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## **By Electronic Filing**

British Columbia Utilities Commission  
Suite 410, 900 Howe Street  
Vancouver, BC V6Z 2N3

**Attention: Patrick Wruck, Commission Secretary**

Dear Sirs/Mesdames:

**Re: British Columbia Utilities Commission – An Inquiry into Gasoline and Diesel Prices  
in British Columbia – Project No. 1599007  
Parkland Fuel Corporation (“Parkland”) Final Submission**

We enclose for filing Parkland’s Final Submission in the above-noted proceeding.

Yours truly,

**FASKEN MARTINEAU DuMOULIN LLP**

*[Original signed by]*

Matthew Ghikas  
Personal Law Corporation

MTG/lh  
Enclosure



**BEFORE THE BRITISH COLUMBIA UTILITIES COMMISSION**

**AN INQUIRY INTO GASOLINE AND DIESEL PRICES  
IN BRITISH COLUMBIA**

**FINAL SUBMISSION OF PARKLAND FUEL CORPORATION**

**August 8, 2019**

FASKEN MARTINEAU DuMOULIN LLP  
Matthew Ghikas and Tariq Ahmed

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## PART ONE: INTRODUCTION AND OVERVIEW

### A. INTRODUCTION

1. This Inquiry provides a valuable opportunity for educating the public about drivers of gasoline and diesel prices since 2015, based on evidence - the voluntary testimony of market participants and informed economic analysis. The evidence in this Inquiry demonstrates the complexity of competitive market dynamics, which will make it challenging for the British Columbia Utilities Commission (“BCUC”) to provide a simple explanation for prices and to make any “silver bullet” recommendations. However, a number of findings are possible.

2. The price of unrefined crude and taxes together represent approximately two-thirds of the cost of a litre of gasoline or diesel in BC. The remainder – the combination of “refining margin”<sup>1</sup> and “retail margin”<sup>2</sup> – must cover the costs and profit of the entire multi-party supply chain from source to retail pump. The price increases since 2015 involve all four of these components.

3. BC **taxes**, which were already among the highest in Canada, have increased since 2015.

4. BC consumers are seeing the effects of **higher (and volatile) crude prices**. Crude prices have increased 17 cents per litre since 2015.

5. Increases in wholesale prices and refining margin differentials since 2015, and associated differentials with neighbouring jurisdictions, reflect the workings of a continental

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<sup>1</sup> In this Final Submission, “refining margin” means the difference between the price of crude and the wholesale price. It is a gross measure, involves multiple steps in the supply chain including transportation, and is not the same as a refinery’s profit. Expressed as a formula: *Refinery margin = Rack price - crude price*: Exhibit A-2, Appendix B, Order in Council No. 254, p. 2; Exhibit A2-3, Kent Presentation to BCUC, PDF p. 118; Exhibit A2-1, Deetken Phase 1 Report, p. 20.

<sup>2</sup> In this Final Submission, “retail margin” means the pump price, less the wholesale price, excluding taxes. It is a gross measure, and is not the same as a retailer’s profit. Expressed as a formula: *Retail Margin = Pump Price – Taxes – Wholesale price*: Exhibit A-2, Appendix B, Order in Council No. 254, p. 2; Exhibit A2-3, Kent Presentation, PDF p. 119; Exhibit A2-1, Deetken Phase 1 Report, p. 25; Tr. 1, p. 18, ll. 2-8 (Lepine).

wholesale market. Refined products consumed in BC are supplied not only by local refineries, but also by refineries in Alberta and across the United States. They are delivered by a variety of integrated and independent marketers who compete for market share. Each BC wholesale market participant prices its products independently, with an eye to published pricing and market signals from customers.

6. Wholesale prices and refining margins in BC since 2015 have reflected a fundamental principle of market economics – the price in a competitive market will be determined by the costs of the marginal source of supply (or “marginal barrel”).

- With the supply of refined products shipped via the **Trans Mountain Pipeline (“TMPL”)** having been sharply constrained since 2015, BC demand has been met by ever more expensive sources of supply from as far away as California, the US Midwest and the Gulf Coast. In other words, the marginal source of supply is now a more costly source of supply, and the wholesale price has increased correspondingly.
- New costs imposed on marketers supplying the BC market, such as those associated with **BC’s low-carbon regulatory requirements**, has only amplified this effect.

These same factors have widened the refining margin differential with neighbouring jurisdictions.

7. The BC retail market is also highly competitive. There are hundreds of retail stations in BC, and prices at those stations are controlled by dozens of different parties. Retailers adjust prices - often multiple times each day - to ensure they remain price competitive; consumers will respond to price differentials as small as 0.1 cents per litre.

8. Although prices are set on a day-to-day basis with reference to market considerations, retailers can only remain in business if gross retail margins are sufficient over time to cover costs (including the cost / opportunity costs of invested capital). That dynamic

has driven gross retail margins upwards in some areas since 2015. There have been a number of **new costs imposed on all BC retailers** since 2015, including

- carbon tax increases;
- a 21% increase in minimum wage;
- credit card costs; and
- costs (and opportunity costs) associated with escalating property values.

9. The entire differential in retail margins relative to the Western provinces can be explained (and then some) by the combined effect of (a) a distortion resulting from the data set used to determine the differential, (b) the disproportionate impact of rising land values and credit card costs in BC, and (c) collapsed retail margins in the depressed Calgary and Edmonton markets in recent months. These factors reflect standard market dynamics.

10. The Inquiry Panel should recommend against attempting to regulate the BC wholesale or retail markets. Introducing price regulation would contradict prior decisions of the British Columbia Utilities Commission (“BCUC”), the principles articulated by Bonbright (a treatise on regulation often cited by the BCUC), and the expert testimony of Dr. Kahwaty and Deetken. The evidence is unequivocal that price regulation would distort the market to the detriment of consumers. An alternative type of “transparency regulation” would be novel, place upward pressure on retail prices, and provide no benefit to BC consumers.

## **B. ORGANIZATION OF SUBMISSION**

11. This Submission is organized as follows:

- Part Two provides a summary response to each of the Inquiry Terms of Reference, together with cross-references to the remainder of this Submission.
- Part Three outlines the four components of the retail price, in order of greatest to least significance: taxes, crude costs, refining margin, and retail margin.

- Part Four identifies the factors influencing retail prices since 2015, which include increased taxes, increased crude prices, and standard market dynamics affecting the refining and retail margins.
- Part Five addresses the differentials in the refining and retail margins relative to other jurisdictions, which are attributable to market fundamentals.
- Part Six explains why government intervention in these markets should be avoided.
- Part Seven is a conclusion.

## PART TWO: SUMMARY RESPONSES TO INQUIRY QUESTIONS

12. In this Part, Parkland provides summary responses to the Terms of Reference issues, based on the evidence before the BCUC. We provide cross-references to other portions of this Submission, where more discussion and footnotes to the evidence are found.

**(a) the BCUC must advise on the factors influencing gasoline and diesel prices since 2015 and the mechanisms the Province could use to moderate price fluctuations and increases;**

13. The Inquiry Panel should acknowledge up-front that market complexity prevents identifying all factors that influence prices, or assigning particular portions of the price to individual factors. That said, the evidence demonstrates that the following notable factors have contributed to higher gasoline and diesel prices in BC since 2015. All of these considerations are consistent with a functioning market:

- (a) **High taxes:** Taxes have been the single largest component of the retail price in BC since 2015, and have increased. Taxes represented approximately 36% of the price of a litre of gasoline in Greater Vancouver in Q1 2019 (53.9 cents per litre) - more than the cumulative costs and profits of all of the participants in the multi-step supply chain; (Part 3 Section C; Part 4, Section B)
- (b) **Higher crude prices:** Increased crude prices are the most significant driver of increased retail prices since 2015, as well as being the main source of volatility; (Part 4, Section C)
- (c) **TMPL capacity constraints:** Constraints on the TMPL have necessitated sourcing more expensive sources of delivered supply to serve BC demand. In the language of market economics: the refining margin has increased, primarily because the marginal source of supply – which dictates the equilibrium price in a functioning market – is now more costly; (Part 4, Section D)

- (d) **BC's unique low-carbon regulatory requirements:** BC's unique Low Carbon Fuel Standard ("LCFS") and other regulatory requirements have layered new and significant costs on all supply destined for the BC market since 2015. In the language of market economics: BC's regulatory requirements have made BC's marginal source of supply – which dictates the equilibrium price in a functioning wholesale market – more costly; (Part 4, Section D)
- (e) **Retailers face higher costs:** BC retailers, as a group, have faced cost (and opportunity cost) pressures since 2015. These have included carbon tax increases, minimum wage increases, employer health taxes, credit card fees, and costs (and opportunity costs) related to land values. In the language of market economics: while retail prices are set day-to-day (or hour-by-hour) with reference to competitive considerations, over time the retail margin has had to increase for retailers to remain viable; and (Part 4, Section E)
- (f) **Volatility:** BC's prices have been influenced by volatility in crude prices and supply shocks associated with a number of planned turnarounds, and unplanned disruptions in BC, Alberta and the US. (Part 4, Section F)

14. The Inquiry Panel should recommend against attempting to regulate the BC wholesale or retail markets. The BCUC, in prior decisions and Inquiry reports, has been unequivocal that "Competitive forces are generally accepted as providing societal benefits and consumer protection more efficiently and effectively than economic regulation."<sup>3</sup> It has confined the role of regulation to "natural monopoly situations", citing the public interest. Bonbright echoes these conclusions, as have experts testifying in the present Inquiry. Simply put, the conditions precedent for sound regulation are not present here. Regulatory intervention would distort the market to the detriment of consumers. (Part 6)

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<sup>3</sup> *In the Matter of FortisBC Energy Inc. Inquiry into the Offering of Products and Services in Alternative Energy Solutions and Other New Initiatives* Report, BCUC Order No. G-201-12 (the "AES Report"), p. 14. See also: p. 71.

**i. the differences, if any, in refining margins among British Columbia and other jurisdictions in Canada and the reasons for any differences;**

15. Some of the same market factors that have resulted in higher wholesale prices and refining margins in BC since 2015 (outlined immediately above) explain the increased differential in refining margins compared to neighbouring jurisdictions. With the constraints on TMPL, BC is being served by imported supply sources that have higher transport and logistics costs. BC's unique, and more onerous, regulatory requirements are also notable contributors to refining margin differentials.

16. The "unexplained" differential that Deetken identified in some instances can be fully explained by the fact that its transportation cost assumptions were too low and it did not account for real logistics costs that marketers incur. It should also be recognized that general market dynamics - market friction and a fluid marginal source of supply - preclude perfect alignment with textbook economic principles. Markets continually respond to changing conditions; however, adjustments are not instantaneous and play out over time. (Part 5, Section D)

**ii. the differences, if any, in retail margins among British Columbia and other jurisdictions in Canada, and among different regions in British Columbia, and the reasons for any differences;**

17. The entire differential in retail margins relative to the Western provinces since 2015 can be explained by the combined effect of (a) a distortion resulting from the data set used to determine the differential (i.e., collecting data at 10 am, which is generally the highest point of the daily price cycle in the Vancouver region but not necessarily elsewhere), (b) the disproportionate impact of rising land values and credit card costs in BC, and (c) collapsed retail margins in the depressed Calgary and Edmonton markets in recent months. These factors reflect standard market dynamics, not anti-competitive behaviour. (Part 5, Section E)

**iii. factors that have contributed to the increases in gasoline and diesel prices, both retail and wholesale, including, without limitation,**

**A. the access of refineries in British Columbia to crude oil supply and other components,**

18. Parkland Fuel Corporation (“Parkland”) has had issues accessing light crude by virtue of constraints on TMPL, and has, at times, resorted to higher cost options to maximize refinery utilization. However, Parkland’s challenges in this regard are not a key determinant of wholesale prices and refining margins in BC. Wholesale prices in BC (as with any functioning market) are determined by the marginal supply cost, and Parkland’s Burnaby Refinery is not the marginal source of supply (it is *infra*-marginal). Parkland can only charge a competitive price, and must absorb any costs associated with crude supply challenges. (Part 4, Section D)

**B. the amount of gasoline and diesel stored in British Columbia for sale in British Columbia,**

19. There has been no material change in the amount of gasoline and diesel stored in BC since 2015, apart from Imperial adding some storage. BC terminals are operating at, or close to, economic capacity. However, since 2015, regulatory requirements intended to reduce greenhouse gas emissions have resulted in an increased requirement for renewable feedstocks tankage. The reallocation of tank capacity has effectively reduced working storage for refined products. This loss of supply chain flexibility has increased the overall cost of distribution and storage. The loss of flexibility since 2015 will also tend to amplify price volatility associated with supply shocks. (Part 4, Section F)

**C. usage of refinery and pipeline capacity,**

20. BC’s refineries (i.e., Parkland’s Burnaby Refinery and the Husky Energy (“Husky”) Prince George Refinery) are operating at their economic capacity, and have been since 2015 other than for specific operational reasons. The full economic utilization of these refineries has a favourable impact on the wholesale price in BC, since they are relatively low cost (*infra*-

marginal) sources of supply. Accessing relatively low cost supply avoids the need to access higher cost imports that will drive-up the wholesale price and refining margins. (Part 4, Section D)

21. The evidence is unequivocal that constraints on TMPL since 2015 have had a significant upward impact on BC prices. The wholesale price in a competitive market is determined by the cost of the marginal source of supply. The refined products shipped via TMPL are one of the cheapest sources of delivered supply for the BC market. With the supply of refined products shipped via the TMPL having been reduced by approximately half since 2015, BC demand has been met by increasingly costly sources of supply from as far away as California, the US Midwest and the Gulf Coast. In other words, the marginal source of supply that determines the wholesale price in a functioning market is now a more costly source of supply. (Part 4, Section D)

**D. wholesale and retail market sizes and demand,**

22. The most notable changes in BC's market since 2015 are supply-related, not demand-related. There has been no material change in the size of the wholesale or retail markets since 2015.

**E. methods of distribution of gasoline or diesel to retailers, and**

23. The cost of distribution from the marketer to the retailer is reflected in retail margin.<sup>4</sup> The costs of distribution between storage facilities and retailers are subject to general inflation, but were otherwise not singled out as a notable contributor to price changes since 2015. There was no evidence of a change in these methods since 2015.

**F. seasonal variations in supply and demand;**

24. Seasonal variations in supply and demand do play a part in seasonal price fluctuations. Refineries change over to produce specific fuel formulations for summer and

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<sup>4</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, paras. 5 and 14.

winter. Gasoline demand increases in the summer, placing upward pressure on prices. (The seasonal variations have contributed to the myth of the “holiday weekend price increase”.) Deetken also identified clear patterns in retail margins over the course of the year associated with supply and demand. The seasonal pattern since 2015 is consistent with what it had been in previous years. (Part 4, Sections F and G)

**iv. the extent to which price changes in gasoline and diesel have been determined by market competition and the extent to which those changes have been determined by other factors;**

25. The evidence demonstrates that price changes in gasoline and diesel, whether intra-day, intra-week or over longer periods, have been determined entirely by competitive market dynamics.

26. The wholesale markets in British Columbia are supplied by multiple refineries and dozens of marketers, via several modes of transportation. No single refinery can exercise market power, as each only serves a minority of the market. Marketers face little in the way of barriers to entry in BC, and can (and do) respond to arbitrage opportunities. Refineries and marketers pay close attention to public pricing data and set their rack prices independently from one another. Wholesale rack prices reflect the cost of the marginal source of supply (e.g., participants are referencing published US market data when setting prices), as one would expect in a functioning competitive market. Retailers can switch suppliers and enjoy sufficient leverage to negotiate discounts from rack prices. Dr. Kahwaty, who has deep expertise in competition economics, and Mr. Charlebois from the National Energy Board (“NEB”) see a functioning competitive market. (Part 4, Section D)

27. The competition in the retail market is fierce. There are over 1300 retail stations in BC, owned and operated by many different marketers and independent retailers. Retailers post their prices on large signs to the tenth of a cent. Retailers testified how they must be cognizant of prices established by other competing retailers. Consumers respond to very small price differentials. It can be damaging to gain a reputation as a high cost retailer. Competitive

prices are essential to maintaining sales volumes that drive more lucrative non-fuel sales. As with the wholesale market, Dr. Kahwaty sees a functioning competitive retail market. (Part 4, Section E)

**v. measures used in other jurisdictions in Canada and North America to enhance transparency about how gasoline and diesel fuel prices are determined.**

28. This Inquiry has accomplished the objective of enhancing transparency about how gasoline and diesel fuel prices are determined. It should be acknowledged that this Inquiry has represented a significant investment of time and money by the BCUC and every one of the voluntary participants. The Inquiry Panel has received and heard a prodigious volume of evidence.

29. Adopting ongoing, detailed reporting and transparency measures in the context of a competitive market would be unique, put upward pressure on retail prices, and deliver no benefit to BC consumers. BC consumers already have access to considerable information from sources like the Competition Bureau of Canada, the NEB, Natural Resources Canada, the BC Ministry of Finance and commercial services such as GasBuddy.com and the Kent Group. (Part 6, Section G)

### PART THREE: COMPONENTS OF THE PUMP PRICE

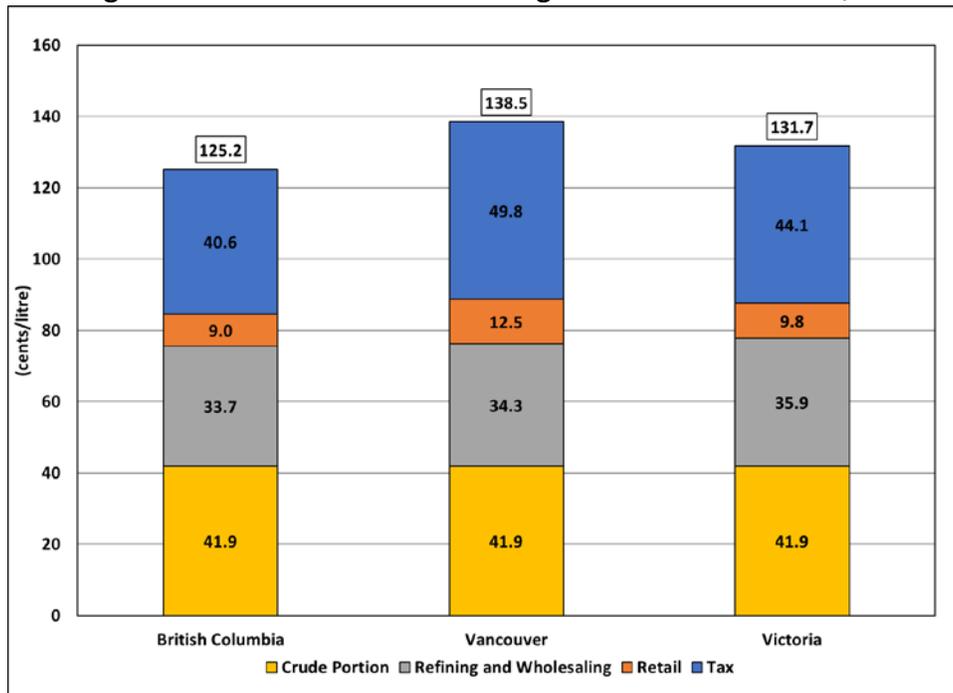
#### A. INTRODUCTION

30. The Terms of Reference direct the BCUC to consider “the factors influencing gasoline and diesel prices since 2015...”. The starting place for that analysis has to be identifying the components of the pump price. As shown in the following figures, the cost paid by BC consumers for a litre of gasoline or diesel is associated with (in order of decreasing percentage) (1) taxes, (2) commodity price, (3) wholesale costs, and (4) retailing costs.

#### B. THERE IS CONSENSUS AROUND THE COMPONENTS OF THE RETAIL PRICE

31. There is general consensus about the major components that go into the price of gasoline.<sup>5</sup> They are: (1) taxes (2) crude, (3) refining component / margin, and (4) retailing or marketing component / margin. Dr. Kahwaty depicted the components as follows.

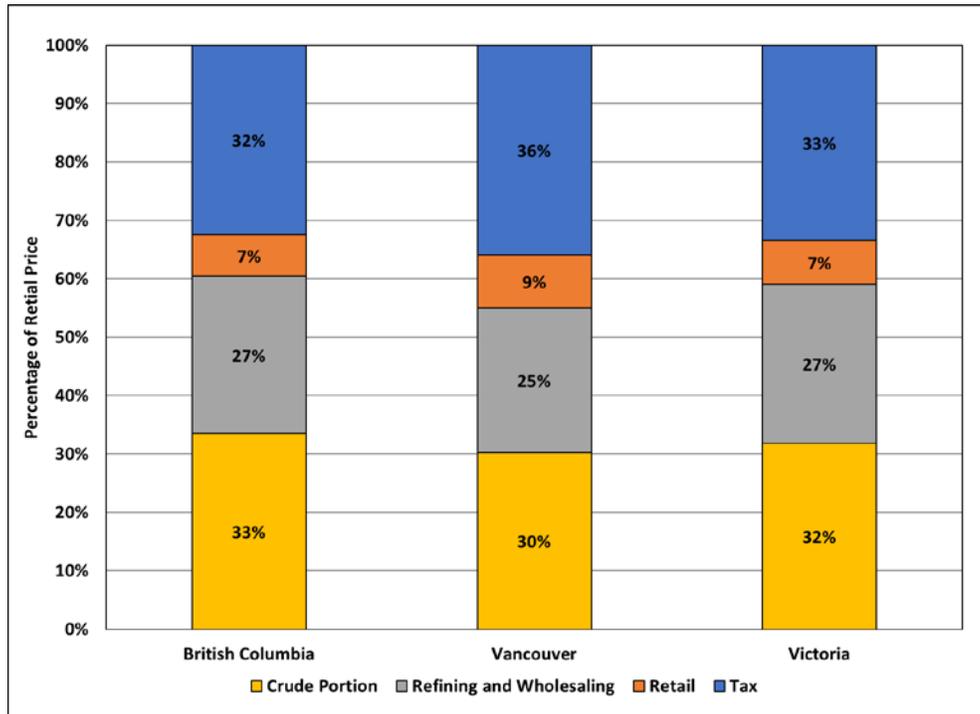
**Average Retail Price Breakdown for Regular Gasoline in BC - Q1 2019<sup>6</sup>**



<sup>5</sup> Most participants rely on Kent Group data. The Kent Group depicts the components of the pump price in a generic fashion in its presentation to the BCUC, Exhibit A2-3, PDF p. 115.

