heating fuel,
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> (*a*) within the province, other than the parish of Grand Manan, and
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> (*b*) in the parish of Grand Manan.

Maximum full service charge

5.1(1) The Board has authority to set, and shall set, the maximum full service charge that may be charged by a retailer for motor fuel sold on a full service basis to a consumer.

Prohibitions

9(4) A retailer shall not charge a consumer more for delivery costs for motor fuel than the least of the following:

(*a*) the amount the retailer was charged by the wholesaler;

(*b*) the actual costs incurred by the retailer for the delivery of the fuel where it is delivered by someone other than a wholesaler;

(*c*) the maximum amount for delivery costs that may be charged by a wholesaler to a retailer for the delivery of motor fuel set by the Minister or the Board, as the case may be.

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.

[9] The following provisions of the Regulation are also 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.

C. Issues

[10] This decision addresses whether adjustments are justified with respect to:

1. Maximum retail margin, delivery cost and full service charge for motor fuels (gasoline and diesel fuel), and

2. Maximum retail margin and delivery cost for heating fuel (furnace oil and propane).

[11] Some interveners presented concerns that relate to policy matters beyond the scope of this review and the Act. The Board cannot address issues beyond its legislated role.

D. Analysis

1. Motor Fuels (Gasoline and Diesel Fuel)

(a) Survey Sample

[12] The Gardner Pinfold survey was intended to collect operating cost data from licensed motor fuel retailers in New Brunswick. Mr. Gardner received 137 responses, of which 126 were sufficiently complete for inclusion in the analysis. These included 32 of the 332 independent retailers (9.6%) and 94 of the 106 corporate retailers (88.7%).

[13] The survey data analysis was based on total operating costs for both petroleum and non-petroleum operations. Mr. Gardner differentiated between those retailers who experienced a change in operating costs based on normal operations, and retailers whose operating costs increased as a result of a "change in format", such as an expansion of operations.

[14] Based on this, Mr. Gardner concluded that 21 corporate retailers and one independent retailer had a change in format, since the last review. He excluded these 22 retailers and based his recommendation on the data from the remaining 104 surveyed retailers, consisting of 31 independent and 73 corporate (104 retailer group).

[15] In its pre-filed evidence, ACSA concluded that the survey response was representative of the provincial *corporat*e retailer population identified as not having had a change in format. ACSA stated, however, that the *independent* retailer survey responses represented only 9.3% of that population and was not representative of independent retailers. It submitted that the independent retailer data be excluded from the assessment and that the Board rely only on the corporate data in making a finding.

[16] Mr. Robert Knecht prepared evidence on behalf of the Public Intervener. In an interrogatory response, he concluded that excluding responses from independent retailers would be less representative of the overall population to which the retail margin applies. He cautioned against excluding the independent retailer survey results.

[17] The Board recognizes that the Gardner Pinfold survey was not a random sample of the population, as retailers chose whether or not to respond. In the absence of better data, however,

the Board will rely on the data collected by Mr. Gardner for the current review. In particular, the Board relies on the results of cost data provided by the 104 retailer group.

(b) Base Year

[18] The maximum margins were last set by the Board in 2014, based on data up to and including 2012. Two issues were raised by Mr. Knecht in relation to the base year for the Gardner Pinfold review. The first relates to the period of Mr. Gardner's study, which used 2012 as the base year and which reviewed cost changes from 2013 to 2015 (study period).

[19] Subsection 9(1) of the Regulation could be interpreted such that 2014 would be the base year for the next margin review, being the date of the decision when the margin was last set. Mr. Knecht suggested, however, that using 2012 as the base year is "consistent with a common sense interpretation of the legislation." The Board finds that the Regulation contemplates consideration of cost increases from the time that they were last measured, and not based on the date of the previous decision. The Board therefore concludes that 2012 is the appropriate base year.

[20] The second issue relates to Mr. Gardner using 2015 industry costs to allocate weighting factors to the operational costs derived from the survey results. Mr. Knecht stated that this was technically incorrect, and that the base year of 2012 should be used for the allocation of cost weightings. Mr. Gardner acknowledged, when testifying, that using weighting factors for 2012 is more correct. The Board concludes that the 2012 base year costs should be used for determining cost weighting factors for the study period.

(c) Volume Effects

[21] Volume of sales is a factor to be considered when reviewing retail margins. With fixed unit margins, volume influences the ability to recover overhead costs. Higher volumes tend to increase this ability while lower volumes tend to decrease it. A change in industry-wide average operating costs could, therefore, be adjusted for any material change in average volumes over the study period.