<sup>6</sup> Figure 10, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 32. Source: Kent Petroleum Price Data, Kent Group Ltd., available at <https://charting.kentgroupltd.com/>. See Kahwaty Report, para. 32 for an equivalent figure for diesel. Note that “Vancouver” represents the Greater Vancouver area.

**Average Retail Price Percentage Breakdown for Regular Gasoline  
in BC - Q1 2019<sup>7</sup>**



**C. TAXES ARE THE SINGLE LARGEST COMPONENT OF THE PRICE PER LITRE IN BC**

32. While the Terms of Reference require the BCUC to refrain from inquiring into taxation, it would be misleading for the BCUC to report the factors influencing prices in BC without acknowledging the substantial contribution of taxes.

33. Taxes are the single largest component of the retail price in British Columbia. As the figures above show, taxes represented approximately 36% of the price of a litre of gasoline in Greater Vancouver in Q1 2019. The NEB reports that, in April 2019, the total tax portion of regular gasoline in Vancouver averaged 53.9 cents per litre<sup>8</sup> - more than is shown in the figures above. To put this in perspective, consumers in Greater Vancouver have paid more tax in the price of a litre of gasoline than the combined refining and retailing margin. In other words, the cost of taxes in Greater Vancouver is *more than the cumulative costs and profits of all of the*

<sup>7</sup> Figure 11, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 33. Source: Kent Petroleum Price Data, Kent Group Ltd., available at <<https://charting.kentgrouppltd.com/>>. See Kahwaty Report, para. 33 for an equivalent figure for diesel. Note that “Vancouver” represents the Greater Vancouver area.

<sup>8</sup> Exhibit C4-3, NEB Direct Evidence, PDF p. 6.

*participants in the multi-step supply chain.* In Victoria and elsewhere in BC, taxes approximately equal the cumulative costs and profits of the entire supply chain.

34. The total taxes paid by consumers in BC are greater than in most other places in Canada, and the differential is particularly large with Greater Vancouver and Victoria. They are a significant source of the differential that people see when they compare pump prices in BC to prices in other provinces.<sup>9</sup> The NEB reports that, in April 2019, the total tax portion of regular gasoline in Vancouver (averaging 53.9 cents per litre) was approximately 21% higher than the Canadian average tax.<sup>10</sup>

#### **D. COST OF CRUDE IS THE SECOND LARGEST COMPONENT OF THE PRICE PER LITRE IN BC**

35. The second largest component of the retail price is the cost of unrefined crude oil. It reflects approximately one-third of the price per litre at the pump. Dr. Kahwaty explained that “[b]ecause crude oil can be imported and exported across the world, and therefore is subject to worldwide supply and demand dynamics, refiners ‘...are [considered] “price takers” and have very little influence on the price they pay for crude oil.’”<sup>11</sup>

#### **E. REFINING MARGIN IS ONLY ¼ OF THE PRICE AND COVERS MULTIPLE STEPS IN SUPPLY CHAIN**

36. As shown in the figures above, the refining margin represents only approximately one-quarter of the price of a litre of gasoline in BC. The refining margin is simply the difference between the cost of the raw input material used by a refinery, e.g., crude oil, and the wholesale rack price for the refined gasoline and diesel. (Expressed as a formula: *Refinery margin = Rack price - crude price.*)<sup>12</sup>

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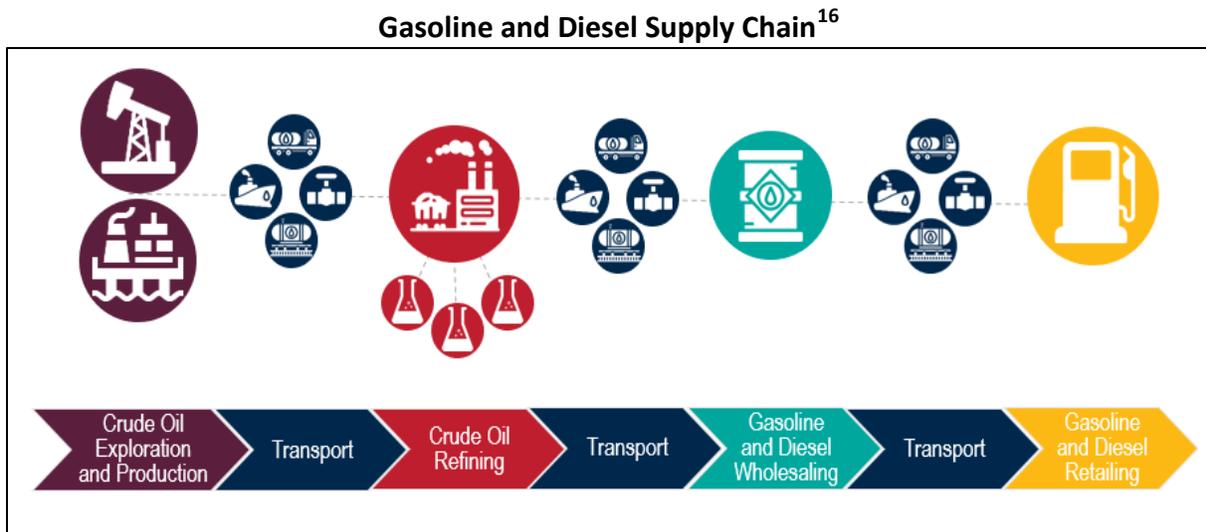
<sup>9</sup> See Part 5, Section B for further discussion.

<sup>10</sup> Exhibit C4-3, NEB Direct Evidence, PDF p. 6.

<sup>11</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 22, citing Natural Resources Canada, “Refinery Economics”, available at <<https://www.nrcan.gc.ca/energy/energy-sources-distribution/refinery-economics/4561>>.

<sup>12</sup> Exhibit A2-3, Kent Presentation, PDF p. 118. Deetken similarly defined “refining margin” as: “Refining Margin = Wholesale – Crude Index”: Exhibit A2-1, Deetken Phase 1 Report, p. 20.

37. It has been emphasized by a number of participants in this proceeding, including Parkland,<sup>13</sup> Dr. Kahwaty<sup>14</sup> and Deetken<sup>15</sup> that the reported refining margins are not synonymous with a refinery's profit margin. The refining / wholesaling component encompasses the costs and profit margin of each party engaged in the five middle steps in the following diagram.



38. The refining margin is a gross measure, determined before accounting for a host of costs incurred by a refinery, such as:

- The cost to transport crude to the refinery;
- Losses incurred on Low Value Products (fuel oil, asphalt, propane, butane) sold at less than the price of crude;<sup>17</sup>
- Discounts from the posted wholesale rack price offered to customers, which can be significant;<sup>18</sup>

<sup>13</sup> Exhibit C5-2, Parkland Evidence, pp. 23-30; Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 9.

<sup>14</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 5.6; see also paras. 132, 135 and 146.

<sup>15</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 20.

<sup>16</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 15.

<sup>17</sup> Exhibit C5-2, Parkland Evidence, p. 24 and Appendix A, Parkland Response to Questionnaire, Q. 5. While all refineries try to maximize their proportion of higher value gasoline, diesel, and jet fuel, the production of Low Value Products is an unavoidable by-product.

- The cost to meet renewable fuel content requirements, whether that takes the form of credits or higher cost fuels;<sup>19</sup>
- Operating and maintenance costs;<sup>20</sup>
- Capital investment costs, which for a refinery are very significant;<sup>21</sup> and
- Opportunity costs.<sup>22</sup>

#### F. RETAIL MARGIN REPRESENTS LESS THAN 10% OF THE PRICE PER LITRE

39. The retail margin is simply the difference between the wholesale price and the price at which fuel is sold to the consumer before taxes. Expressed as a formula: *Retail Margin = Pump Price – Taxes – Wholesale price*.<sup>23</sup> It is only a proxy for gross margin, not profit.<sup>24</sup> While prices are set based on competitive considerations<sup>25</sup>, retailers can only remain in business if that competitive price (and the resulting retail margin) covers their costs, including opportunity costs, and provides a return over time. As many of these costs are fixed, profit is largely a

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<sup>18</sup> Exhibit C5-2, Parkland Evidence, p. 24. Parkland's public evidence was that these discounts can range, and it elaborated *in camera* (Confidential Tr. 4A, p. 47, ll. 2-21) and with Exhibit C5-17, Parkland Confidential Undertaking No. 1. See also: Exhibit C2-2, Suncor Response to Questionnaire, Q. 18; Tr. 4, p. 707, l. 16 to p. 708, l. 7 (McLean); Exhibit C7-2, Husky Response to Questionnaire, Q. 17; Tr. 2, p. 542, ll. 15-20 (Friesen); Tr. 2, p. 543, ll. 7-14 (Friesen); Tr. 4, p. 754, l. 21 to p. 755, l. 12 (Rosencrans).

<sup>19</sup> Exhibit C5-2, Parkland Evidence, p. 8 and Appendix A, Parkland Response to Questionnaire, Q. 4-5.

<sup>20</sup> These costs will include energy costs, catalyst costs, chemical costs, labour costs, materials costs, maintenance costs, compliance and regulatory costs, etc.

<sup>21</sup> Mr. Charlebois of the NEB described the matter as follows: "Refineries are expensive to build, and costs are recovered over a long time horizon. Case and point, the Sturgeon refinery in Alberta (also known as Northwest Redwater) is just becoming fully utilized right now, and it has a price tag of about -- or close to \$10 billion. Crude oil costs, regulations, supply and market dynamics, technology, as well as society's values and preferences all evolve through time and are difficult to predict. The NEB expects though that potential investors and refining infrastructure would account for all of those factors, and even more potentially, before making any investment decision rather than just focusing on current refining margins." Tr. 1, p. 84, ll. 11-23. Dr. Kahwaty provided similar evidence at Tr. 1, p. 169, l. 16 to p. 172, l. 3.

<sup>22</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 27.

<sup>23</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 25; Tr. 1, p. 17, ll. 20-24 (Lepine).

<sup>24</sup> Depending on the delivery model, the retail margin can be shared between a dealer and marketer. Kent's slides also depict the sharing that occurs in the case of marketer-owned and independent retailers. Exhibit A2-3, Kent Presentation, PDF p. 120.

<sup>25</sup> See Part 4, Section E of this Submission for further discussion.

function of volume sold; maintaining volumes is critical for driving more lucrative non-gasoline sales.<sup>26</sup>

40. The retail margin component of the price of gasoline and diesel at the pump is small, relative to the tax, commodity and refining margin components. Today, the retailing component represents only approximately 9% of prices in Vancouver.<sup>27</sup>

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<sup>26</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 23.

<sup>27</sup> See Figures 10 and 11 from Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, paras. 32 and 33, respectively.

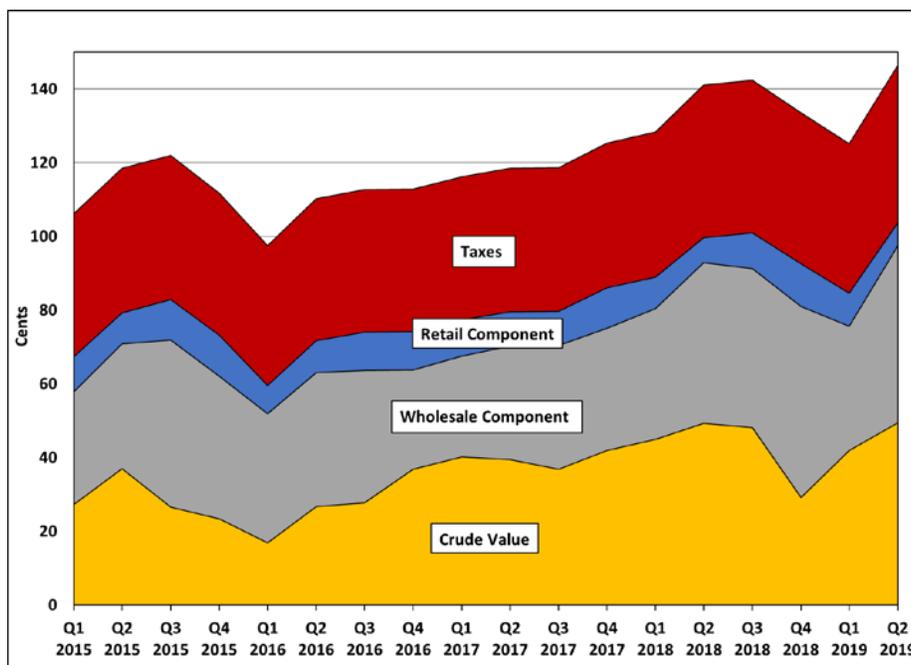
## PART FOUR:FACTORS INFLUENCING THE PRICE PER LITRE IN BC SINCE 2015

### A. INTRODUCTION

41. This Part addresses the primary issue raised by the Terms of Reference, which is to identify “the factors influencing gasoline and diesel prices since 2015...”. (This is a distinct issue from what accounts for the differentials in prices and margins *vis-à-vis* neighbouring jurisdictions, a topic addressed in Part 5.) The Inquiry Panel should meet its mandate by describing, primarily in a qualitative way, factors that have likely contributed to the price and margin changes observed since 2015. It should avoid the pitfall of trying to quantify, with artificial precision, the extent to which each market factor has contributed to prices and margins. The simple fact is that markets are complex and defy nice, tidy explanations (hence the common characterization of market forces as the “Invisible Hand”).

42. The following figure shows how the four components of the price per litre have varied since 2015:

**British Columbia (Simple Weighted) Regular Gasoline Prices 2015 – 2019<sup>28</sup>**



<sup>28</sup> Figure 37, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 126. Source: Kent Petroleum Price Data, British Columbia (Simple Weighted) Unleaded Crude Price, through May 31, 2019, available at <<https://charting.kentgrouppltd.com/>>. See Kahwaty Report, para. 126 for an equivalent figure for diesel.

43. This Part is organized according to the following points:

- First, taxes have influenced prices since 2015 by virtue of representing a significant component of the price, and taxes in Victoria and Greater Vancouver have increased.
- Second, the increased cost of crude is a major contributor to higher gasoline and diesel prices since 2015.
- Third, the increase in refining margin since 2015 reflects basic market dynamics, with wholesale prices increasing in response to reduced flow of refined products on TMPL, general cost increases facing refiners and marketers, and costs associated with new low carbon regulatory requirements.
- Fourth, gross retail margins have increased since 2015 in response to new costs faced by BC retailers, including general inflationary pressures, carbon tax increases, rising land values, rising credit card costs and minimum wage increases.
- Fifth, the retail price since 2015 has, at times, been characterized by significant volatility. There are also seasonal trends. Both of these features reflect BC's functioning market.
- Sixth, it would be inappropriate to infer improper conduct on the part of market participants from price and margin changes that can be fully explained by market fundamentals.

**B. ALREADY SIGNIFICANT TAXES HAVE INCREASED SINCE 2015**

44. Taxes impact BC consumers both directly (paid at the pump by the consumer) and indirectly (paid by retailers as a cost, and reflected in prices over time, e.g., carbon tax). In terms of the former, we described in Part 2 the significant contribution that consumer taxes

have made to gasoline and diesel prices since 2015. Consumer taxes in Victoria and Vancouver have increased during that period.

- The Victoria regional transit service area tax on gasoline and diesel increased by 2 cents per litre, increasing from 3.5 cents per litre to 5.5 cents per litre on April 1, 2018.<sup>29</sup>
- The Vancouver TransLink service region tax on gasoline and diesel increased by 2 cents per litre in 2017 (to 17 cents per litre), and then by another 1.5 cents per litre (to 18.5 cents per litre) on July 1, 2019.<sup>30</sup>

45. The carbon tax has increased significantly since 2015, which has placed upward pressure on retail margin (and, hence, consumer prices) over time. GST on top of the carbon tax represents a “tax on the tax”, which exacerbates the effect.<sup>31</sup> The carbon tax is discussed in Part 4, Section E below in the context of gross retail margin increases.

### **C. COST OF CRUDE HAS INCREASED BY OVER 17 CENTS PER LITRE SINCE 2015**

46. As discussed previously, the cost of unrefined crude oil is the second largest component of the retail price in BC. It reflects approximately one-third of the price per litre at the pump. The following figure shows that the price of crude has increased by over 17 cents per litre since 2015, which is reflected in wholesale prices.<sup>32</sup> As discussed later, retail prices, in turn, tend to follow wholesale prices; there is a very high correlation (R-squared of 94%).<sup>33</sup>

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<sup>29</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 107.

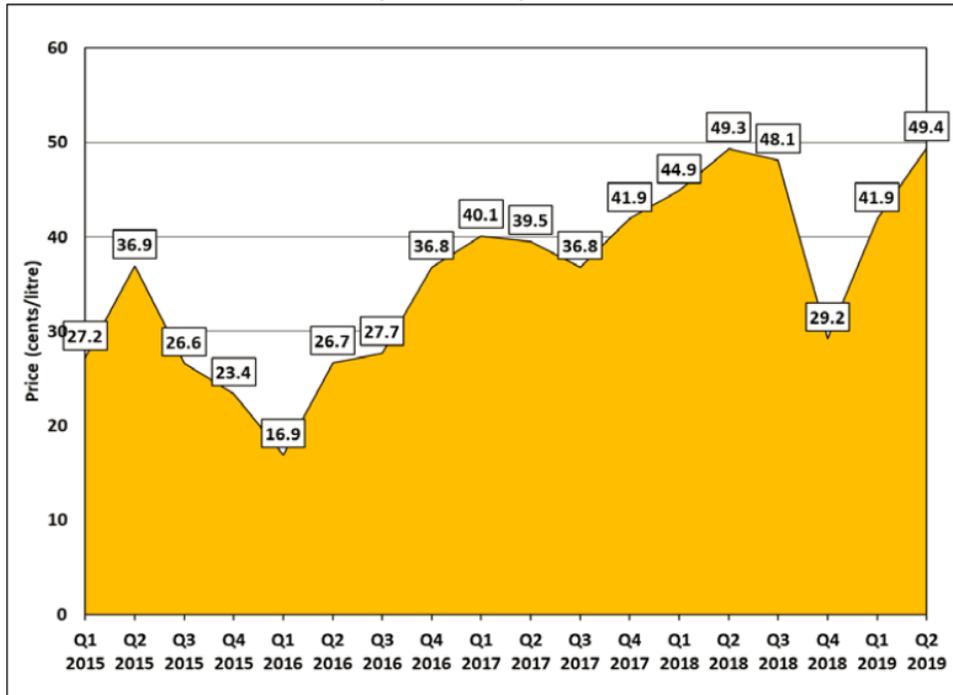
<sup>30</sup> Exhibit E-42, Kent Overview of the BC Fuels Market, p. 17; Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 108.

<sup>31</sup> The GST acts in a similar manner to credit card fees in amplifying the effect of tax increases, as they are charged on the final retail price. Credit card fees, and their impact on retail margin, are discussed in Part 4.

<sup>32</sup> Figure 34, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 104. It shows the significant correlation between the commodity cost (represented by West Texas Intermediate [“WTI”]) and Parkland’s Vancouver rack price.

<sup>33</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 78. Dr. Kahwaty provided a similar analysis for diesel.

### Value of the Crude Oil Included in 1 Litre of Regular Gasoline Q1 2015 – Q2 2019



Source: Kent Petroleum Price Data, Kent Group Ltd., British Columbia (Simple Weighted) Unleaded Crude Price, through May 31, 2019 available at <https://charting.kentgroupltd.com/>.

#### D. HIGHER REFINING MARGIN SINCE 2015 REFLECTS STANDARD MARKET DYNAMICS

47. As described in this section, a fundamental tenet of market economics is that prices will be dictated by the cost of the marginal source of delivered supply. BC's wholesale prices and margins bear that out. Since 2015, constraints on TMPL have progressively starved the BC market of lower cost (*infra*-marginal) supply of refined products. BC demand has been met by imports that are progressively more expensive to deliver, whether that is using aftermarket capacity on TMPL, shipping by rail or truck from Alberta, or shipping by barge or truck from throughout the US. We also describe below how the effect of resorting to supply sources "higher up the supply curve" has been compounded by inflationary pressures and new and unique BC regulatory requirements, which have driven-up the cost of the "marginal barrel".

**(a) Market Economics: Market Prices Reflect the Cost of the Marginal Source of Supply**

48. There was alignment between Deetken and Dr. Kahwaty about how competitive markets function: prices will be dictated by the cost of the marginal source of supply. Or, as Deetken put it: “The price of gasoline will be set by the marginal unit, that is, the most expensive delivered source of supply that would be required in order to satisfy local demand.”<sup>34</sup> Navius also seems to agree.<sup>35</sup>

49. Deetken explained and illustrated the application of this market principle as follows.<sup>36</sup> Deetken’s diagram, below, was referred to extensively in the Oral Workshop.

In theory, wholesale prices across regions should not be separated by more than the transport costs for refined product from one region to another (e.g. Edmonton to Vancouver) plus the cost of doing business in the delivery location. In this way, wholesale prices are often thought to be determined by the margin barrel, meaning that, even cheaper cost supply can fetch a high price in a market that needs to import from a more expensive region in order to meet demand. Chart 4.2.1 below presents an illustrative case in which we see that Source 4 must be used in order to meet local demand at the equilibrium price. This means that all products that are consumed from Sources 1, 2, and 3 will also receive the equilibrium price, despite the fact that it is beyond their marginal costs of supply.

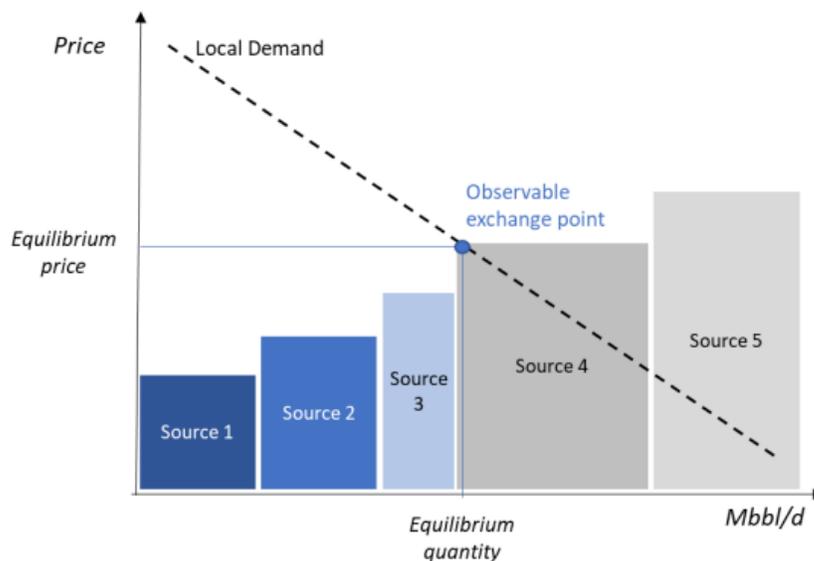
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<sup>34</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 33.

<sup>35</sup> Navius implicitly agreed during the Oral Workshop: Tr. 3, p. 632, l. 17 to p. 933, l. 4 (Wolinetz). Navius also articulated the same principle in the context of discussing crude oil markets: “The marginal crude oil is the most expensive crude stream entering a market. A properly functioning wholesale market would allow the price to rise until demand is satisfied, and that might entail using a higher cost crude oil (e.g. from a more distant market, or a higher priced market). In a competitive market, the price of the marginal crude oil supply will have the strongest relationship with the wholesale price.” Exhibit A2-2, Navius Report, p.18.

<sup>36</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 22.

**Chart 4.2.1 Illustrative demand and supply cost matching**



This is particularly important to consider for RPPs due to the limitations of transport and the varying costs of transport for petroleum products.

50. This basic principle of market economics has several critical implications for the BCUC’s assessment of the BC wholesale market:

- First, Ms. Lepine confirmed that, based on economic theory, the most expensive source of gasoline and diesel supply that is needed to fulfill the BC market is what will determine the wholesale prices in BC.<sup>37</sup>
- Second, since the wholesale price is not a “cost plus” price akin to what a regulated public utility might charge, focussing on the costs or net margin earned on a delivered litre of refined product is a “red-herring” where *infra*-marginal (non-marginal) supply is concerned.<sup>38</sup> It is to be expected that *infra*-marginal sales will be more profitable than marginal supply sales.<sup>39</sup> Ms. Lepine agreed that (a) there is nothing antithetical to a functioning competitive market for

<sup>37</sup> Tr. 1, p. 48, ll. 5-20 (Lepine).

<sup>38</sup> Deetken provided this example: “The wholesale price is set by the marginal unit of supply. Therefore, if the marginal unit of gasoline is, for example, trucked in from Edmonton, then the increased costs to local producers may reduce local profit margins but would not be expected to impact price.” Exhibit A2-1-1, Deetken Phase 2 Report, p. 33.

<sup>39</sup> Dr. Kahwaty stated: “Returns on capital may be high because the capital asset being considered is inframarginal and therefore more profitable than marginal supply sources.” Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 191.

Sources 1, 2 and 3 to charge the same price as Source 4, and (b) Source 1 could be expected to be the most profitable because it would have the greatest competitive advantage.<sup>40</sup>

- Third, if *infra*-marginal sources are removed from the market, then the market demand must be served by suppliers “further up the supply curve” (i.e., if you remove Sources 1 and 2, you will now need to rely on Source 5). That drives the wholesale “equilibrium price” upwards. As discussed later, that is exactly what has happened in the BC market. Since 2015, the constraints on TMPL have reduced by half one of the lowest cost sources of supply in BC, requiring backfilling from more expensive sources that drive up the “equilibrium” wholesale price.
- Fourth, if costs are layered on the marginal source of supply, the “equilibrium” wholesale price in BC goes up. As discussed later, that is exactly what has happened since 2015 with general cost inflation and the introduction of regulatory requirements like LCFS.

**(b) The BC Wholesale Market is Competitive: Refineries and Marketers Compete on a Continent-Wide Basis and Retailers Have Leverage**

51. There are two types of businesses that are active as sellers in the wholesale market: refiners selling their products to downstream entities (refiner-marketers), and non-refining wholesalers or marketers. The evidence, discussed below, shows that there are a number of refineries from which supply can be obtained for the BC market, as well as a number of marketers actively importing refined products. Retailers have real options, and have the leverage to negotiate more favourable terms. Simply put, there is a functioning wholesale market. It should be expected that the principles of market economics discussed in the previous section will play out in BC.

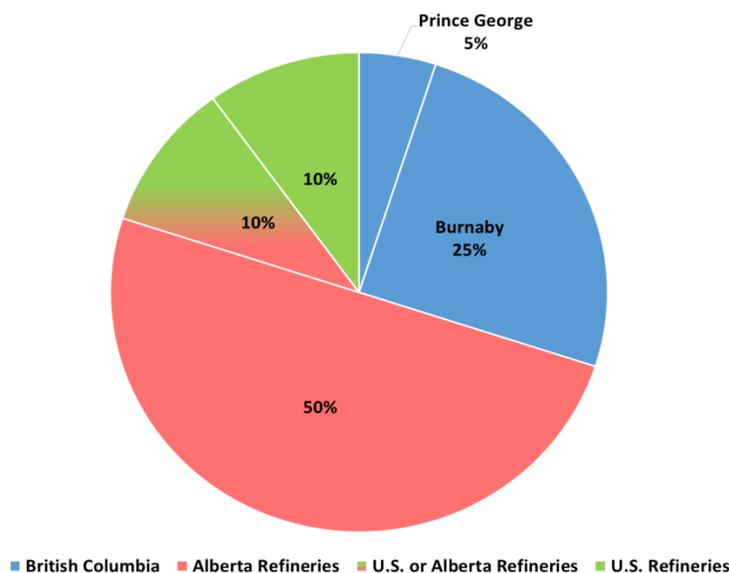
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<sup>40</sup> Tr. 1, p. 50, ll. 4-26 (Lepine).

**BC Wholesalers Obtain Products from Various Sources in BC, Alberta and the US**

52. The British Columbia retail market as a whole is approximately 200,000 bpd. Dr. Kahwaty included the following figure in his report, showing the varied sources of supply of gasoline.<sup>41</sup> It is a similar story with diesel.<sup>42</sup> Deetken echoed that “BC imports gasoline and diesel from a multitude of locations.”<sup>43</sup>

**Estimated Percentage of Total British Columbia Refined Products Demand Supplied by Refinery Location**



53. As shown above, Parkland’s Burnaby Refinery<sup>44</sup> (despite running at economic capacity<sup>45</sup>) can only serve approximately 25% of the demand. The Husky refinery in Prince George supplies a further 5%, also operating at a high utilization rate.<sup>46</sup> Imperial Oil Limited (“Imperial”), Suncor Energy (“Suncor”), and Shell Canada Limited (“Shell”) operate refineries in

<sup>41</sup> Figure 22, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para 54. See also: para. 82. Also, Kent included a figure in its presentation to the BCUC (Exhibit A2-3, pp. 59-60), which shows Western Canadian Gasoline flow in 2017. It confirms that the capacity of BC refineries can only serve approximately one-third of the market in BC. BC must import the remainder from Alberta and the US.

<sup>42</sup> Kent included a figure in its presentation to the BCUC (Exhibit A2-3, pp. 59-60), which shows Western Canadian Diesel flow in 2017.

<sup>43</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 11.

<sup>44</sup> Parkland has run the refinery since Q4 2017.

<sup>45</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 8.

<sup>46</sup> Exhibit C7-2, Husky Response to Questionnaire, Q. 8.

Alberta.<sup>47</sup> They ship refined products into British Columbia, primarily via the TMPL but increasingly by (more expensive) truck and rail due to constraints on TMPL. In addition, BC is served by imports from refineries located in the US. There are four large refineries in Washington,<sup>48</sup> as well as a number of others elsewhere in the US, from which refined products can be (and are) obtained by marketers for sale in the BC market.

54. Refineries throughout the region are therefore competing with one another to serve the BC market themselves and to sell to independent marketers who operate in the BC market. They are also competing with fuel brought by independent marketers from more distant refineries. Dr. Kahwaty characterized BC as having “a diversity of supply and the market is not dominated by any individual supplier.”<sup>49</sup> Dr. Kahwaty noted at the Oral Workshop that all marketers are looking at markets and thinking about where they can arbitrage them.<sup>50</sup> Mr. Wolinetz did not find significant volatility in refining differential that previously occurred in Washington State to be surprising as he said it was “not abnormal”.<sup>51</sup>

***BC Imports Come from as Far as California, the US Midwest and the Gulf Coast***

55. The following diagram, prepared by Deetken, shows the truly continental nature of the wholesale market; a material amount of BC’s gasoline supply comes from distant locations.<sup>52</sup> It also shows how the region of origin has fluctuated over time, but always includes supply from PADD 5 (Western US) and PADD 2 (US Midwest). These are large regions with multiple refineries, and the BC-bound supply originates from a variety of sources; the majority of the PADD 5 imports are from refineries in California and Washington.<sup>53</sup> In 2015, BC started

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<sup>47</sup> See Exhibit C5-2, Parkland Evidence, p. 15, fn. 11 for the capacity of these refineries.

<sup>48</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 82. These refineries and their capacities are: BP Cherry Point – 242,000 barrels per day; Phillips 66 Ferndale – 105,000 barrels per day; Shell Anacortes – 145,000 barrels per day; and Marathon Anacortes – 119,000 barrels per day.

<sup>49</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 88.

<sup>50</sup> Tr. 1, p. 133, l. 9 to p. 134, l. 19 (Kahwaty).

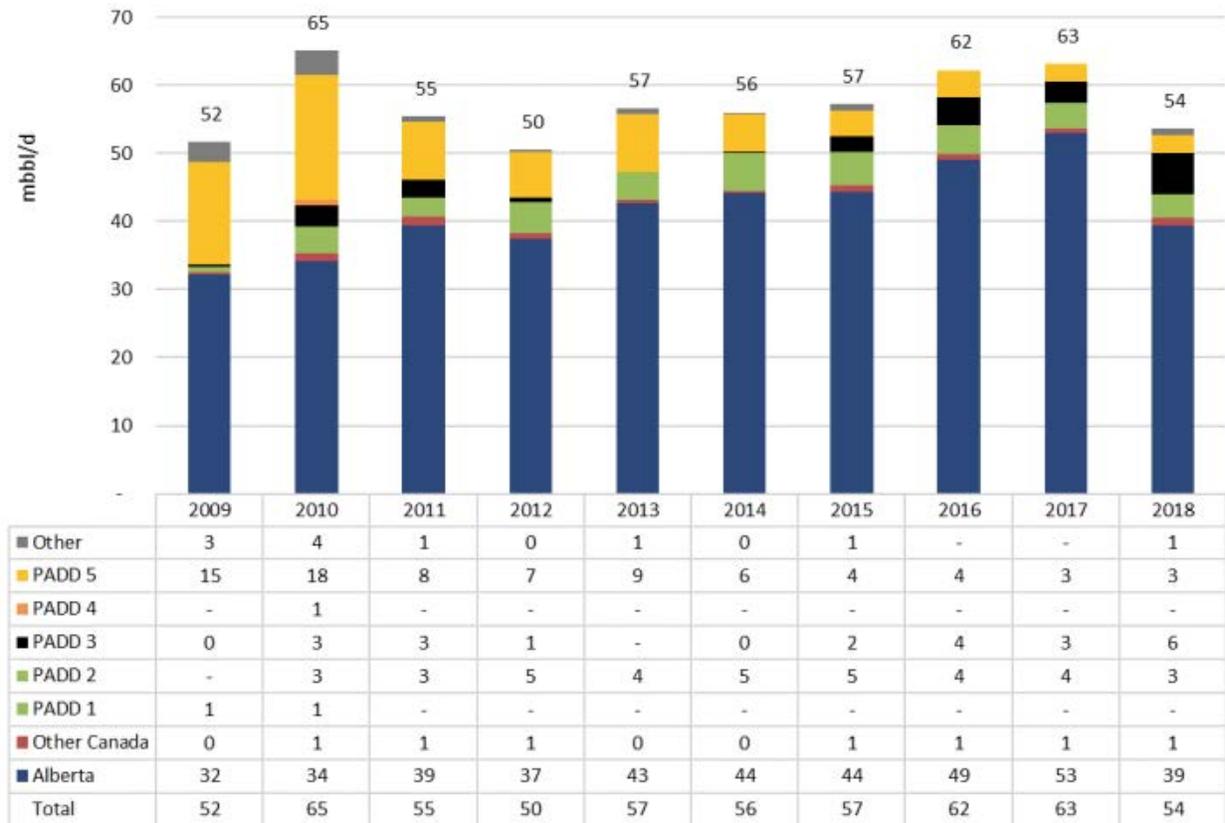
<sup>51</sup> Tr. 3, p. 619, ll. 7-11 (Wolinetz).

<sup>52</sup> Exhibit A2-1-3, Deetken PowerPoint Presentation, PDF p. 5.

<sup>53</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 12.

receiving material amounts of refined product originating in PADD 3 (US Gulf Coast).<sup>54</sup> The fluctuation in composition reflects changing market conditions in BC and the US - the nature and extent of the arbitrage opportunity from each location differs depending on factors such as relative market prices, transportation cost differentials and logistical issues. Put another way, the marginal source of supply can change over time.

**BC imports of road-use (clear) gasoline by source location**



56. Kent’s presentation to the BCUC underscores the extent of the integration, not just with Pacific Northwest markets, but with markets in the US Midwest as well:<sup>55</sup>

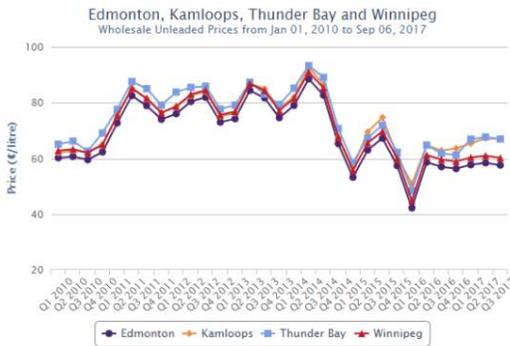
<sup>54</sup> Exhibit A2-1-2, Deetken PowerPoint Presentation, PDF p. 5.

<sup>55</sup> Exhibit A2-3, Kent Presentation, PDF pp. 116 and 132 respectively.

- **In Wholesale Markets** - where petroleum Refiners compete on a *continental* scale to sell refined petroleum products to retail marketing organizations.

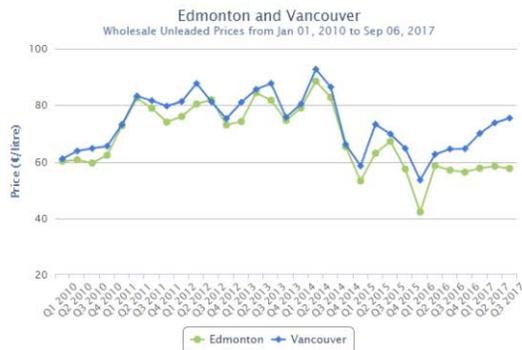


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- Deeply connected with US refined product markets in the Midwest

- Vancouver is often influenced by US west coast (Washington)



**Many Marketers Already Compete in BC and More Are in the Wings**

57. There are many gasoline and diesel wholesalers/marketers operating in British Columbia, listed in the following table.<sup>56</sup> Dr. Kahwaty observed that there has been recent entry into this market.<sup>57</sup> Moreover, there are other marketers capable of capitalizing on any arbitrage opportunities associated with supply from diverse locations in North America.<sup>58</sup>

<sup>56</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 34.

<sup>57</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, p. 3.

<sup>58</sup> Tr. 1, p. 133, l. 9 to p. 134, l. 19 (Kahwaty).

Marketer	Type	Brands
Parkland Fuel Corporation	Refiner-Marketer	Chevron, Esso, Fas Gas Plus, Race Trac
Unidentified Marketers or Dealers	Non-Refiner	Unbranded/Unknown
Suncor Energy Products, Inc.	Refiner-Marketer	Petro-Canada
Shell Canada Limited	Refiner-Marketer	Shell
Husky Energy Inc.	Refiner-Marketer	Husky
7-Eleven Canada, Inc	Non-Refiner	Petro-Canada, Esso, 7-Eleven
Federated Co-operatives Limited	Refiner-Marketer	Tempo, Save on Gas, Co-op
McDougall Energy	Non-Refiner	Pump, Esso, Unbranded/Unknown
Super Save Group	Non-Refiner	Super Save Gas
BCP IV Service Station LP/BG Fuels	Non-Refiner	Mobil
Proctor Petroleum	Non-Refiner	Gas N Go
Centex Petroleum	Non-Refiner	Centex, Unbranded/Unknown
Couche-Tard Inc.	Non-Refiner	Mac's, Shell, Petro-Canada, Esso, Husky
Sobeys Capital Inc.	Non-Refiner	Safeway
Gas Plus Inc.	Non-Refiner	Gas Plus, Unbranded/Unknown
Canco Petroleum	Non-Refiner	Canco
Costco Wholesale Canada Ltd.	Non-Refiner	Costco
XTR Energy Company Limited	Non-Refiner	Gulf, XTR
Canadian Tire Petroleum	Non-Refiner	Canadian Tire
Domo Gasoline Corporation Ltd.	Non-Refiner	Domo
Shell Pilot Flying J Joint Venture	Refiner-Marketer	Shell and Flying J
BVD Petroleum	Non-Refiner	Petro-Canada
G&B Fuels Inc.	Non-Refiner	G&B Fuels
GTI Petroleum Ltd.	Non-Refiner	GTI

Source: "2018 National Retail Petroleum Site Census," Kent Group Ltd., June 7, 2019.

58. Parkland explained the low barriers to entry for marketers as follows:<sup>59</sup>

The wholesale/bulk sales channel is characterized by low barriers to entry, as is evidenced in part by the large number of small competitors that are active in this industry in Canada. Notably, ownership of a bulk plant and transportation network is not required to supply bulk fuel. For example, competitors may supply fuel from nearby supply points or transport fuel products greater distances from existing supply points to minimize the capital expenditures and lease costs associated with owning and operating a bulk plant. Two US refining companies supply 60% of the Vancouver International Airport by barge and tanker truck. Further, fuel marketers can and do enter the wholesale supply business with as little as a single truck, or may contract with local brokers or third party haulers to transport fuel on their behalf. Fuel marketers may also expand their service area with little capital expenditure by creating a new supply point with the acquisition of a large tank trailer which is parked in a pre-determined location and used to fill tandem trucks (i.e., smaller vehicles used to

<sup>59</sup> Exhibit C5-2, Parkland Evidence, p. 33.

make deliveries to customers who require smaller volumes of bulk fuels). We understand that a number of small marketers haul fuel in trucks from Alberta, taking advantage of the 75 ML/year threshold contained in the BC low carbon fuels regulations, thereby avoiding some of the compliance costs that have been described in this Evidence.

59. The identity of the marketers who are responsible for the imports shown in the figure above (i.e., whether some of the imports are attributable to refiner-marketers importing supply to backfill during a temporary shortfall in their own supply) is a “red herring”. It is the delivered cost of the marginal source of supply that matters. The imports will have the same impact on the equilibrium price regardless of the importer. Deetken pointed out that the equilibrium price would be affected, simply by the substitution of one lower cost mode of transport for another higher cost mode.<sup>60</sup>

***Retailers Have Options, and Are Able to Negotiate Favourable Terms***

60. Dr. Kahwaty observed about the BC wholesale market: “With multiple brands and marketers seeking dealer business, dealer stations have options in terms of the brands they utilize and the sources of gasoline and diesel for their stations.”<sup>61</sup> As discussed below, the evidence is that retailers exercise those options, and have sufficient leverage over marketers to negotiate discounts.

61. The following chart, presented by Dr. Kahwaty based on data from the Kent Group, illustrates an active market – dealers are able to change their fuel supplier and their fuel brand, and sites open and close in response to market forces.<sup>62</sup>

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<sup>60</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 34 and 35: “It is helpful to consider the example of a litre of gasoline travelling from Edmonton to Vancouver. If pipeline transportation is priced at 1 cent/L until capacity is reached and if the next best alternative is rail, then both forms of transport will be priced at the marginal cost of rail transport.”

<sup>61</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 38.

<sup>62</sup> Exhibit C5-2, Parkland Evidence, p. 19.

Type	BC Retail Station Count				Comments
	2018	2017	2016	2015	
Change in marketer	14	187	80	26	Reflects major entry (i.e., BG Fuels, 7-Eleven, Parkland) and exit (i.e., Loblaw, Imperial, Chevron) from market, and change in dealers
Change in brand	46	12	12	11	Reflects re-brand activity, often when independent dealers have decided to change suppliers (e.g. an independent dealer deciding to move to Shell instead of remaining a Parkland (Chevron) dealer).
New site	13	21	10	11	New to industry locations
Closed site	5	16	4	8	Site closures

Source: Kent Group Ltd.

62. Given the wholesale supply options available to retailers, it would be unwise and unsustainable for marketers to set uncompetitive rack prices. Dr. Kahwaty elaborated:

Long-term, if I'm, as a wholesaler, develop a reputation as trying to take advantage of my contracting relationships and increase the price to my dealers, what's going to happen? When the contracts come up, the dealers are going to sign up with a different supplier. If Shell were to try to charge the prices that were too high, you could see people switching over to Suncor or to Parkland, or to Global. You would also see the wholesale supplier disadvantaged in signing up new dealer contracts for new stations that might open.

...

But there's a steady stream of contracts that are coming up for renewal. Over time you're going to see wholesalers that try to take advantage of this contracted pricing relationship losing [sic] supply, losing [sic] contracts to other wholesalers and ultimately seeing their wholesale businesses erode. And in the long term can I maintain a price above a competitive level in terms of what the market will support where there are other wholesalers out there bidding for these contracts. I think the answer to that is no, you're not going to be able to maintain a price in that environment above a competitive level for an extended period of time.<sup>63</sup>

<sup>63</sup> Tr. 1, p. 155, l. 9 to p. 156, l. 18 (Kahwaty).