[22] In his analysis Mr. Gardner relied on volume data submitted by wholesalers and retailers to the Board under the reporting requirements of the Regulation. The survey did not request volume data from respondents.

[23] Mr. Gardner evaluated the impact of volume changes over the study period based on average province-wide retail volumes, in addition to the average volume changes from retailers responding to the survey. On a province-wide basis, average volumes increased by 1.9%. According to Mr. Gardner, sales volumes for the 104 retailer group have been stable, exhibiting a modest increase of 0.3% over the study period. He concluded that any basis for a margin adjustment would remain unaffected by volume considerations.

[24] Mr. Knecht considered the province-wide volume change to be material to the costs changes measured in the survey. He concluded that any cost increases "should be scaled back" to reflect the province-wide effect.

[25] Earlier in this decision, it was determined that the 104 retailer group data is the appropriate sample with a resulting 0.3% volume increase. This is not a material change. The Board finds that the volume effects are essentially neutral and will not adjust costs in this review for volume effects in relation to motor fuels.

(d) Benchmark to Rack Price Spread

[26] An issue in this proceeding focused on the difference between the New York Harbor benchmark price (NYH benchmark) and the Saint John rack price (SJ rack). The average difference between the two prices had widened in recent years. In Mr. Gardner's opinion, this would have the effect of reducing retail margins "for any retailer whose acquisition cost was tied in a fixed relationship to the rack price." Mr. Gardner did not provide a definitive reason for this trend.

[27] ACSA compared the average monthly spread between the previous (2010-2012) and current study periods. It concluded that the SJ rack differential cost to resellers (i.e. wholesalers and retailers) in the current study period was 0.72 cent per litre higher. The Scholten Group also expressed concern with the increase in the spread, and submitted that retailers have been losing margin because of this trend. It submitted that a majority of retailers purchase petroleum products on a fixed variable off the SJ rack. Both parties recommended that the Board increase the retail margin accordingly, in addition to any other adjustment.

[28] It is important to note that when resellers chose to purchase product on a fixed variable to the rack price, they have generally decided to "opt out" of regulation. Subsection 4(4) of the Act, which allows for parties to "opt out", provides:

> 4(4) Notwithstanding that a maximum margin is set for a wholesaler and a retailer, if the wholesaler and the retailer agree in writing, they may apportion the total allowed margin between them in such manner as they see fit.

[29] A threshold question must now be answered. If parties chose to "opt out" of regulation, should the Board even consider the impact of any difference between the NYH benchmark and the SJ rack when setting the margin? (i.e. Is this a relevant factor for consideration, as contemplated by the legislation?)

[30] Mr. Gardner comments on this issue stating in part at paragraph 56 in his report:

> This source of reduced margin is not the result of increased input costs, but is an artifact of the regulatory framework itself. Finding a way to address it in a margin review poses a challenge, since it is not tied to any of the factors specified in the legislation. Perhaps it could be considered under the rubric of Regulation 9(1)(a)(i) - the cost of transporting fuel from NYH to the province - but only if this is interpreted as referring to all factors that could influence the price spread (cost may be a factor, but not necessarily the most relevant).

[31] Similarly, Mr. Knecht stated in his report at page 14, that "it is not clear that this trend is a significant issue for retailers. This effect will only serve to squeeze margins when a retailer has opted not to purchase supplies at the regulated wholesale price."

[32] This threshold question was not sufficiently addressed in this review and remains an issue to be decided. Whether the Board should or in fact has the authority to consider this issue is best left for a future review when both the wholesale and retail margins are being examined.

[33] Moreover, if the Board were to determine that it is a relevant factor, more detailed information would be required. In this review, the Board has not been provided with evidence as to how many retailers have opted to purchase their product on a fixed variable from the rack price or the reasons for doing so. The Board has no survey data that establishes actual wholesale prices (for those retailers who opt out) and their relationship to regulated maximum wholesale prices.

[34] Finally, the SJ rack price data is based on the only publicly available rack price in the province, as other wholesalers do not publish their rack prices. Thus, there is no evidence of whether other rack prices have exhibited the same behavior in relation to the NYH benchmark, as was described in Mr. Gardner's evidence.

[35] Clearly more in-depth analysis would be required, should the Board decide this issue is relevant for consideration. For the purpose of this review, no adjustment will be made as a result of any difference from the NYH benchmark and the SJ rack.