63. Marketers participating in this Inquiry echoed Dr. Kahwaty's assessment that attempting to take advantage of a customer under contract would backfire:

- Mr. Krogmeier's evidence for Parkland was as follows:

The market signal we get is when we know we are not competitive is our buyer will choose to go to a different supplier. And so that is really the price signal that guides us in terms of the competitiveness of that contract price.<sup>64</sup>

- Mr. Scammell's evidence for Imperial was as follows:

But really what matters is, well we'll propose this price to a customer and one of two things is going to happen. They are probably going to say "Hey, you guys are really uncompetitive today, you are 10 cents out, we are not going to buy from you today." And that's our signal that something else has happened in that market. I don't know if it is another piece of supply, or someone has lost their supply or whatever, and we adjust. And it's that adjustment at the end is how we account for all those unknowns. That there is something going on that we can't see on that marginal layer of the market.<sup>65</sup>

- Mr. McLean's evidence for Suncor was as follows:

It's very similar to retail pricing where you have to match the price sign, except this is at the wholesale rack.

...

Customers are generally forgiving, generally, if you're close because they know on average you'll be the same. So you might be -- and we're talking tenths of a cent, tenths of a cent higher one day and you'll be tenths of a cent lower. If you are out you will hear very quickly because our entire wholesale pricing is predicated on the rack.<sup>66</sup>

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<sup>64</sup> Tr. 1, p. 161, l. 23 to p. 162, l. 3 (Krogmeier). See also: Tr. 4, p. 662, l. 18 to p. 663, l. 8 (White).

<sup>65</sup> Tr. 1, p. 276, ll. 5-16 (Scammell). See also: Tr. 1, p. 279, l. 21 to p. 280, l. 3 (Scammell).

<sup>66</sup> Tr. 2, p. 339, ll. 14-24 (McLean).

64. Moreover, the marketers that participated in this Inquiry provide discounts on the rack price - often significant ones - to many of their customers.<sup>67</sup> This reflects the fact that retailers have leverage in negotiations with marketers. Such discounts would not exist if marketers were capable of exercising market power.

***Dr. Kahwaty and an NEB Witness Agree: There is a Functioning Wholesale Market in BC***

65. Dr. Kahwaty and a witness for the NEB characterized the BC wholesale market as a functioning market.

66. Dr. Kahwaty observed, for instance, that the BC wholesale market for gasoline and diesel “is competitive structurally and is a well-functioning market.”<sup>68</sup> He explained that “Markets are viewed as functioning well if they have a sufficient number of competitors or lack substantial barriers to entry.”<sup>69</sup> [Emphasis added.] The BC market checks both boxes. Dr. Kahwaty cited “the diversity of British Columbia’s supply sources and the relatively low shares for individual gasoline and diesel marketers”.<sup>70</sup> He also cited the low barriers to entry and the presence of potential entrants:<sup>71</sup>

Recent significant market entry is an indication that the market lacks significant barriers to entry or expansion. Global Fuels is a recent entrant competing to supply dealer stations in British Columbia. In 2018, Global Fuels supplied 71 stations in Ontario, 39 stations in Québec, and 13 stations in New Brunswick. Ninety-three of these stations are Esso branded, 23 of these stations are Global branded, and 7 stations are Mobil branded. Other non-refining marketers compete in this business elsewhere in Canada and could enter the business in British Columbia if the market in British Columbia had elevated prices due to insufficient competition among the current British Columbia market participants.

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<sup>67</sup> Tr. 1, p. 161, ll. 16-22 (Krogmeier); Exhibit C5-2, Parkland Evidence, p. 24. Parkland’s public evidence was that these discounts can range, and it elaborated *in camera* (Confidential Tr. 4A, p. 47, ll. 2-21) and with Exhibit C5-17, Parkland Confidential Undertaking No. 1. See also: Exhibit C2-2, Suncor Response to Questionnaire, Q. 18; Tr. 4, p. 707, l. 14 to p. 708, l. 7 (McLean); Exhibit C7-2, Husky Response to Questionnaire, Q. 17; Tr. 2, p. 542, ll. 15-20 (Friesen); Tr. 2, p. 543, ll. 7-14 (Friesen); Tr. 4, p. 754, l. 21 to p. 755, l. 12 (Rosencrans).

<sup>68</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 101.

<sup>69</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 53.

<sup>70</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 101.

<sup>71</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 87.

As an example, MacEwen owns and operates retail gas stations in Ontario and Québec and also serves as a branded wholesaler of Esso products in Ontario, Québec, and Manitoba.

67. Mr. Van Sluys of the NEB reached a similar conclusion, advising the Inquiry Panel:<sup>72</sup>

So, yeah, there is both exports from B.C. to external markets and there's imports to B.C. from external markets. In my view that's a signal that it's a well-functioning market and that the B.C. gasoline market is well integrated with nearby markets. So there's plenty of opportunity to move product back and forth.

**(c) Declining TMPL Volumes Have Necessitated Reliance on Progressively More Costly Supply**

68. Refined products shipped from Alberta via the TMPL are one of the least expensive sources of supply for the BC market.<sup>73</sup> This section presents the evidence that TMPL capacity constraints have reduced the refined products shipments on TMPL by approximately one-half since 2015, such that marketers have relied on progressively more expensive delivered supply to serve the BC market. Consistent with the textbook market dynamics depicted in the often-cited "Deetken Diagram", reliance on progressively more expensive sources of delivered supply since 2015 has increased the equilibrium wholesale price.

***The Evidence is Overwhelming that TMPL Capacity is Constrained***

69. Despite the claims of Allan/Eliesen, the evidence leaves no room for doubt that TMPL capacity is constrained:

- TMPL's owner confirmed that all of the capacity on the TMPL is being used.<sup>74</sup>
- NEB - the regulator of the TMPL - publishes data on capacity utilization. It shows that TMPL is operating at capacity.<sup>75</sup> Mr. Charlebois told the Panel that he was

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<sup>72</sup> Tr. 1, p. 96, ll. 11-20 (Van Sluys).

<sup>73</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 50.

<sup>74</sup> Exhibit E-68, TMPL Letter of Comment, pp. 2-3.

“confident in the quality of the pipeline data that the NEB provides Canadians” because it is provided pursuant to regulations, is scrutinized by the NEB’s market analysts, and the NEB market analysts can follow up if anomalies are detected.<sup>76</sup>

- The pipeline has been under allocation, which means that the desired shipping usage exceeds its capacity; line space is allocated to shippers according to a formula based on historic usage.<sup>77</sup>
- Various marketers, including Parkland<sup>78</sup>, Suncor<sup>79</sup> and Imperial<sup>80</sup>, confirmed that they have been unable to get sufficient capacity at times.
- The existence of an aftermarket for capacity on TMPL, and the price of that capacity, is objective evidence of the constraint. The average successful bid for aftermarket capacity on TMPL has ranged between approximately 7 to 34 times the TMPL base tariff.<sup>81</sup> Ms. Lepine agreed that there is no world in which a company behaving rationally would pay between 7 and 34 times the TMPL base tariff if there was capacity on that pipeline that could be purchased for the base

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<sup>75</sup> Exhibit C4-3, NEB Evidence, PDF pp. 4-5: “In recent years, all available capacity on the Trans Mountain pipeline has been utilized by shippers each month. The average utilization rate on the pipeline was 98.5% in the first quarter of 2019.” NEB Representatives from the NEB reiterated this at the Oral Workshop: Tr. 1, p. 81, ll. 12-18 (Charlebois). As did Deetken: Tr. 1, p. 53, ll. 17-23 (Lepine).

<sup>76</sup> Tr. 3, p. 637, ll. 7-13 (Charlebois).

<sup>77</sup> The NEB, in RHW-001-2013, transitioned all land shippers to a historical averaging volume allocation process effective in Q2 of 2015. Section 14 of Trans Mountain pipeline Tariff No. 105, which was released in October 2018, outlines the allocation process of available capacity on the Trans Mountain pipeline. A copy of Trans Mountain pipeline Tariff No. 105 is Exhibit A2-10 on the BCUC website. Kent, in its presentation to the BCUC (Exhibit A2-3, PDF p. 69), described Trans Mountain Pipeline as being “essentially full...under allocation for several years”, and stated that the expansion project “Will likely increase space allocation for refined product in Line 1”.

<sup>78</sup> Exhibit C5-2, Parkland Evidence, pp. 15, 16 and 27; Appendix A, Parkland Response to Questionnaire, Q. 2. Parkland indicated that it is now bringing in approximately 5 -10% of the overall crude supply for the Burnaby refinery by rail at additional cost.

<sup>79</sup> Suncor Response to Questionnaire, Q. 11, revised in Exhibit C2-2-1. “Logistical Cost Drivers - over the last 3-5 years, the Trans Mountain Pipeline (TMPL) has decreased its line space (capacity) allocated to finished products (gasoline and diesel) delivered to Suncor’s terminals in British Columbia by approximately 60 ml per month, which resulted in an increase in the more costly transportation of these products by rail and truck.”

<sup>80</sup> Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 11.

<sup>81</sup> Exhibit C5-2, Parkland Evidence, p. 32.

tariff price.<sup>82</sup> Mr. Charlebois also told the Panel that the fact that a secondary market exists at a price much higher than the regulated toll also suggests that the pipeline is fully utilized.<sup>83</sup>

***Refined Products on TMPL Have Sharply Declined Since 2015***

70. Refined products are competing for space with crude exports, and the more favourable economics associated with crude exports has made it difficult for refined products to compete for aftermarket capacity.<sup>84</sup> As a result of the TMPL constraint, NEB-approved apportionment rules, and the high cost of aftermarket capacity, there has been a significant decline in the amount of refined products shipped on TMPL since 2015.

71. The following two figures highlight the TMPL capacity constraint and its effect on the movement of refined products by pipeline. The figure immediately below shows the percent of total estimated capacity used on TMPL over time (top blue line) and the percent of throughput allocated to refined products (bottom red line). The percent of throughput allocated to refined products has trended downward since 2015 to the point where it was below 10% in Q1 2019.

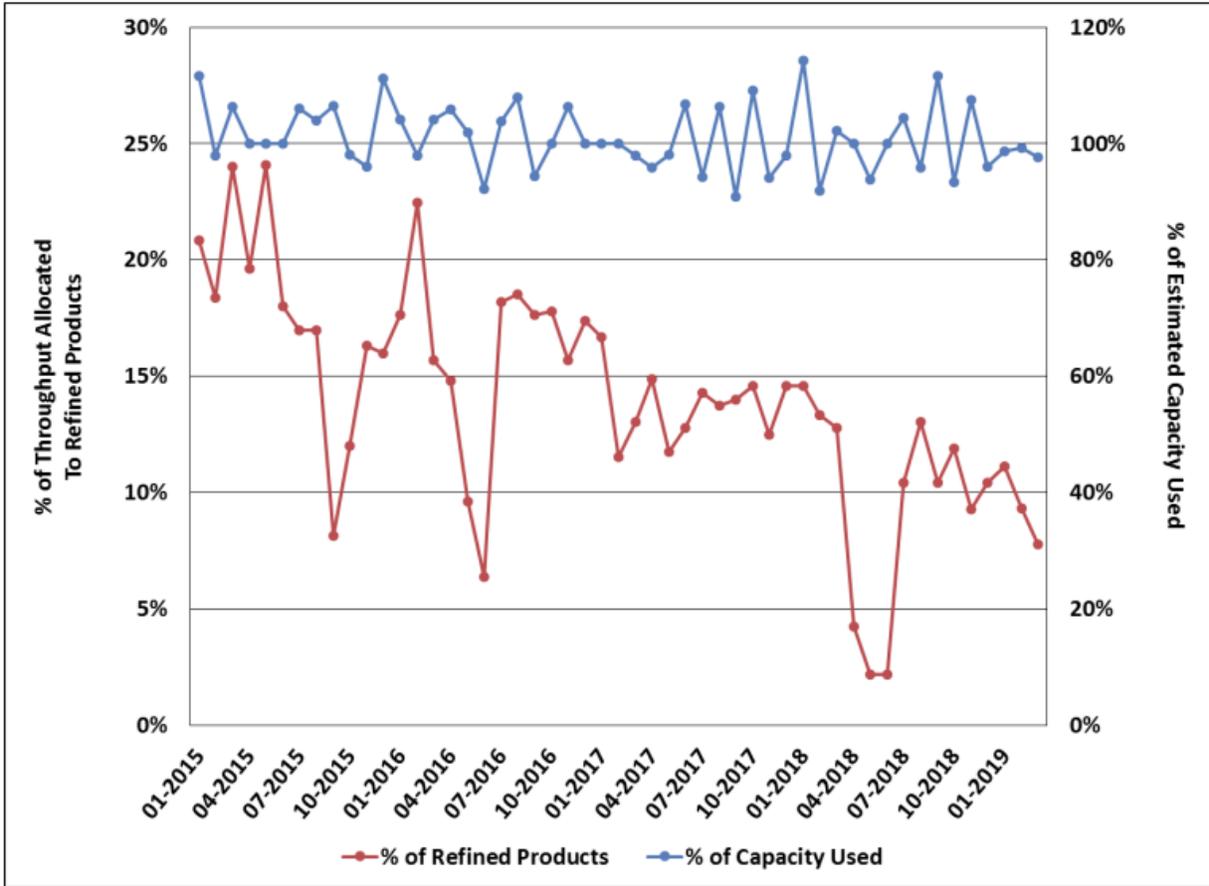
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<sup>82</sup> Tr. 1, p. 65, ll. 6-13 (Lepine).

<sup>83</sup> Tr. 3, p. 638, ll. 18-25 (Charlebois).

<sup>84</sup> The arbitrage opportunity on crude exports is largely in light of the depressed price of land-locked Alberta crude and high prices in Asia, etc. Exhibit A2-1-1, Deetken Phase 2 Report found at p. 36 that "In 2018 and 2019 the capacity for export of crude out of Alberta was fully utilized and unable to meet demand. Pipelines were full and the Province of Alberta announced a restriction in production of crude to address the situation. These capacity constraints resulted in a growth of the arbitrage opportunity for crude product exported from Alberta, particularly in 2018. This arbitrage opportunity created the market conditions for refined product traveling through the TMPL to be partially replaced with crude for export." See also: Tr. 2, p. 306, l. 21 to p. 307, l. 8 (Wallin) and p. 346, ll. 2-24 (Wallin).

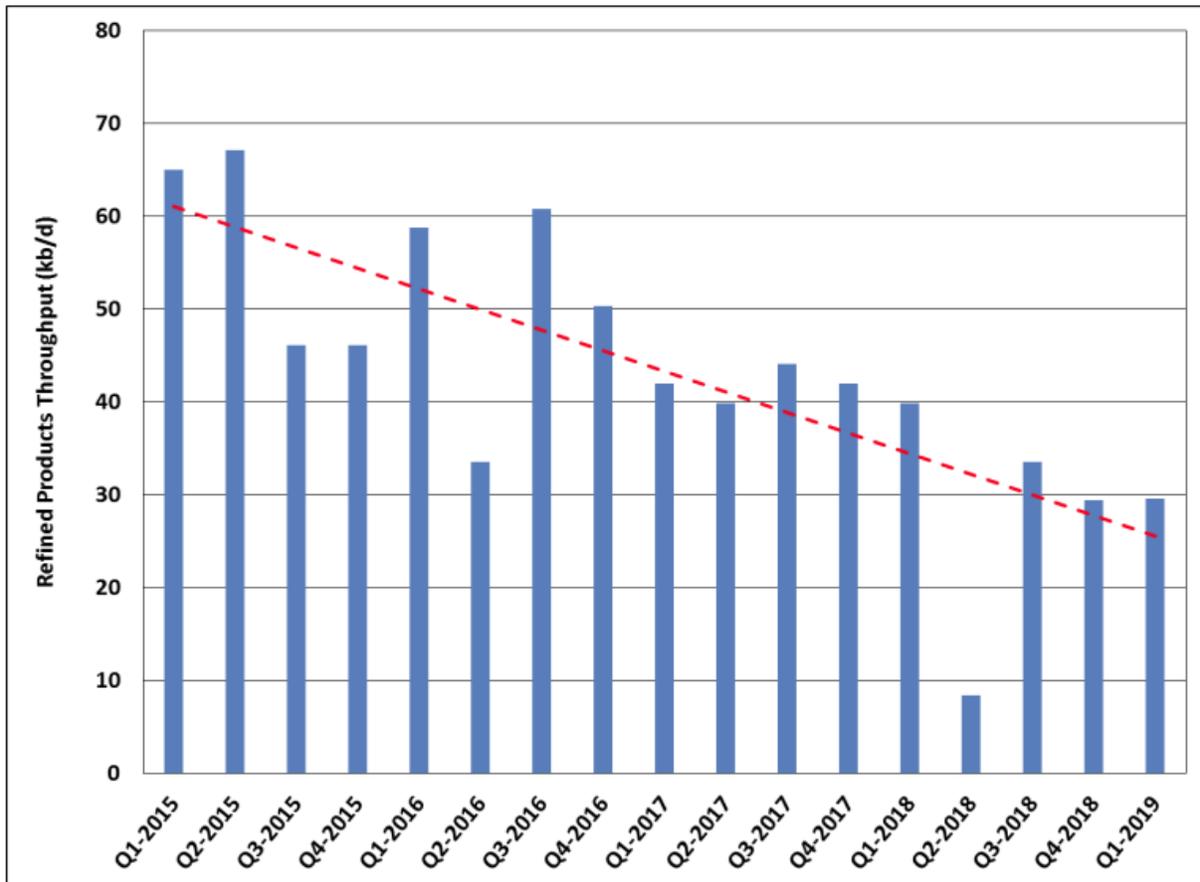
**Trans Mountain Pipeline Percentage of Throughput Allocated to Refined Products and Percentage of Estimated Capacity Used 2015 - Q1 2019<sup>85</sup>**



72. This next figure provides quarterly throughput volumes of refined products on TMPL since the start of 2015. It also shows the simple linear time trend in these data. The downward trend is, once again, unmistakable.

<sup>85</sup> Figure 16, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para 52. Sources: Government of Canada, "Pipeline Throughput and Capacity Data – Trans Mountain Pipeline", available at <<https://open.canada.ca/data/en/dataset/dc343c43-a592-4a27-8ee7-c77df56afb34>>; "Pipeline Profiles: Trans Mountain", National Energy Board, September 2018, available at <<https://www.neb-one-gc.ca/nrg/ntgrtd/pplnprfls/crdl/trnsmntn-eng.html?=&wbdisable=true>>.

### Trans Mountain Pipeline Average Quarterly Throughput Allocated to Refined Products 2015 – 2019<sup>86</sup>



Note: The red dashed line is a simple linear trend line across all data points.

73. In essence, there is a 30,000 bbl/day difference between Q1 2015 and Q1 2019. 30,000 bbl/day represents 15% of the BC market demand.

#### ***The Supply that Has Replaced TMPL Supply is Much More Costly***

74. The demand in BC that is no longer served by products shipped via TMPL must still be met from somewhere.

<sup>86</sup> Figure 17, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para 52. Sources: Government of Canada, “Pipeline Throughput and Capacity Data - Trans Mountain Pipeline”, available at <<https://open.canada.ca/data/en/dataset/dc343c43-a592-4a27-8ee7-c77df56afb34>>; “Pipeline Profiles: Trans Mountain”, National Energy Board, September 2018, available at <<https://www.neb-one.gc.ca/nrg/ntgrtd/pplnprtl/pplnprfls/crdl/trnsmntn-eng.html?=&wbdisable=true>>.

75. The NEB representatives explained that, if an Alberta shipper cannot move all of its product on the TMPL under its allocated capacity, then it must acquire aftermarket capacity or rely on other modes of transportation such as rail, truck or marine.<sup>87</sup> All of these alternatives are more expensive, leading to a higher delivered cost.<sup>88</sup> Dr. Kahwaty echoed this observation:<sup>89</sup>

For the past several years, Trans Mountain has been operating near or at capacity, with refined fuels for British Columbia making up only a relatively small amount of the products transported. The result of refined product competition with crude oil for space on Trans Mountain is that the transport of refined fuels into British Columbia is relatively more expensive than it would otherwise be. Any refined fuels shipped from Alberta that cannot be allocated pipeline capacity are essentially required to be transported via truck or rail. On a per barrel basis, both of these are significantly more expensive than transport via pipeline at tariff rates.

76. The evidence of marketers bears this out. For instance, Suncor is moving product by rail and truck,<sup>90</sup> which it described as “suboptimal”.<sup>91</sup> Imperial stated:<sup>92</sup>

As a result of pipeline apportionment on the Trans-Mountain Pipeline, Imperial has:

o increased the amount of refined products it ships to British Columbia by rail and marine vessel, which are typically more expensive means of transportation than transportation by pipeline; and

o secured increased storage to serve the Vancouver area and increased marine logistics from that facility to Imperial’s existing distribution facilities in British Columbia.

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<sup>87</sup> Tr. 1, p. 81, ll. 22-26 (Charlebois).

<sup>88</sup> Exhibit A2-4, NEB Research Paper, *Western Canadian Crude Oil Supply, Markets, and Pipeline Capacity*, p. 11: “Rail transportation of crude oil is a more expensive alternative to pipeline transportation. Rail is typically only used when pipeline infrastructure is not available, or when price differentials are wide enough for rail to be economic.” Parkland indicated that crude by rail costs are 10 to 15 times the TMPL base tariff: Exhibit C5-6, Response to Questions for Oral Hearing, Q. 1A. See also: Exhibit C5-2, Appendix A, Parkland Response to Questionnaire, Q. 2, Attachment 1A.

<sup>89</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 51.

<sup>90</sup> Suncor Response to Questionnaire, Q. 11, revised in Exhibit C2-2-1; see also Tr. 2, p. 303, ll. 17-22 (McLean).

<sup>91</sup> Tr. 2, p. 307, ll. 9-11 (Wallin).

<sup>92</sup> Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 11. See also: Tr. 1, p. 291, l. 8 to p. 292, l. 15 (Scammell).

***Allan/Eliesen’s Focus on Absence of Supply Shortages Misses the Point***

77. Allan/Eliesen repeatedly suggested that TMPL constraints must not have been a real issue because there have been no product shortages. There are two answers to this argument. First, they are attacking a “straw-dog”; none of the market participants who testified in this Inquiry have suggested that TMPL constraints have caused shortages in BC. Second, Allan/Eliesen’s argument misses the point. The market has met the BC demand despite the TMPL constraints, *but it has been met with higher cost supply*. The market has done its job, behaving exactly as economic theory would suggest it should. This underscores the importance of allowing the market to function, since price controls may have generated shortfalls by making it uneconomic to import higher cost supply.

**(d) The Marginal Supply Cost Has Increased Due to Cost Escalation and Regulatory Requirements, Thereby Increasing Wholesale Prices / Refining Margin**

78. The corollary of the basic market economics principle that wholesale prices will reflect the cost of the marginal source of supply (i.e., the “Deetken Diagram”) is that the equilibrium wholesale price will increase when new costs are imposed on the marginal supply source. This has happened in BC since 2015. We focus below on two developments: (1) there has been general inflation in refining and transportation costs; and (2) new regulatory requirements, particularly those unique to BC, have made refined products much more costly to produce for the BC market.

***Market Economics: Increasing the Delivered Cost of the Marginal Barrel Increases the Wholesale Price***

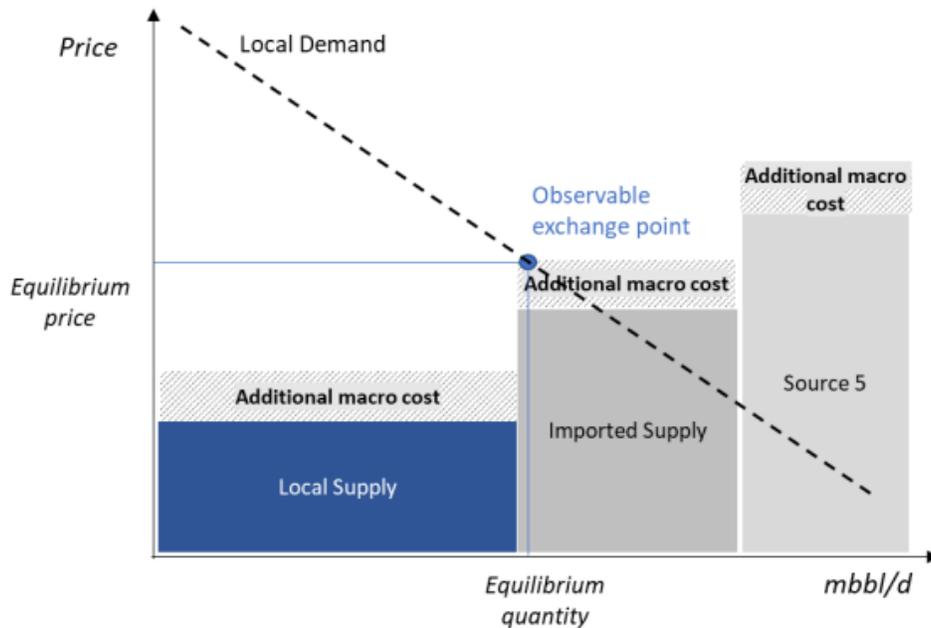
79. Deetken provided other conceptual illustrations of how market prices are affected when costs are imposed on suppliers. The price response differs depending on (a) whether costs are unique to an *infra*-marginal supplier(s) or (b) whether they affect all market participants, including the marginal supplier. The latter scenario is depicted in Deetken’s figure inserted below.<sup>93</sup> It shows that layering additional costs (shown as “Additional macro cost”) on top of the cost of the marginal source of supply (shown as “Imported Supply”) drives up the

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<sup>93</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 34.

equilibrium price. In other words, economic theory indicates that these additional “macro” costs will be passed on to the consumer in the form of higher prices.<sup>94</sup>

**Chart 4.2.2 Example of the impact of a macro shock**



80. Dr. Kahwaty outlined “a long list” of operating and capital costs that go into producing gasoline and diesel. Consistent with the economic theory articulated above, he stated that cost increases in any of these categories of costs since 2015 “could lead to changes in gasoline or diesel pricing over time.”<sup>95</sup> The same principle would apply to refined product transportation costs. He also addressed the impacts of BC’s low carbon initiatives, stating that “Economic theory predicts that marginal cost increases will result in increased prices, especially for products like gasoline, that have inelastic demand.”<sup>96</sup>

<sup>94</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 11.

<sup>95</sup> Exhibit C5-2, Parkland Evidence, Exhibit B, Kahwaty Report, para. 124. These costs include personnel costs (salaries, wages, and benefits), maintenance costs (maintenance materials, contract maintenance labor, and equipment rental), insurance (both for the fixed assets and inventory), depreciation (annual accounting charge for the capital assets), general and administrative (all office and other administrative expenses), chemicals and additives, catalysts, royalties, utilities (electricity, steam, water), and refinery fuel (natural gas).

<sup>96</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 60.

***Refining and Transportation Costs Are Subject to Inflationary Pressures***

81. The evidence demonstrates that refining costs have increased since 2015. For example, Parkland estimates that the total cost to operate its refinery has increased by approximately 35% since 2015.<sup>97</sup> While the Parkland refinery is unlikely to be the marginal supply source, it is reasonable to expect that the marginal source of supply is similarly subject to inflationary pressures. The cost of transportation of refined products is similarly subject to inflationary pressures, including the rising cost of diesel fuel for tanker trucks.

***BC's Regulatory Requirements Have Had a Significant Impact on Wholesale Prices and Refining Margin Since 2015***

82. There have been some notable changes in regulatory requirements since 2015 that have affected all BC refiners and/or marketers selling in to BC. Given their impact on the marginal supply source in BC, these regulatory requirements have contributed significantly to higher gasoline and diesel prices at the pump in British Columbia since 2015.

83. New federal standards have been implemented since 2015 that limit sulphur content. Parkland indicated that in order to comply, the Burnaby refinery has had to operate in a more costly operating posture to produce low sulfur gasoline components to build credits for the 2020 deadline.<sup>98</sup>

84. BC's renewable fuel content standards require 5% renewable content for gasoline and 4% for diesel. Various marketers described the implications of compliance as including direct costs of compliance (e.g., purchasing higher cost renewable fuel<sup>99</sup>). Parkland described costs associated with the loss of flexibility.<sup>100</sup> Note that, while these regulations are

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<sup>97</sup> Exhibit C5-2, Parkland Evidence, p. 24. See also: Appendix A, Parkland Response to Questionnaire, Q. 4.

<sup>98</sup> From 2016 to 2020, the sulfur content of gasoline at any point in the distribution system is being reduced from 40 mg/kg sulfur ultimately to 10 mg/kg. See Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 4.

<sup>99</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire", Q. 4; Exhibit C2-2, Suncor Response to Questionnaire, Q. 4 and 5; Tr. 2, p. 303, ll. 8-14 (McLean); Exhibit C7-2, Husky Response to Questionnaire, Q. 5.

<sup>100</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 4. See also: Parkland Evidence, p. 30 - "In a facility with inflexible storage capacity such as the Burnaby Refinery, the requirement to

undeniably contributing to higher prices in BC, they are not a major source of the refining margin *differential* with other jurisdictions because they are similar to standards in other provinces.

85. Two regulatory changes are unique to BC, and are thus also contributing to a refining margin differential relative to other regions:

- (a) **BC's Low Carbon Fuel Standard (LCFS):** BC is the only province with a LCFS requirement.<sup>101</sup> It requires refiners who produce fuel for the BC market to progressively lower the carbon intensity of fuels produced at the facility every year. There are limited pathways to comply with this legislation, all of which involve significant costs.<sup>102</sup> Parkland characterized the implications as follows:<sup>103</sup>

These requirements in BC have significant ramifications for production costs and, ultimately prices:

- Renewable fuels that meet this lower carbon intensity requirement are typically higher in unit cost, are much lower in availability and must be sourced in the international marketplace. The international sourcing leads to exposure to other jurisdictions' clean fuels programs and demands that are larger and higher volume than BC.
- Production of a renewable fuel requires a manufacturer to invest in the refinery to process and produce low carbon fuels (i.e., R&D and actual scaled processing of bio-intermediate stocks to produce low carbon intensity renewable fuels), which can threaten the base operability of a refinery. These are experimental processes at or near the leading edge of renewable fuel production.

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store an increasing volume of renewable fuels for blending into refined products will necessarily reduce the storage available for existing products. This exacerbates the supply uncertainty associated with TMPL, and the Burnaby Refinery's ability to respond quickly to the market."

<sup>101</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 5.2.

<sup>102</sup> Exhibit C5-2, Parkland Evidence, p. 8.

<sup>103</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 4.

- It necessitates acquiring and trading credits in a marketplace that currently does not exist. When credits have been periodically made available through limited auctions and through a few agencies, bids have sold in excess \$200/MT (1.5 cents per litre).

Suncor similarly stated:<sup>104</sup>

The main changes over the last 3-5 years relate to the implementation of the British Columbia Low Carbon Fuel Requirements (BC LCFRR) and preparation for the implementation of the British Columbia Clean Fuel Standards (CFS). These changes have increased both the regulatory compliance costs and the operating and capital costs associated with the production of gasoline and diesel for sale in British Columbia, particularly in relation to meeting blending requirements.

Husky also highlighted that “The increasing BC LCFS requirements and more stringent renewable fuel mandate have increased the cost of supplying fuel in BC relative to the Edmonton market.”<sup>105</sup> Dr. Kahwaty elaborated on the implications of LCFS in his report.<sup>106</sup>

- (b) **British Columbia Cleaner Gasoline Regulation:** BC’s cleaner gas regulations for gasoline are more stringent during certain times of the year than the other provinces or the US Pacific Northwest. This discrepancy leads to higher manufacturing and blending costs for any refineries selling product for the BC market during those times.<sup>107</sup>

86. Dr. Kahwaty pointed out the trade-off that comes with low carbon initiatives: “There is a trade-off between emissions and production costs, and British Columbia has opted to accept higher costs in order to achieve additional emissions reductions. Other provinces

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<sup>104</sup> Exhibit C2-2, Suncor Response to Questionnaire, Q. 4.

<sup>105</sup> Exhibit C7-2, Husky Response to Questionnaire, Q. 5.

<sup>106</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, paras. 59-61.

<sup>107</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 4.

have opted for lower costs, but at the cost of higher emissions.”<sup>108</sup> His observation is intuitive. Moreover, it is supported by analysis of the California LCFS system, which suggests that the cost of compliance is being passed on to California consumers. There is every reason to expect that BC’s compliance costs – which in some cases have trended even higher than California’s costs - would have a similar effect.<sup>109</sup>

**(e) There is Ample Evidence that the Wholesale Market is Behaving as Expected**

87. Various marketers gave evidence that they set their prices in a manner consistent with a competitive continental market, where marginal supply costs are a key consideration. Data shows the strong links between BC’s wholesale rack prices and US and Alberta markets. The evidence supporting these two points is discussed below.

***Marketers Reference US Market Prices, Not their Own Costs, When Setting Wholesale Rack Prices***

88. Imperial indicated that it does not consider changes in its own costs or refining margins when setting its wholesale gasoline and diesel prices day-to-day.<sup>110</sup> Rather, it considers local competitiveness, “relevant U.S. finished product benchmark prices”<sup>111</sup> (including benchmarks in the Pacific Northwest and Chicago), and transportation and logistics costs (i.e., the cost of bringing product from those other markets):<sup>112</sup>

The wholesale price for gasoline or diesel in a given area is determined by the competitive supply and demand dynamics for each of those products. The wholesale price will land at the point where available supply and demand reach a balance.

The competitive supply and demand factors include (i) what customers in that area are willing to pay for the product as compared to their alternatives, and (ii) what other competitors are willing to sell their product for as compared to their

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<sup>108</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 172.

<sup>109</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 60.

<sup>110</sup> Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 3, Q. 4 and Q. 5.

<sup>111</sup> Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 17.

<sup>112</sup> Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 17.

alternatives. If one competitor drops its price to attract new customers, others may drop their price to retain their customers and/or attract new customers.

Factors that influence the setting of wholesale prices may include (i) relevant U.S. finished product benchmark prices (e.g., wholesale prices in British Columbia may be influenced by Chicago spot prices and Pacific Northwest spot prices since finished products priced in terms of such benchmarks can be shipped to British Columbia), (ii) U.S. – Canadian foreign exchange rates; and (iii) local factors such as transportation and storage costs, regulatory compliance costs (e.g., Low Carbon Fuels Standard in British Columbia) and supply disruptions.

It is understood that, over time, general trends in North American crude prices may influence U.S. finished product benchmark prices.

89. Parkland confirmed that it follows similar pricing practices to those identified by Imperial,<sup>113</sup> highlighting both (a) local market conditions (“We strive to be competitively priced within our markets, and therefore we monitor and adjust our prices accordingly.”), and (b) benchmark prices for finished products in other markets.<sup>114</sup> Parkland emphasized that “just because our cost of goods (raw material) and transportation costs are increasing does not mean that we can necessarily pass on those costs with a higher crack spread. The market sets the wholesale prices and the crack spread, and Parkland faces competition from other wholesale suppliers.”<sup>115</sup>

90. Suncor’s approach is similar:<sup>116</sup>

Market prices and competitors’ wholesale (rack) prices are the primary factors governing the level and changes in the wholesale price of gasoline and diesel on a daily basis.

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<sup>113</sup> Exhibit C5-6, Parkland Responses for Oral Workshop, Q. 2B.

<sup>114</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 18.

<sup>115</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 2.

<sup>116</sup> Exhibit C2-2, Suncor Response to Questionnaire, Q. 17.

Market prices:

-Levels and changes in the wholesale (rack) prices are heavily influenced by market prices for gasoline and diesel.

- Market prices are generally based on North American and International benchmarks (referenced daily from various independent reporting agencies e.g. Argus Media and OPIS (Oil Price Information Service)).

- The cash traded price for gasoline and diesel in the Pacific North West (Portland) and in Chicago as reported by OPIS are the main benchmarks Suncor references to help determine Wholesale (rack) prices in British Columbia.

- Market prices are also influenced by the value of Canadian currency (CDN): wholesale gasoline and diesel benchmarks for the Pacific North West (Portland) and Chicago are priced in USD. Suncor adjusts these benchmarks to Canadian Dollars (CDN) referencing daily changes in Canadian currency valuation. Competitive wholesale (rack) prices:

-Suncor's monitors competitive wholesale prices (rack postings) for gasoline and diesel by terminal location as reported by OPIS.

-Suncor must remain competitive in each unique market within British Columbia and so competitive wholesale (rack) prices ultimately set the market price in each market.

***Wholesale Prices in Vancouver Are Correlated With Edmonton and US PADD 5***

91. Given the diverse sources of supply and the pricing strategies used by marketers, it is to be expected that the BC product supply/demand balance is strongly related to, and influenced by, the market dynamics in PADD 5 and Alberta.

92. Parkland characterized the relationship as follows:<sup>117</sup>

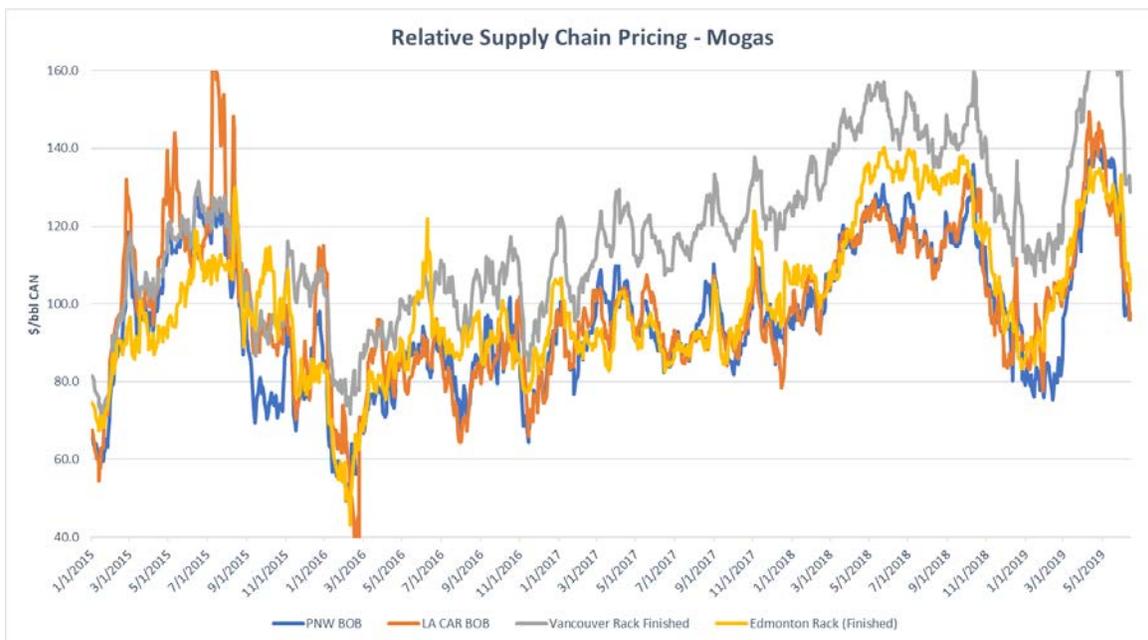
The wholesale prices of refined products produced at Parkland's Burnaby refinery adjust in a lagging manner to the broader finished fuels marketplace. The price for refined products at the Burnaby refinery are based on independent market dynamics impacted by the broader West Coast (PADD V) refined

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<sup>117</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 3.

products marketplace (supply, inventory and demand). This actively influences the price that refined products produced at the Burnaby refinery can be sold for in the market. Parkland is not able to unilaterally increase the price of wholesale products from the Burnaby refinery to pass through all increases in Parkland's cost of crude supply to customers or its retail operations. Parkland is constrained by how other wholesalers are pricing their products, and by whether Parkland retail operations can pass on any such increases to end users in the context of their own competitive market.

93. The tight relationship between Vancouver wholesale gasoline prices and the Pacific Northwest is shown in the figure below.<sup>118</sup> (The reasons for the differential between the Vancouver rack price and the Pacific Northwest and Edmonton rack prices are discussed in Part 5 of this Submission.)



94. Suncor identified the correlation between wholesale rack prices in Vancouver and Portland as being 98% for Ultra Low Sulphur Diesel (ULSD) and 90% for gasoline.<sup>119</sup>

<sup>118</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 7. See Q. 7 for an equivalent figure for diesel.

<sup>119</sup> Exhibit C2-2, Suncor Response to Questionnaire, Q. 17.

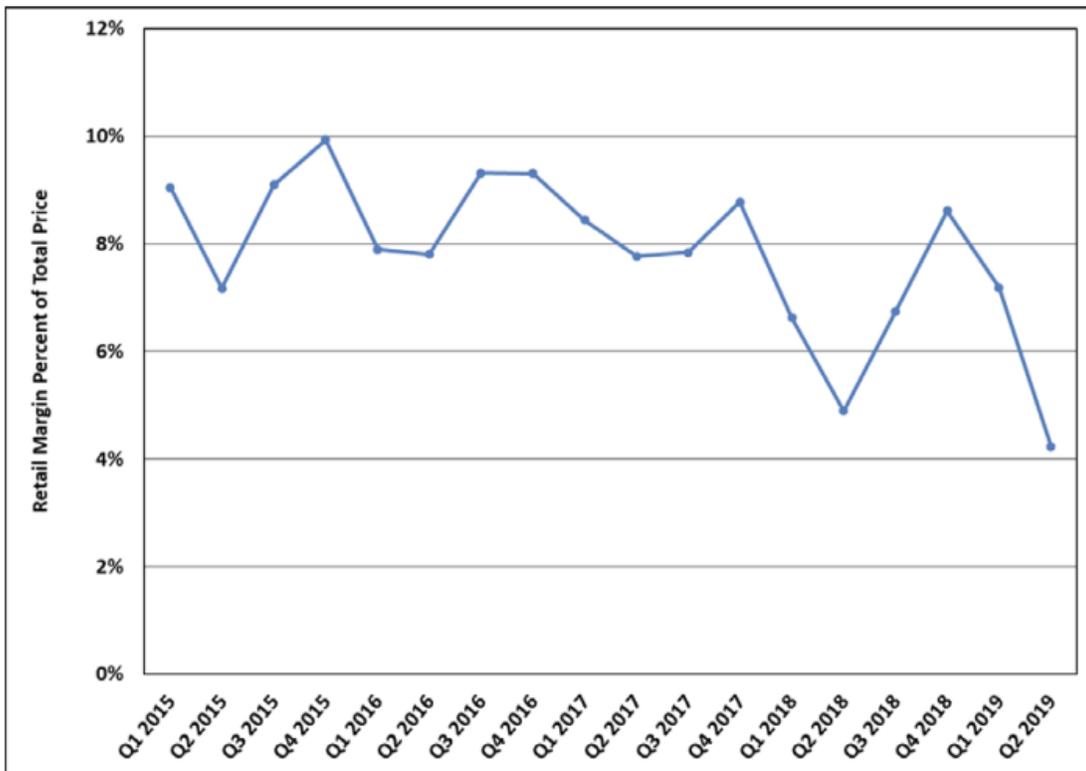
**E. HIGHER GROSS RETAIL MARGIN SINCE 2015 REFLECTS STANDARD MARKET DYNAMICS**

95. This section describes the competitiveness of the retail sector, and demonstrates how BC gross retail margins yielded by competitive market dynamics have increased since 2015 in response to new costs faced by all retailers.

**(a) Retail Margins Have Decreased Since 2015 as Percentage of Pump Price**

96. While retail margins have increased in absolute terms, they have actually declined since 2015 as a percentage of the total pump price. This is shown in the following figure.