(e) Adjustment – Maximum Retail Margin

[36] Based on the survey data from the 104 retailer group, and without applying a volume adjustment as concluded above, Mr. Knecht calculated that retailer costs have increased by 0.04 cent per litre over the study period.

[37] ACSA submitted that the maximum retail margin should be increased by 0.3 cent per litre, based on the survey data of corporate retailers only. The Board has rejected that methodology, as noted above. The Board also did not accept any additional adjustment based on the NYH benchmark to SJ rack spread.

[38] The Scholten Group also recommended an increase based on the increased spread between the NYH benchmark price and SJ rack price, as well as a 0.37 cent per litre increase based on a 2015 weighting of costs. The Board does not accept either adjustment, for the reasons previously given.

[39] In his report, Mr. Knecht concluded that there does not appear to be clear evidence that an increase in motor fuel retail margins is justified based on the Gardner Pinfold survey results. In coming to this conclusion, he considered the fixed nature of retailer costs and the potential bias associated with the voluntary participation in the Gardner Pinfold survey. He calculated that the adjustment using the 104 retailer group and 2012 weighting would be 0.04 cent per litre. Mr. Knecht stated that if the province-wide volume effect was used, it would result in a small decrease in the maximum retail margin.

[40] Based on the above conclusions with respect to the survey sample, base year weighting and volume effects, the Board finds the change in retailer costs over the study period is 0.04 cent per litre. Adjustments are normally made in increments of one-tenths of a cent per litre. The result of rounding down is that retailers would not be recovering the cost increase. The Board therefore will increase the retail margin by 0.1 cent per litre.

[41] The Board concludes that an increase of 0.1 cent per litre to the current retail margin for motor fuels is justified and orders that, effective May 11, 2017, the maximum retail margin for motor fuels shall be adjusted to 6.5 cents per litre.

(f) Adjustment – Maximum Delivery Cost

[42] The Gardner Pinfold Report noted that the current delivery charge is inadequate for approximately 11% of retailers, most of whom are situated in the north of the province. He recommended an increase of 0.5 cent per litre in the maximum delivery charge. No party took issue with the need for an adjustment.

[43] In relation to maximum delivery costs in the parish of Grand Manan, Mr. Gardner stated in a response to an interrogatory that the data indicated that the current delivery charge is adequate to cover the actual cost of delivery. There was no other evidence or submissions on this point.

[44] Delivery charges for some retailers within the province are higher than the current maximum delivery charge of 2.5 cents per litre. Subsection 9(4) of the Act provides that a retailer can only charge the actual delivery costs or the maximum delivery costs, whichever is less. Any increase would only impact on a small percentage of retailers.

[45] The Board concludes that an increase of 0.5 cent per litre to the current delivery cost for motor fuels is justified and orders that, effective May 11, 2017, the maximum delivery cost for motor fuels, other than for the parish of Grand Manan, shall be adjusted to 3.0 cents per litre.

(g) Adjustment – Maximum Full Service Charge

[46] The Act allows retailers to charge an additional fee for dispensing motor fuels by an attendant. According to Mr. Gardner, there does not appear to be a case for adjusting the maximum full service charge from the level set in 2011. No party argued or presented evidence for an adjustment.

[47] The Board finds no evidence to justify any adjustment in the maximum full service charge for motor fuels. The charge will remain at 3.0 cents per litre.

2. Heating Fuel

(a) Furnace Oil

[48] Mr. Gardner sent a survey to the 32 active furnace oil retailers that operate in New Brunswick. Responses were received from seven of these retailers. Six of those survey responses were of sufficient detail to include in his analysis. Sales volume data for the responding retailers was obtained from the Board's database of annual reports filed by furnace oil retailers. Province-wide sales volume data was obtained from the New Brunswick Department of Finance.

[49] In his report, Mr. Gardner stated that the sample was not necessarily representative of the industry because it only included 20% of the retailer population and sales, and because it was not randomly selected.

[50] Based on his survey results, and using 2015 weighting factors, Mr. Gardner indicated that operating expenses had increased by 1.1%, while total survey sales volumes had increased by 1.4% during the study period. Mr. Gardner concluded that the increase in operating costs was insufficient to have a meaningful impact on margins, given the offsetting increase in total volume from the survey participants. Mr. Gardner recommended no adjustment to the retail margin.