**British Columbia Regular Gasoline Retail Gross Margin as a Percent of Total Price  
Q1 2015 - Q2 2019<sup>120</sup>**



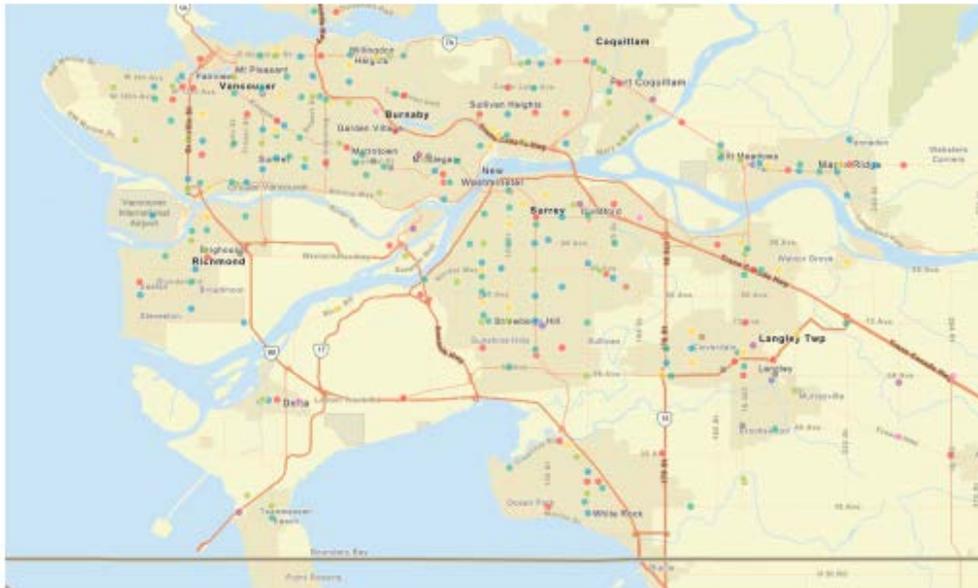
<sup>120</sup> Figure 7, Exhibit C5-2, Parkland Evidence, Appendix B, Kahway Report, p. 27, Figure 7. Source: Kent Petroleum Price Data, Kent Group Ltd., available at <<https://charting.kentgrouppltd.com/>>.

**(b) The BC Retail Market is Highly Competitive**

97. The evidence is clear: the BC retail market is highly competitive, with hundreds of stations, diverse ownership with diverse business approaches, and fluid price response to market signals. We emphasize aspects of the evidence below.

***The 1300 BC Retail Stations Are Owned and Operated By Many Parties***

98. As of December 31, 2018, there were 1,368 retail gas stations in British Columbia.<sup>121</sup> The stations are distributed throughout all areas of the province, including hundreds in the Lower Mainland. The map below shows a portion of the Lower Mainland, and illustrates the high density of stations in this region.<sup>122</sup>



99. A common misconception is that all of the stations identified with a major brand (e.g., Esso, Chevron, Shell, Petro-Canada) are owned and operated by the same entity. In

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<sup>121</sup> Note that the currency date of the count is different from the Kent data used by Dr. Kahwaty, thus resulting in a different total number.

<sup>122</sup> Exhibit C5-8, Parkland Presentation, slide 5.

reality, the BC market includes a variety of ownership and operating models.<sup>123</sup> Stations in BC sell 29 different brands of gasoline marketed by 24 distinct companies.<sup>124</sup>

100. No marketer has control over the retail price for more than 12.6% of the gas stations in British Columbia. Pricing for nearly half of the gas stations in the province is determined by the dealer that operates the station, rather than a marketer. This is seen in the last column of the table below.<sup>125</sup>

**British Columbia Retail Gas Stations by Marketer December 31, 2018**

Marketers and Brands Sold			Number of Stations by Control			Marketer Share by Station Count	
Marketer	Type	Brands	Marketer Control	Dealer Control	Total	Share of Supply	Share of Price Control
Parkland Fuel Corporation	Refiner-Marketer	Chevron, Esso, Fas Gas Plus, Race Trac	173	100	273	20.0%	12.6%
Unidentified Marketers or Dealers	Non-Refiner	Unbranded/Unknown	0	204	204	14.9%	0.0%
Suncor Energy Products, Inc.	Refiner-Marketer	Petro-Canada	116	60	176	12.9%	8.5%
Shell Canada Limited	Refiner-Marketer	Shell	89	49	138	10.1%	6.5%
Husky Energy Inc.	Refiner-Marketer	Husky	80	45	125	9.1%	5.8%
7-Eleven Canada, Inc	Non-Refiner	Petro-Canada, Esso, 7-Eleven	124	0	124	9.1%	9.1%
Federated Co-operatives Limited	Refiner-Marketer	Tempo, Save on Gas, Co-op	0	77	77	5.6%	0.0%
McDougall Energy	Non-Refiner	Pump, Esso, Unbranded/Unknown	0	65	65	4.8%	0.0%
Super Save Group	Non-Refiner	Super Save Gas	25	15	40	2.9%	1.8%
BCP IV Service Station LP/BG Fuels	Non-Refiner	Mobil	39	0	39	2.9%	2.9%
Proctor Petroleum	Non-Refiner	Gas N Go	24	0	24	1.8%	1.8%
Centex Petroleum	Non-Refiner	Centex, Unbranded/Unknown	2	16	18	1.3%	0.1%
Couche-Tard Inc.	Non-Refiner	Mac's, Shell, Petro-Canada, Esso, Husky	14	0	14	1.0%	1.0%
Sobeys Capital Inc.	Non-Refiner	Safeway	10	0	10	0.7%	0.7%
Gas Plus Inc.	Non-Refiner	Gas Plus, Unbranded/Unknown	2	7	9	0.7%	0.1%
Canco Petroleum	Non-Refiner	Canco	0	7	7	0.5%	0.0%
Costco Wholesale Canada Ltd.	Non-Refiner	Costco	7	0	7	0.5%	0.5%
XTR Energy Company Limited	Non-Refiner	Gulf, XTR	0	5	5	0.4%	0.0%
Canadian Tire Petroleum	Non-Refiner	Canadian Tire	4	0	4	0.3%	0.3%
Domo Gasoline Corporation Ltd.	Non-Refiner	Domo	3	0	3	0.2%	0.2%
Shell Pilot Flying J Joint Venture	Refiner-Marketer	Shell and Flying J	3	0	3	0.2%	0.2%
BVD Petroleum	Non-Refiner	Petro-Canada	1	0	1	0.1%	0.1%
G&B Fuels Inc.	Non-Refiner	G&B Fuels	0	1	1	0.1%	0.0%
GTI Petroleum Ltd.	Non-Refiner	GTI	1	0	1	0.1%	0.1%
Total			717	651	1368	100.0%	52.4%

Notes: 1) "Share of Supply" in this table refers to the percentage of retail stations in British Columbia for which the marketer listed in the first column has the right to sell fuel. 2) "Share of Price Control" in this table refers to the percentage of retail stations in British Columbia for which the marketer listed in the first column has the right to set the price of fuel at the pump.

Source: "2018 National Retail Petroleum Site Census," Kent Group Ltd., June 7, 2019.

<sup>123</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 37 summarizes the various ownership models.

<sup>124</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 35.

<sup>125</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 70; Exhibit A2-1, Deetken Phase 1 Report, pp. 17-18. Pricing that is not set by a marketer is set by the dealer, so 100%-52.4%=47.6% controlled by independent dealers.

***Being Price Competitive Is Essential to Survival in the Retail Market***

101. Gasoline and diesel prices can be readily observed and compared by consumers on an ongoing basis. Each retailer markets its price on signage that is highly visible to the public from the street. Kent put it this way: “Gasoline: can comparison shop at 60 Km/hr”.<sup>126</sup> Online tools, such as GasBuddy.com, exist to help the public better understand real-time pricing and identify the lowest price in an area.<sup>127</sup> In a market like this, retailers recognize that price competitiveness is the “ticket to the game”, with all other considerations being secondary. Mr. White of Parkland put it this way:<sup>128</sup>

Parkland's retail business is all about driving customer traffic to our locations with the intent of selling fuel and other important higher margin consumable products such as convenience store items, meals, car washes, et cetera. And trying to do it better than our competitors.

....For context, I would ask the Commission to consider what other retailer in this country would take their highest volume SKU [Stock Keeping Unit] or product and price it to the tenth of a cent and post it on a large pylon sign for customers and competitors to see and compare.

On the fuel side of our business we have one SKU with three variations, regular, mid and premium. So the opportunity to differentiate your fuel business is, needless to say, quite difficult. Our research year after year indicates that a competitive retail price, again priced to the tenth of a cent, is table stakes and a ticket to the game for us. Qualities like location, clean washrooms, friendly staff also play a role, but without a competitive price customers will not consider visiting your location. They're simply not in the game. [Emphasis added.]

102. The net result of these dynamics is that retailers must (and do) set retail prices with a keen eye to what competitors in the vicinity are doing.<sup>129</sup> They are continually adjusting retail prices - often multiple times each day - to hold on to their “ticket to the game” in light of

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<sup>126</sup> Exhibit A2-3, Kent Presentation, PDF p. 165.

<sup>127</sup> Exhibit C5-2, Parkland Evidence, p. 18.

<sup>128</sup> Tr. 1, p. 106, l. 4 to p. 107, l. 3 (White).

<sup>129</sup> Exhibit C2-2, Suncor Response to Questionnaire, Q. 27; Exhibit C7-2, Husky Response to Questionnaire, Q. 22; Exhibit C10-2, Shell Response to Questionnaire, Q. 27.

the actions of competitors, changes in demand and/or specific business objectives. For instance, Parkland stated:<sup>130</sup>

Market dynamics are the primary factor considered when Parkland sets its prices across BC. Parkland uses surveys of pricing information (i.e., posted street prices) – conducted by its employees, retail operators, and/or taken from other public sources (e.g., Gas Buddy, social media) – to determine specific street prices in accordance with its pricing strategies. Parkland determines its pricing strategies based on local site characteristics, market factors and competitors, performance objectives (i.e., at a location, at several locations, in a region, across BC, across Canada, and / or across Parkland), and current performance. It evaluates and adjusts these pricing strategies regularly.

Retail fuel is an extremely dynamic industry with different competitors and different incentives and behavior, across different streets, markets, and regions, which change daily. A competitor’s specific retail price could be impacted by unknown and diverse reasons (e.g., specific store staffing, ownership, local traffic patterns, store promotions, store hours). As such, Parkland does not have a fixed set of “rules” or “factors” and instead uses its retailing expertise and commercial discretion in evaluating and determining its pricing strategies.

103. Parkland “...frequently changes product prices at its locations multiple times per day.”<sup>131</sup> The same is true for other retailers who presented evidence in this Inquiry.<sup>132</sup> The price fluctuations seen in BC are thus evidence of effective competition, as discussed further in Part 4, Section G below.

### ***Driving Higher Volumes and Non-Fuel Sales is Critical to Profitability***

104. There is an inherent trade-off between higher net margins and sales volume, and there is a significant incentive for many retailers to set pump prices to drive higher sales

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<sup>130</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 27.

<sup>131</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 28. Across Parkland’s company-owned network in Medium and Major Cities during May 2019, 70% of its sites changed prices more than once per day, while 54% of its sites changed prices more than three times per day.

<sup>132</sup> Ms. Courtright of Shell noted “constant street retail price changes” (Tr. 1, p. 259, ll. 18-24); Mr. Rosecrans of 7-Eleven noted that information is gathered by observations of competitors by our store managers and through an OPIS feed that provides verified credit card information of other retailers in the area (Tr. 2, p. 566, ll. 7-23). Mr. Vanderkerkhove of Super Save Group told the Panel: “And we’ll move the price six, seven, eight times a day. We’ll move the price while we’re sitting here by texting, while we’re sitting in the inquiry (Tr. 4, p. 743, ll. 3-6).

volumes. Non-fuel revenues - primarily from convenience store merchandise sales, convenience store rents, car wash revenues, and other ancillary sales - tend to be more lucrative and are a critical part of maintaining successful and profitable operations.<sup>133</sup> The Kent Group explained:<sup>134</sup>

In this report we also measure the market representation of a number of site features and offerings: the type of pump service (full, self or split), convenience store size, car washes, fast food, automotive service, and diesel penetration. The provision of goods or services other than gasoline is of vital importance to the competitiveness and viability of retail gasoline outlets, since (based on other research) the gross margin on gasoline itself is generally not sufficient to provide for the operating costs and reasonable return on the operation of these facilities. [Emphasis added.]

105. Parkland put it this way: “Price changes that result in reduced volume will have a detrimental effect on the bottom line as non-fuel sales and margins decrease with a decrease in fuel traffic.”<sup>135</sup> Not surprisingly, poor performing stations generally have low fuel volume sales.<sup>136</sup>

#### ***Retail Prices in BC Are Responsive to Reductions in Wholesale Prices***

106. Parkland pointed out that, as wholesale costs decrease, retail prices in BC will quickly decrease because “certain retail stations want to be the first to move prices down in the market, as this will increase fuel and non-fuel sales and create a perception of being the ‘cheapest’ to the consumer.”<sup>137</sup> The data backs this up. There is a very high correlation between retail and wholesale rack prices - the R-squared values are greater than 94% - signaling a high degree of responsiveness on the part of retailers to changes in wholesale prices.<sup>138</sup> This

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<sup>133</sup> Exhibit C5-2, Parkland Evidence, p. 22. Discussed further in Appendix A, Parkland Response to Questionnaire, Q. 22A.

<sup>134</sup> Exhibit A2-3, Kent Presentation, *National Retail Petroleum Cite Census*, PDF p. 184.

<sup>135</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 22A.

<sup>136</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 22A: Parkland showed the correlation between non-fuel margins and fuel sales.

<sup>137</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 22A.

<sup>138</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 78. See Kahwaty Report, para. 78 for a similar analysis for diesel.

data demonstrates the fallacy of any notion that retailers have market power and are exercising that power to keep prices artificially elevated for a prolonged period of time.

***Dr. Kahwaty Describes BC as Having a Functioning Retail Market***

107. Dr. Kahwaty concluded that there is a functioning retail market in BC. He summarized his opinion as follows:<sup>139</sup>

Yes, there is now and has been a functioning retail market for gasoline and diesel in British Columbia. Markets are viewed as functioning well if they have a sufficient number of competitors or lack substantial barriers to entry. There are numerous retailers of gasoline and diesel fuels in British Columbia, and there has been a track record of retail gas station entry. There are many independent gas stations in British Columbia, and based on province-wide gas station counts, no marketer has control over the retail price for more than 12.6 percent of the gas stations in the province. In addition, retail gasoline and diesel prices in British Columbia have responded to factors that typically affect either supply or consumer demand in the manner expected in a well-functioning market.

108. Deetken's mandate did not include opining on this specific issue. However, Deetken did find that: "...it does not appear that competition in the retail space has undergone substantial change in the pre- and post-2015 periods and therefore no evidence was found based on market composition and concentration to suggest that the competitive landscape in BC has changed over these periods."<sup>140</sup>

**(c) Gross Retail Margins Have Had to Increase Over Time to Account for Rising Costs Since 2015**

109. In order to remain in business, the retail margin yielded by competitive market pricing must be sufficient over time cover a retailer's costs and generate a return on investment. There are a variety of retailing costs that have increased since 2015, including those noted below, that explain the growth in retail margins in BC. (A sub-set of these factors is contributing to retail margin *differentials* with other provinces, a topic that is addressed in Part 5.)

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<sup>139</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 5.3.

<sup>140</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 22.

***Market Economics: Costs Affecting All Retailers Get Passed on to Consumers***

110. Deetken explained how retail prices can be expected to respond in a competitive market to cost increases that affect all retailers:<sup>141</sup>

If cost components which must be paid by all retail stations in the same jurisdiction rise then, given that demand for gasoline is relatively inelastic, economic theory indicates that the majority of these costs will be passed on to the consumer. These cost components are called operational costs and are required in order to provide the service of gasoline retail sales.

***Carbon Tax is a Cost to Retailers and It Has Increased Significantly Since 2015***

111. The carbon tax is a cost borne by retailers. Since the start of 2015, the carbon tax on gasoline has increased by a total of 2.22 cents per litre, and on diesel by a total of 2.56 cents per litre.<sup>142</sup> As Dr. Kahwaty pointed out<sup>143</sup>, this is an instance where provincial policy has been to increase the price of gasoline intentionally in order to achieve a policy objective. Consumers and government should not be surprised when, consistent with the intended purpose of the policy, prices at the pump go up.

***Lower Mainland Land Values (Taxes, Rent and Opportunity Cost) Have Increased Significantly Since 2015***

112. Retail stations are typically located at high traffic locations, often in corners of major intersections. These locations also happen to be prime commercial real estate. The costs of land, rents, and property taxes are significant, particularly in urban centres like the Lower Mainland. In order to be profitable and remain in business, retail margins must be sufficient to cover these costs over the longer-term. Several retailers identified real estate and lease costs as an issue.<sup>144</sup>

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<sup>141</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 11.

<sup>142</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 21. Carbon tax on gasoline increased in BC from 6.67 cents per litre to 7.78 cents per litre in 2018, and from 7.78 cents per litre to 8.89 cents per litre in 2019. The BC carbon tax on diesel increased from 7.67 cents per litre to 8.95 cents per litre on April 1, 2018. The BC carbon tax on diesel increased further to 10.23 cents per litre on April 1, 2019.

<sup>143</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, paras. 166-167.

<sup>144</sup> Exhibit C5-2, Parkland Evidence, p. 21; Tr. 1, p. 229, ll. 17-19 (White); Exhibit C7-2, Husky Response to Questionnaire, Q. 21; Tr. 2, p. 547, ll. 10-15 (Friesen); C2-2, Suncor Response to Questionnaire, Q. 21 and 22.

113. Retail margins must also be sufficient over the longer-term to compensate for the opportunity cost (i.e., foregone benefit) associated with being able to sell land for redevelopment.<sup>145</sup> Dr. Kahwaty described the redevelopment potential of a number of sites in Vancouver. A good example is the fate of a station on West Georgia Street, which Chevron sold for redevelopment in 2017 despite the station being one of its “highest performing sites” in BC.<sup>146</sup> Dr. Kahwaty observed:<sup>147</sup>

As shown in the examples of Vancouver-area gas stations currently for sale and the redevelopment options for them, if the station’s return is insufficient to compensate the owner for its opportunity costs, the owner has the option to sell the land so that it can be put to a higher-value use. To continue operating as a retail gas station, the location must be sufficiently profitable to justify its owner’s continued investment of capital in the site.

114. Deetken also recognized the impact of land opportunity cost on retail margins. In fact, Deetken attributed most of the retail margin differential between Vancouver and other provinces to land values. Deetken states: “Combing the land value and retail margin plots, it is clear how tightly correlated land values and retail margins are in Vancouver and Toronto.”<sup>148</sup> Given the extent of commercial land value increases in BC since 2015, it is reasonable to conclude that those increases are a significant driver of the growth in retail margins.

***Credit Card Costs Have Increased Retail Prices and Margins in BC Since 2015***

115. Credit card processing costs are often the largest operating cost for retailers after labour costs. Credit card fees are charged to retailers as a percentage of the sale price, which means they are significantly impacted by the higher taxes and higher fuel prices in BC.<sup>149</sup>

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<sup>145</sup> Exhibit C5-2, Parkland Evidence, p. 21.

<sup>146</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, paras. 129-130.

<sup>147</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 131. See also: Tr. 1, p. 121, ll. 1-10 (Kahwaty).

<sup>148</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 26.

<sup>149</sup> Exhibit C5-2, Parkland Evidence, p. 21; Appendix A, Parkland Response to Questionnaire, Q. 21; Exhibit C5-6, Parkland Response to Questions for Oral Hearing, Q. 4A.

Husky also noted that the credit card costs have increased as a higher percentage of transactions have shifted to credit cards, and there has been an increase in fraud charges.<sup>150</sup>

***Wages in BC Have Risen Since 2015, Along With Payroll Taxes***

116. Wages are a significant cost for BC retailers. BC's minimum wage has increased three times since 2015 by a total of 21%<sup>151</sup>, to the point where it is among the highest in Canada. Since retail stations often employ younger employees and part-time hourly staff, minimum wages have a material impact on employment costs at retail fuel stations.<sup>152</sup> Even if actual wages are not at minimum wage levels, the minimum wage often acts as a marker on which actual wages are based. BC's labour market is strong with low unemployment. These are conditions in which higher rates of wage growth would be expected.<sup>153</sup>

117. Payroll taxes, such as the recent Health Care tax, have also increased retailer costs.<sup>154</sup>

***Maintenance and Utilities Costs Have Increased***

118. Suncor estimated that maintenance costs have increased by 30% increase in maintenance costs in the last 3-5 years.<sup>155</sup> Husky also cited rising maintenance costs, along with rising utility and site energy costs.<sup>156</sup>

**(d) Market Dynamics Preclude a Nice, Tidy Quantification of Cost Impacts on Retail Margin**

119. The Terms of Reference require the Inquiry Panel to "identify the factors influencing" prices since 2015, not to quantify the contribution made by each factor. From the discussion above, it is clear that there have been market-wide cost increases, and in many cases

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<sup>150</sup> Exhibit C7-2, Husky Response to Questionnaire, Q. 21.

<sup>151</sup> Exhibit C2-2, Suncor Response to Questionnaire, Q. 21.

<sup>152</sup> Exhibit C5-2, Parkland Evidence, p. 22; Exhibit C7-2, Husky Response to Questionnaire, Q. 21.

<sup>153</sup> Tr. 1, p. 189, ll. 5-23 (Kahwaty).

<sup>154</sup> Exhibit C7-2, Husky Response to Questionnaire, Q. 21.

<sup>155</sup> Exhibit C2-2, Suncor Response to Questionnaire, Q. 21.

<sup>156</sup> Exhibit C7-2, Husky Response to Questionnaire, Q. 21.

those can be quantified. We can also reasonably conclude, based on basic market theory, that these costs would have contributed to a wider gross retail margin. However, the complexity of retail market dynamics makes it unreasonable to expect that retail costs will perfectly sum to the gross retail margin at a point in time. Margins will differ by location, and retailers do not set prices on a cost-plus basis. Parkland submits that the Inquiry Panel should keep this in mind when preparing its report, and focus on identifying contributing factors rather than quantifying their contribution to prices and margins.

**F. VOLATILITY AND SEASONAL VARIATIONS IN WHOLESALE PRICES ARE MARKET DRIVEN**

120. The retail price since 2015 has, at times, been characterized by significant volatility. There are also seasonal trends. As discussed below, both of these features reflect BC's functioning market.

**(a) Crude Price Has Been the Largest Source of Retail Price Volatility Since 2015**

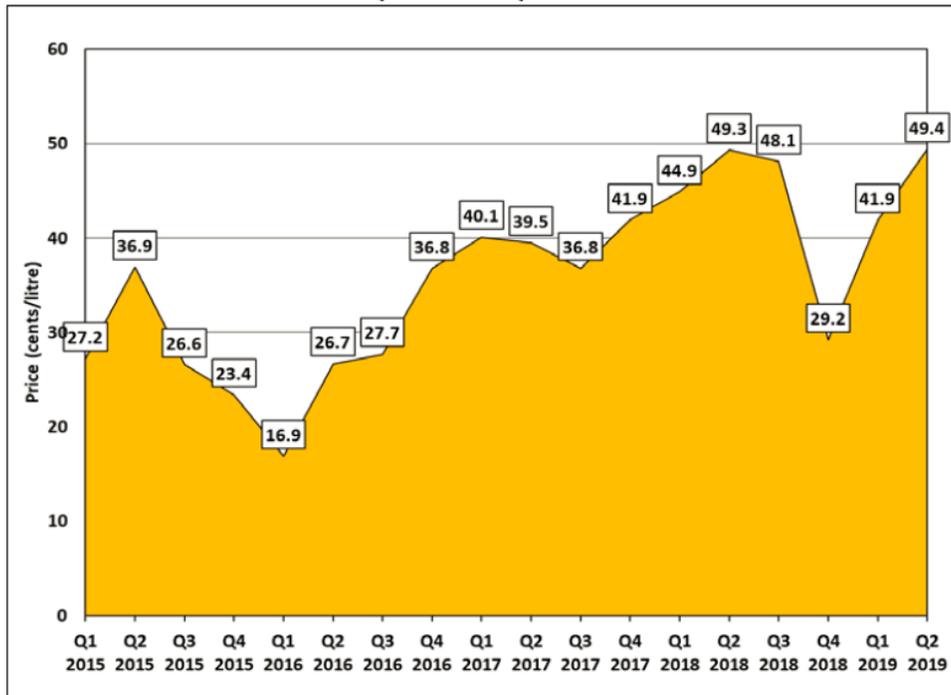
121. As discussed in Parts 3 and 4 above, the price of crude represents approximately one-third of the total retail price in BC. In addition to being the most significant contributor to retail price increases since 2015, crude prices have also been the most significant contributor to volatility.

122. The following figure illustrates the volatility since 2015. The quarterly value of the crude oil needed to refine one litre of regular gasoline has fluctuated between 16.9 cents per litre in Q1 2016 and 49.4 cents per litre in Q2 2019 - a swing of 32.5 cents per litre. The maximum value was nearly three times the minimum. The value increased by 17.2 cents per litre between Q1 2015 and Q1 2019.<sup>157</sup>

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<sup>157</sup>Figure 34, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 104.

**Value of the Crude Oil Included in 1 Litre of Regular Gasoline  
Q1 2015 – Q2 2019**



Source: Kent Petroleum Price Data, Kent Group Ltd., British Columbia (Simple Weighted) Unleaded Crude Price, through May 31, 2019 available at <https://charting.kentgrouppltd.com/>.

**(b) Supply Shocks Associated With Turnarounds and Refinery Disruptions Have Influenced Prices Since 2015**

123. Price increases in response to supply shocks are to be expected in a functioning market. Dr. Kahwaty explained:<sup>158</sup>

There have been recent instances when supply shocks or disruptions have removed productive capacity from the market. Wholesale and retail prices have responded to these supply shocks by increasing in the short term. In general, prices tend to increase in markets when supply is tight, and increase further when there are negative shocks to supply on top of generally tight conditions. This is a basic, standard principle of economics. An increase in prices because supply is tight, due to reasons other than conduct designed artificially to withhold supply from the market, is not a price increase arising from an exercise of market power. Prices arising from such conditions would be expected in a functioning market and are not an indication of anticompetitive activity.

<sup>158</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 102. See also: para. 113.

124. In the case of BC, the demand for refined product in BC is met by supply from Alberta, Parkland's Burnaby refinery, and US refineries. When there are supply disruptions from any of these supply points (for example, refinery turnarounds) it creates a scenario where demand exceeds supply and thus prices increase.<sup>159</sup> In essence, "[a]s product supply becomes more scarce, bidders are willing to pay higher prices to avoid product run-outs and shortages."<sup>160</sup>

125. The period since 2015 has been marked by a number of significant planned turnarounds and unplanned events in Alberta, the Pacific Northwest and California that have resulted in supply shocks in BC and the US West Coast. The BC market gets a material portion of its supply from all three of these locations (the majority of the PADD 5 imports are from refineries in California and Washington).<sup>161</sup> Each of these sources is a potential source of the "marginal barrel" in BC at any given point in time (it could also be from further away). If the price of BC's marginal barrel gets "bid up" in California or the Pacific Northwest, the equilibrium price in BC can be expected to rise too.

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<sup>159</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 17.

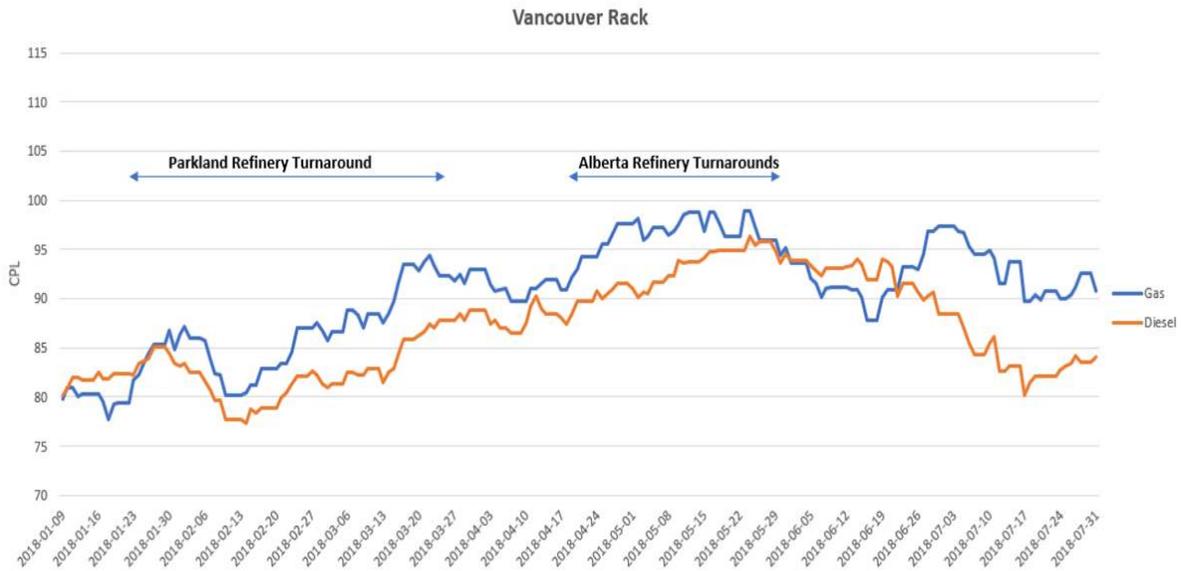
<sup>160</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 18.

<sup>161</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 12.

126. The supply shocks since 2015 have included:

Summer 2016	Suncor wildfire resulted in supply shortages <sup>162</sup>
April 2017	Washington (BP, Tesoro) turnarounds <sup>163</sup>
January 2018	Parkland turnaround <sup>164</sup>
May 2018	Suncor, Shell, and Imperial turnarounds <sup>165</sup>
Fall 2018	Enbridge T-South pipeline rupture <sup>166</sup>
Spring 2019	California refinery outages <sup>167</sup>

127. The data clearly shows the price response to those events. For instance, the following two figures show, respectively, the price response to the Parkland and Alberta turnarounds in 2018, and the 2017 Washington refinery turnarounds.



<sup>162</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 117.

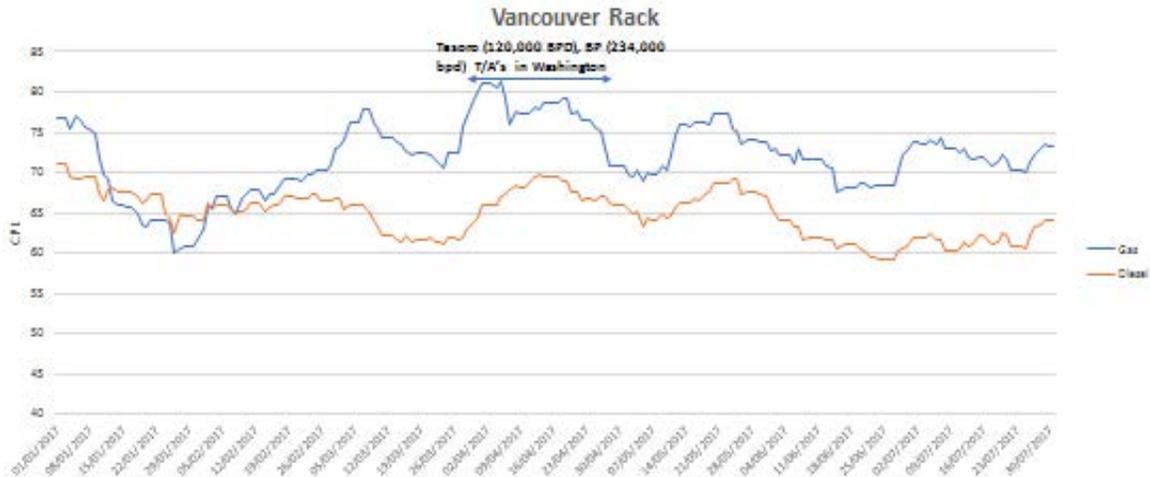
<sup>163</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 17.

<sup>164</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 17.

<sup>165</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 17.

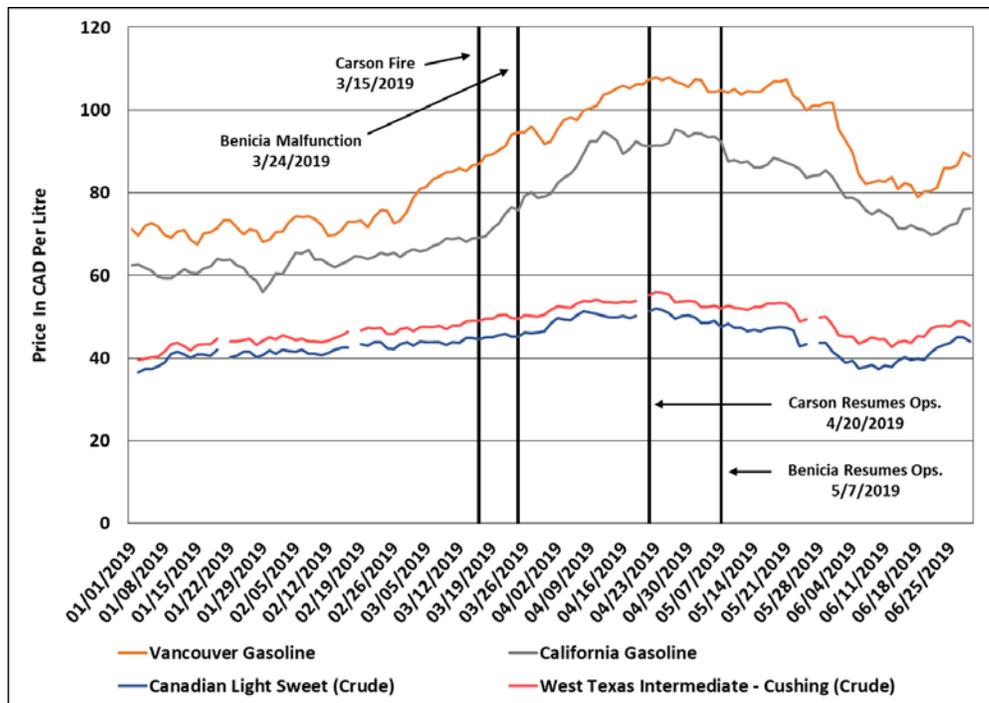
<sup>166</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 115.

<sup>167</sup> Exhibit C5-9, Kahwaty Slides, PDF p. 20; Tr. 1, p. 177, l. 22 to p. 180, l. 5 (Kahwaty).



128. Dr. Kahwaty's presentation at the Oral Workshop included a similar chart showing the effects of outages of California refineries on gasoline prices.<sup>168</sup>

### California Refinery Shutdowns Gasoline Wholesale and Select Crude Prices, H1 2019



<sup>168</sup> Exhibit C5-9, Kahwaty Slides, PDF p. 20.

129. It is important to bear in mind, however, that other factors beyond refinery outages will affect prices and price differentials.

130. Storage acts as a buffer against price shocks in the very short-term. Marketers in BC have had their storage flexibility compromised since 2015 due to the Province's low carbon initiatives. Parkland explained: "Since 2015, the increase in low carbon mandates and initiatives has resulted in an increased requirement for renewable feedstocks tankage. The reallocation of tank capacity has effectively reduced Parkland's working storage for refined products."<sup>169</sup> It is reasonable to conclude that the price response to supply shocks since 2015 has been amplified by the loss of storage flexibility in BC.

131. There has been no material change in the amount of storage capacity in BC since 2015. BC terminals are operating at, or close to, economic capacity.<sup>170</sup>

**(c) Seasonal Trends Have Remained Consistent Since Prior to 2015**

132. Wholesale gasoline prices tend to rise in the late spring and early summer, and decline in the fall.<sup>171</sup> The Competition Bureau of Canada explains that this is driven by supply and demand.<sup>172</sup> There is a distinct seasonal pattern in demand in BC; it is higher in the summer.<sup>173</sup> Natural Resources Canada states: "Prices do rise during the peak summer driving season when the demand for gasoline is at its highest level."<sup>174</sup> On the supply side, there are also change-overs that occur at refineries to prepare specific fuel formulations for winter and

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<sup>169</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 14. See also: Tr. 4, p. 686, l. 15 to p. 687, l. 24 (Krogmeier).

<sup>170</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 14. Suncor's evidence is also that storage capacity at its terminals has not changed since 2015: Exhibit C2-2, Suncor Response to Questionnaire, Q. 14. Husky's evidence is that there have not been significant changes to its available storage capacities since 2015: Exhibit C7-2, Husky Response to Questionnaire, Q. 14. Imperial Oil's evidence is that it has secured increased storage to serve the Vancouver area as a result of pipeline apportionment on TMPL: Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 11. Shell's evidence is that there have been no significant changes to storage capacity since 2015 and that its terminals generally operate at levels sufficient to supply its retail and commercial operations: Exhibit C10-2, Shell Response to Questionnaire, Q. 14.

<sup>171</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p.79.

<sup>172</sup> Exhibit A2-14, Competition Bureau of Canada, "Factors that affect gas prices at the pumps", July 24, 2018.

<sup>173</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p.81.

<sup>174</sup> Exhibit A2-17, Natural Resources Canada, "Why do gasoline prices go up and down?", August 24, 2016.

summer, which affect their output. Participants also explained that other markets may not have the same specifications or seasonality requirements as BC.<sup>175</sup> This can have the effect of limiting the pool of prospective import sources.<sup>176</sup> Overall, there was no evidence of changes in seasonal trends since 2015.

**G. IT IS ILLOGICAL TO INFER IMPROPER CONDUCT FROM FACTS EASILY EXPLAINED BY COMPETITIVE FORCES**

133. The Terms of Reference require the BCUC to inquire into “the extent to which price changes in gasoline and diesel have been determined by market competition and the extent to which those changes have been determined by other factors.” In terms of “other factors”, Parkland submits for the reasons set out below that it would be inappropriate to infer improper conduct on the part of market participants from price and margin changes that can be fully explained by market fundamentals.

**(a) BC Wholesale Market Dynamics and Structure Are Inconsistent With Anti-Competitive Conduct**

134. Dr. Kahwaty described a functioning market as one in which there is an absence of market power or an absence of barriers to entry, both of which are absent from the BC wholesale market.

***Refineries Are Operating at Capacity - the Antithesis of Exercising Market Power***

135. Dr. Kahwaty defined market power and anti-competitive conduct as follows:<sup>177</sup>

Market power is the ability profitably to maintain prices above a competitive level. Anticompetitive conduct is conduct that has the effect of reducing the supply of a product in a market in an attempt to maintain its price above a competitive level. In the absence of conduct that has the effect of artificially reducing the amount of a product supplied in a market, market participants

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<sup>175</sup> Tr. 2, p. 325, l. 3 to p. 326, l. 12 (McLean).

<sup>176</sup> Tr. 2, p. 332, ll. 3-13 (Wallin).

<sup>177</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 89. See also: Tr. 1, p. 117, l. 4 to p. 118, l. 1 (Kahwaty). Deetken defines market power in the same manner: Exhibit A2-1-1, Deetken Phase 2 Report, p. 16.

cannot be said to be engaging in conduct that has the effect of exercising market power.

That feature of anti-competitive conduct is absent from the wholesale market in BC.

136. Irrespective of how one characterizes the level of market concentration of refineries serving BC (Allan/Eliesen have skewed the results by virtue of a flawed methodology<sup>178</sup>), there is nothing to suggest it is translating into the exercise of market power. Parkland's Burnaby refinery operates up to its economic utilization – up to the point where the margin on a products' barrel is breakeven with the crude barrel acquired.<sup>179</sup> Parkland's lost crude capacity in recent years was associated with constraints on the TMPL and operational issues.<sup>180</sup> Husky's Prince George refinery's capacity utilization rate for the last five years is similarly very high.<sup>181</sup> (The capacity utilization at refineries in Alberta is a "red herring", given the constraints on TMPL. However, Suncor Energy's Edmonton Refinery generally operates at full capacity<sup>182</sup>, as do Imperial's refineries.<sup>183</sup>) Dr. Kahwaty made it clear that operating at less than full capacity for operational or economic reasons is not an exercise of market power that would suggest anti-competitive behaviour.<sup>184</sup>

***There Are No Barriers to Entry that Would Permit Exercising Market Power***

137. Dr. Kahwaty explained that "Businesses cannot exercise significant market power in the absence of barriers to entry because any attempt to restrict supply and drive up prices

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<sup>178</sup> Exhibit C5-23, Parkland Undertaking No. 7 (Kahwaty).

<sup>179</sup> Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 8. Parkland explained that, due to the nature of the inbound aftermarket crude linespace on the Trans Mountain pipeline, the Burnaby refinery may operate in a negative margin position for the marginal or "last barrel." See also: Q. 2 for further discussion, and Exhibit C5-2, Parkland Evidence, p. 29 for monthly utilization.

<sup>180</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 91: Eliminating Q1 2018 (which is when the bulk of the maintenance occurred), Burnaby has operated at an average quarterly utilization of 92% since Parkland took over ownership in Q4 2017. To put this into perspective, the Canadian refinery utilization rate was 83.6% in 2018, and the average world refinery utilization rate was 83.5% in 2018. See also: Appendix A, Parkland Response to Questionnaire, Q. 8.

<sup>181</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 90. It has averaged 89.5 percent.

<sup>182</sup> Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 8.

<sup>183</sup> Exhibit C2-2, Suncor Response to Questionnaire, Q. 8.

<sup>184</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, paras. 89-90.

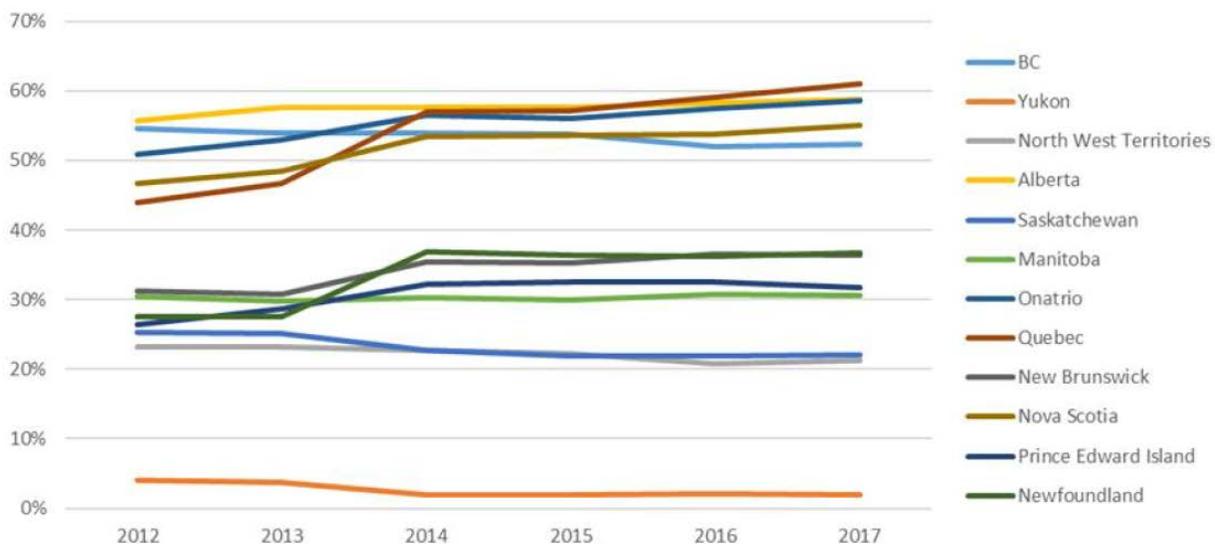
would draw new entry, and that new entry would counteract or deter any attempt to exercise significant market power.”<sup>185</sup> We addressed in Part 4, Section D above how it is possible to enter the wholesale market in BC with little up-front capital investment.

***BC Market Fundamentals Have Not Changed Since 2015***

138. The fundamentals of the BC wholesale market have not changed since 2015.

139. Deeken commented: “Similar to the number of overall sites, the proportion of controlled vs. uncontrolled sites in BC has remained largely consistent in recent years and represents a similar share of total retailers as Alberta, Ontario, and Quebec.”<sup>186</sup> This is shown in the following figure prepared by Deetken:<sup>187</sup>

***Chart 3.4.2 Share of Retailers which are Controlled Across Canada***



140. The number of refineries in and around BC have not changed between 2015 and today. While the number of refineries serving BC may sound relatively small, the number of supply sources available to BC is not unusual in Canada. For context, there are only 15

<sup>185</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 183.