[51] Mr. Knecht agreed with Mr. Gardner's recommendation. Mr. Knecht's evidence noted that, using 2012 weightings, costs during the study period had declined by 0.4%. Mr. Knecht further concluded that the Board had insufficient data in the current review to draw any conclusions.

[52] The Board agrees with Mr. Gardner and Mr. Knecht that the survey may not be necessarily representative of the industry as a whole. The increase in sales volumes for the industry participants included in the survey differs from the province-wide data that shows a decline of 1.7%. The Board will rely on province-wide volume data for purposes of this review. It is more reliable, as it is drawn from mandatory filings by all retailers with the New Brunswick Department of Finance.

[53] Mr. Gardner did state that furnace oil retailers face pressures from competing fuels and technology. These retailers operate in a high-cost environment characterized by fewer customers, often with low customer density. Operating in rural areas results in particularly high operating

costs. Mr. Gardner stated that the primary issue is one of continuity of supply in rural areas. In his view, urban areas are profitable, but profitability in rural areas is marginal.

[54] Mr. Knecht echoed Mr. Gardner's concerns. He stated that delivery costs vary substantially between urban and rural retailers. In his opinion, setting the maximum furnace oil retail margin based on average retailer costs would risk the continuity of supply. Mr. Knecht further agreed with Mr. Gardner's concern that an increase in fuel prices "could cause delivery costs for rural dealers to increase rapidly, and that regulatory lag could threaten the dealers' economic viability before margins are adjusted." Mr. Knecht stated that the Board "would be better served to err on the side of setting fuel oil margins too high rather than too low."

[55] The Board accepts the observations of Mr. Gardner and Mr. Knecht that the industry has been in decline since 2005. This decline may impact on the continuity of supply in which consumers have a vital interest. Taking into account the decline in province-wide volumes, the increased costs for the survey participants during the study period, and the risk to continuity of supply, particularly for rural dealers, the Board finds that an adjustment of 0.3 cent per litre is justified.

(b) Adjustments - Maximum Retail Margin and Maximum Delivery Cost for Furnace Oil

[56] The Board concludes that an increase of 0.3 cent per litre to the current retail margin for furnace oil is justified and orders that, effective May 11, 2017, the maximum retail margin for furnace oil shall be adjusted to 18.5 cents per litre.

[57] Insufficient data was provided to justify an adjustment to the maximum delivery cost. The Board concludes that no adjustment is justified to the current maximum delivery charge within the province for furnace oil. The charge will remain at 5.0 cents per litre.

(c) Propane

[58] Mr. Gardner received only one survey response, and he concluded that it does not provide a sufficient basis for a recommendation. In addition, no intervener brought forward any evidence or made any submission at the hearing relating to propane.

[59] There being insufficient evidence relating to the maximum retail margin and the delivery cost for propane, the Board finds that no adjustment is justified. The maximum retail margin and maximum delivery charge will remain at 25 cents per litre and 10 cents per litre, respectively.

E. Conclusion

[60] During the course of the hearing, interveners pointed to a need to improve the data collection process for future margin reviews. The lack of significant sample responses has been an issue in this and previous margin review proceedings. Improvements in the data collection process, including the timing and frequency of surveys, may provide better and more data for analysis. In any effort to improve the process, industry cooperation is critical.

[61] The following summarizes the Board's conclusions:

Margin and Charge	Current	Adjustment	Revised May 11, 2017
Maximum Retail Margin – Motor Fuels	6.4 cpl*	0.1 cpl	6.5 cpl
Maximum Delivery Cost - Motor Fuels	2.5 cpl	0.5 cpl	3.0 cpl
Maximum Delivery Cost - Motor Fuels, parish of Grand Manan	5.0 cpl	-	5.0 cpl
Maximum Full Service Charge - Motor Fuels	3.0 cpl	-	3.0 cpl
Maximum Retail Margin - Furnace Oil	18.2 cpl	0.3 cpl	18.5 cpl
Maximum Delivery Charge - Furnace Oil	5.0 cpl	-	5.0 cpl
Maximum Retail Margin - Propane	25.0 cpl	-	25.0 cpl
Maximum Delivery Charge - Propane	10.0 cpl	-	10.0 cpl

*cents per litre

Dated in Saint John, New Brunswick, this 5th day of May, 2017.

Raymond Gorman, Q.C.
Chairperson

François Beaulieu
Vice-Chairperson

Michael Costello
Member

Patrick Ervin
Member

John Patrick Herron
Member