<sup>186</sup> Exhibit A2-1, Deetken Phase 1 Report, pp. 17-18.

<sup>187</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 18.

refineries in Canada, and over half of those (eight) are owned by Imperial, Suncor and Shell.<sup>188</sup> Ms. Lepine of Deetken said that it has to be viewed in context of other markets - the refineries are typically few in number.<sup>189</sup> Moreover, there have been no new barriers to new marketers entering the BC market to take advantage of any arbitrage opportunity.

**(b) BC Retail Market Dynamics and Structure Are Inconsistent With Anti-Competitive Conduct**

141. The BC retail market dynamics and structure are also inconsistent with anti-competitive conduct. As discussed in Part 4, Section E there are many retailers and a very high correlation between retail and wholesale prices. This belies any notion that retailers are exercising market power; retail prices in BC come down in tandem with wholesale prices.

142. Deetken also ruled out “lack of competitiveness” as a reason for the increased retail margin since 2015. Ms. Lepine confirmed this at the Oral Workshop:

MR. GHIKAS: Q: And in your view the increased retail margin differential is not due to a lack of competitiveness, is it?

MS. LEPINE: A: Yeah, we found no difference in competitiveness in the Greater Vancouver area both pre- versus post-2015, nor in comparison to other provinces.<sup>190</sup>

**(c) Market Participants Have Systems in Place to Remain in Compliance with Competition Laws**

143. In its evidence, Parkland explained that in addition to a general Code of Conduct that requires staff to behave ethically and in compliance with legal obligations, Parkland has an extensive *Competition Act* compliance policy and conducts regular competition compliance training for staff in all areas of the business.<sup>191</sup>

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<sup>188</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 20.

<sup>189</sup> Tr. 2, p. 387, l. 26 to p. 388, l. 19 (Lepine).

<sup>190</sup> Tr. 1, p. 31, l. 22 to p. 32, l. 2 (Lepine).

<sup>191</sup> Exhibit C5-2, Parkland Evidence, p. 34. See also: Tr. 1, p. 107, ll. 12-16 (White).

144. Parkland supply arm sells, at an internal transfer price, to Parkland's retail arm and other segments. Parkland supply arm also provides transportation services to other segments at an internal transfer price.<sup>192</sup>

145. It can be reasonably assumed that other major participants have similar compliance and transfer pricing arrangements in place.

**(d) Popular Inferences About Price Behaviour Miss the Mark**

146. There appears to be a misconception on the part of some members of the public that volatility in retail prices, price movements in tandem, and price uniformity among retail stations is a product of anti-competitive behaviour. The Competition Bureau's materials, the expert evidence, and the evidence of market participants themselves, all contradict these notions. The evidence also shows that the anecdotal "holiday weekend price increase" is a myth.

***Retail Price Volatility Indicates that Competition is Working***

147. With respect to volatility in retail prices, the Competition Bureau states:<sup>193</sup>

The fact that prices for gasoline can change quickly is generally an indication that competition is working.

Prices go up or down as retailers compete, and each tries to match what the other is charging.

Prices at the pumps also depend on the wholesale price that gas stations must pay their suppliers, which can change on a daily basis.

Price swings are also caused by changes in the level of consumer demand. Prices typically go up when demand is higher (for example, when more people are traveling) and go down when demand is lower.

Factors that affect the global or local gasoline supply also result in price changes. Prices typically go up when supply is reduced (for example, when oil refineries

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<sup>192</sup> Exhibit C5-2, Parkland Evidence, p. 34.

<sup>193</sup> Exhibit A2-14, Competition Bureau of Canada, "Factors that affect gas prices at the pumps", July 24, 2018.

shut down for maintenance or due to a hurricane), and go down when the supply of gas increases.

148. Kent was similarly clear on this point. It stated in its report filed as Exhibit E-42: “Despite the negative connotations that some consumers attach to pump price volatility, it is indicative of competitive price behavior, and markets that exhibit more volatility generally have lower relative retail margins and pump prices.”<sup>194</sup> Kent’s presentation to the BCUC included the following slide:<sup>195</sup>

The slide has a blue header with the title "The Price Volatility Paradox...". The main content is a list of four bullet points. The first bullet point is "Volatile Prices are consistent with a competitive, transparent market" with a sub-bullet "Examples: stock market, commodity markets". The second bullet point is "BUT...". The third bullet point is "Volatile pump prices seem to increase consumer distrust of petroleum marketers' motives". The fourth bullet point is "The Paradox: The more competitive (volatile) the market is, the greater the negative public perception that a competitive market actually exists." In the bottom right corner, there is a logo for "KENT A Kalibrate company".

***Price Uniformity / Prices Moving in Tandem Are Associated With Competition***

149. There is also consensus among experts in this Inquiry and the Competition Bureau of Canada that price uniformity and prices moving in tandem are consistent with competitive market forces. Kent explained, for instance:<sup>196</sup>

Similar to price volatility, price uniformity between competitors is often perceived as anti-competitive, sometimes cited as evidence that marketers

<sup>194</sup> Exhibit E-42, Kent Report, p. 24 (Content was adopted by Parkland, Exhibit C5-6, p. 22).

<sup>195</sup> Exhibit A2-2, Kent Presentation, PDF p. 166.

<sup>196</sup> Exhibit E-42, Kent Report, p. 72 (Content was adopted by Parkland, Exhibit C5-6, p. 22).

engage in direct communication to “fix” prices at an agreed-to level. This is also a misconception.

To understand the phenomenon of uniform pump prices, one must adopt the perspectives of both consumers and competing, adjacent retailers. If one retailer decides to reduce pump prices (by two cents, for example), the effect on many consumers is immediate: they will drive into that station, bypassing the higher-priced outlet. The other retailer has little choice but to quickly match the competitor’s price in order to maintain market share. Pump prices therefore often move uniformly within a very short time.

150. Dr. Kahwaty agreed, noting the high degree of correlation (94%) between BC’s wholesale prices and retail prices.<sup>197</sup>

Given that retail prices move closely with wholesale prices, it is not surprising that retail prices at one gas station tend to move closely with retail prices at other gas stations. I note that common retail gasoline and diesel price movements do not indicate that retail locations are colluding with each other with regard to the prices they charge consumers. Because retail prices at different gas stations are driven by common factors, retail prices should be expected to move together and to track each other. Parallel price-setting conduct is not evidence of retail gasoline or diesel fuel price fixing because retail margins are generally small and all retail locations in an area face similar wholesale market conditions.

151. The Competition Bureau similarly says:<sup>198</sup>

Gas stations typically post their prices on large street-side signs. Since consumers are very sensitive to price, gas stations often strive to meet or beat their competitors' posted rates so they do not lose customers.

As a result, competing gas stations often charge similar or identical prices. Charging the same price is not illegal unless competing gas stations reach an agreement to do so.

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<sup>197</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 79. See also: Tr. 1, p. 126, ll. 2-10 (Kahwaty).

<sup>198</sup> Exhibit A2-14, Competition Bureau of Canada, “Factors that affect gas prices at the pumps”, July 24, 2018.

152. There is no evidence of an agreement to charge the same price. To the contrary, the participants in this Inquiry testified as to the competitive considerations that inform their retail pricing. They have safeguards in place to ensure that they comply with competition law.

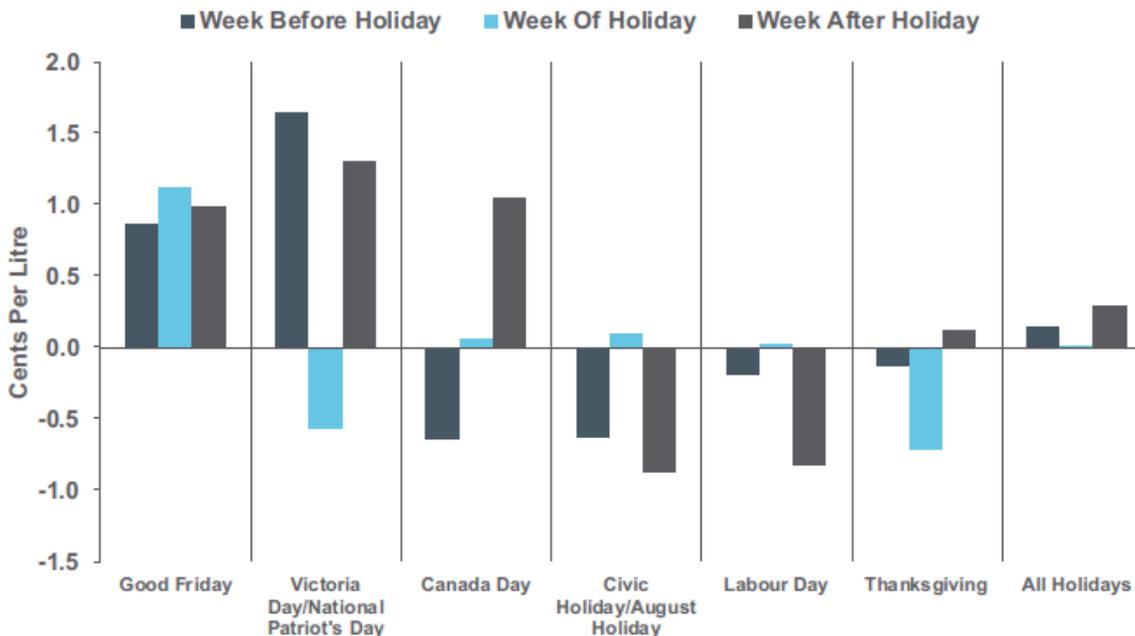
***The “Holiday Weekend Price Increase” is a Myth***

153. Although a “holiday weekend price increase” is sometimes cited in public discourse as “evidence” of inappropriate conduct by retailers, the data shows that the phenomenon is a myth. Natural Resources Canada states:<sup>199</sup>

Gasoline prices go up and down every week in response to how much consumers want to buy and the amount available at gas stations.

A review of actual prices charged across Canada indicates that gasoline prices do not rise or fall before a long weekend any more than they do before any other weekend. Prices do rise during the peak summer driving season when the demand for gasoline is at its highest level.

154. Kent’s data supports this:<sup>200</sup>



<sup>199</sup> Exhibit A2-17, Natural Resources Canada, “Why gasoline prices go up and down?”, August 24, 2016.

<sup>200</sup> Exhibit A2-3, Kent Presentation, PDF p. 147.

155. Competition Bureau of Canada provides a more realistic assessment of what is occurring, focussed on market dynamics:<sup>201</sup>

Wholesale gasoline prices tend to rise in the late spring and early summer because refineries shut down around then for short periods to maintain or upgrade their operations. This timing allows refineries to prepare for summer's high demand. Retailers will often pass along those wholesale price increases to customers, and these increases may (but not always) take effect before a holiday weekend. Conversely, when gasoline demand drops in the fall, wholesale and retail prices generally drop as well. These declines may (but not always) happen before a holiday weekend.

Participants in this Inquiry spoke to the seasonal supply and demand considerations referenced by the Competition Bureau of Canada. They are also addressed in Part 4, Section F.

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<sup>201</sup> Exhibit A2-14, Competition Bureau of Canada, "Factors that affect gas prices at the pumps", July 24, 2018.

## **PART FIVE: EXPLANATION FOR DIFFERENTIALS WITH OTHER JURISDICTIONS**

### **A. INTRODUCTION**

156. The Terms of Reference ask the Commission to assess the refining and retailing margin differentials with other provinces. In that regard, Parkland makes the following points in this Part:

- First, higher taxes in BC account for a significant portion of the retail price differential with other parts of Canada and the US since 2015.
- Second, diesel prices in BC have remained largely consistent with historical trends, and there has been no systematic margin differential between Vancouver and Edmonton since 2015.
- Third, the larger refining margin differentials since 2015 relative to the Western Region reflects BC's unique market characteristics - limited local supply, constrained TMPL pipeline capacity, and unique regulatory requirements.
- Fourth, the larger retail margin differential with the Western Region since 2015 can be explained by (a) a distortion resulting from the data set used to determine the differential, (b) rising land values and credit card costs disproportionately affecting BC retailers, and (c) a recent collapse in margin in the depressed Calgary and Edmonton markets.

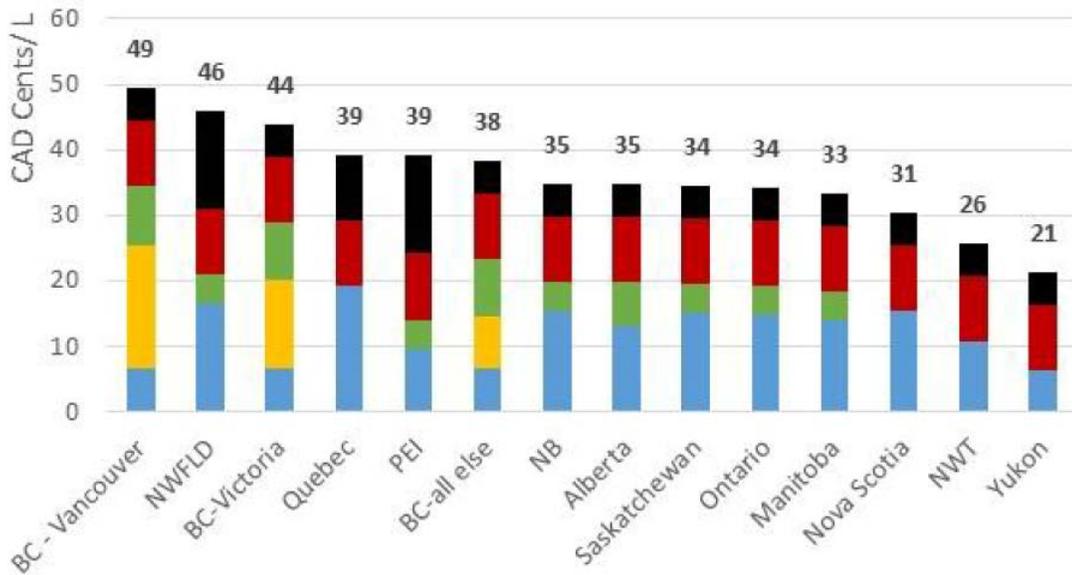
### **B. TAXES ARE HIGHER IN BC THAN IN MOST OF CANADA AND THE U.S.**

157. When consumers in BC complain about paying more for gasoline in BC than in other provinces, they are talking about the total price at the pump, i.e., the price inclusive of all taxes. Consumers do not see margins; they see the price posted on signs. Accordingly, it is important that, coming out of this Inquiry, people understand that a material portion of the differential they are seeing in posted pump prices is attributable to taxes. Victoria and the

Lower Mainland, which together account for more than half of BC's population, have among the highest fuel taxes in Canada.

158. The following figure is from the Deetken Phase 1 Report, showing the extent to which taxation is affecting price differentials relative to other provinces.<sup>202</sup> Greater Vancouver has the highest taxes of the jurisdictions canvassed by Deetken, and Victoria and the rest of BC are not far behind it. The contrast between BC taxes and Alberta taxes is stark, particularly when considering Greater Vancouver and Victoria. Gasoline is 14 cents per litre higher in Vancouver than in Alberta, and 9 cents per litre higher in Victoria.

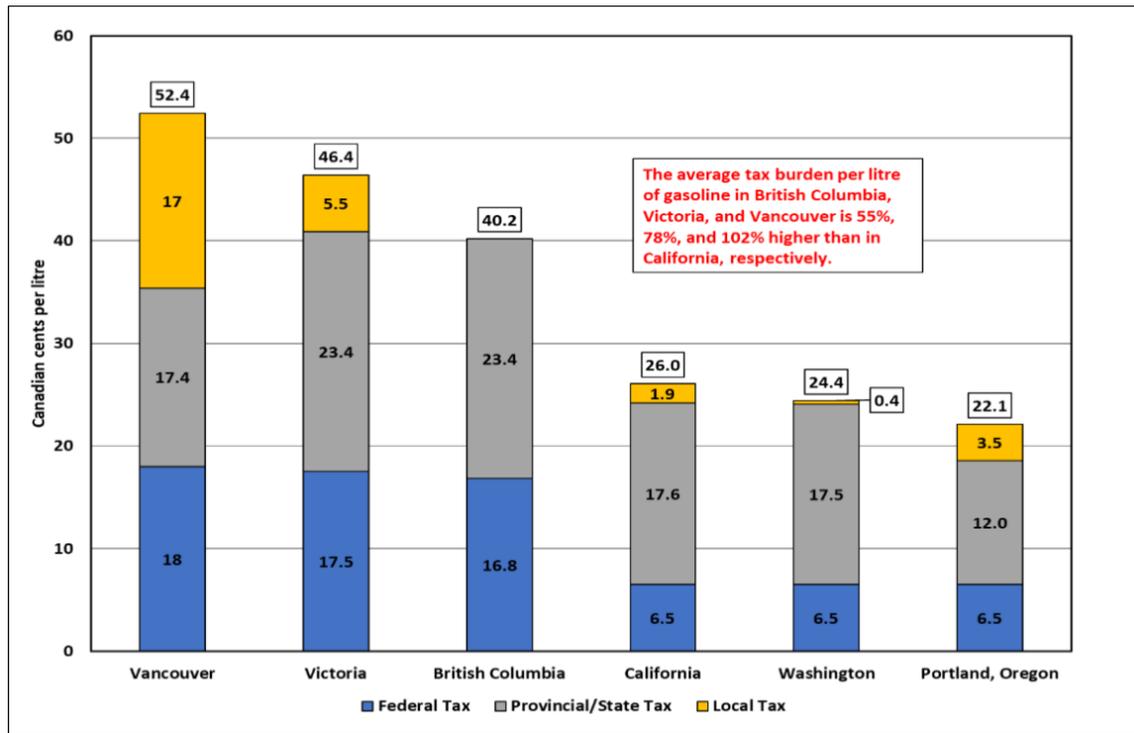
**Chart A.2.1 Clear Gasoline Tax (Provincial & Federal) across Canada<sup>55</sup>**



159. The tax differential with the Western US states is even larger than the differential with Alberta.

<sup>202</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 36. Dr. Kahwaty also provided information about taxes, but used a different currency date and different sources. The pattern is similar to that shown by Deetken, but shows an even larger differential between Greater Vancouver and Alberta: Figure 27, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para 62 and Parkland Evidence, p. 7. See also: Exhibit A2-3, Kent Presentation, PDF p. 121.

### Comparison of Tax Per Litre for Gasoline in British Columbia and West Coast States<sup>203</sup>



#### C. DIESEL IS A NON-ISSUE: THERE HAS BEEN NO CHANGE IN RELATIVE DIESEL MARGINS AND PRICES

160. It is important for the Inquiry Panel to note that the “increasing differential” issue does not arise with diesel. Deetken observed that, when compared to other parts of Western Canada, diesel prices in BC have remained largely consistent with historical trends.<sup>204</sup> Deetken also observed that “the wholesale diesel prices have remained quite tight back to 2011. Furthermore, there appears to be no systematic differential created between Vancouver and Edmonton.”<sup>205</sup> Deetken also found that “The diesel market has not seen a material change in retail margin and whole price differentials in recent years...”, a statement with which

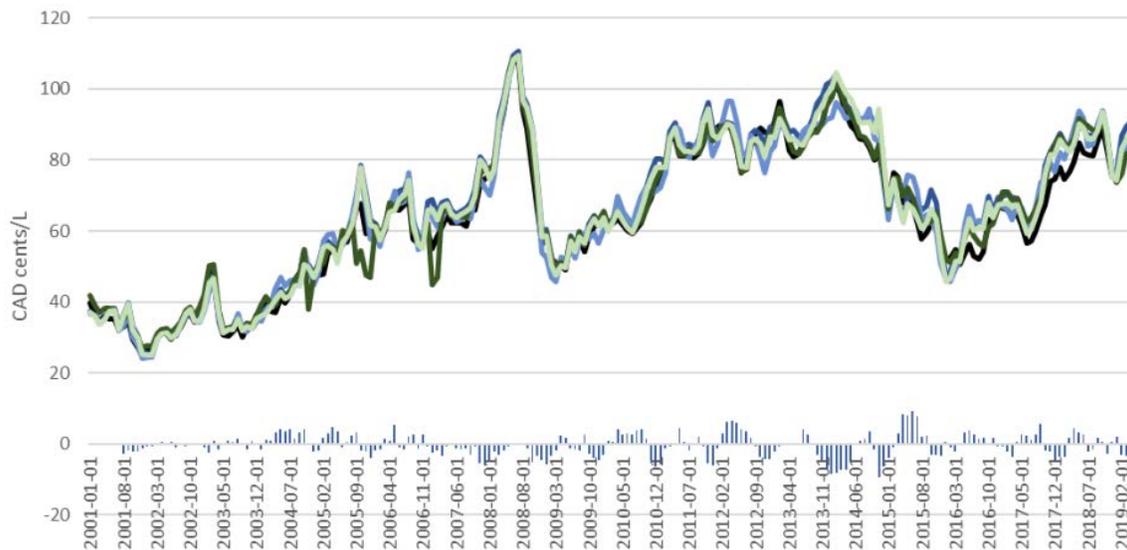
<sup>203</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 66. Note that Dr. Kahwaty used a different currency date from Deetken, so the tax amounts for Vancouver, Victoria and BC, while similar to those set out by Deetken, do not perfectly align.

<sup>204</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 2.

<sup>205</sup> Exhibit A2-1, Deetken Phase 1 Report, p. 24.

Parkland agrees.<sup>206</sup> These observations are reflected in the following figure from Deetken’s Phase 1 Report.

**Chart 4.2.3 Wholesale Diesel Prices across Canada**



161. Deetken’s evidence in this regard is uncontroverted and should be accepted.

**D. REFINING MARGIN DIFFERENTIAL REFLECTS TMPL CONSTRAINTS AND NEW BC REGULATORY REQUIREMENTS**

162. Parkland submits that a quantitative analysis of the differential goes beyond what is required by the Terms of Reference. Nevertheless, the available analysis demonstrates that the increased differential in refining margin<sup>207</sup> since 2015 can be explained by two of the factors discussed in Part 4: the combined effect on wholesale prices and refining margin of importing more costly supply due to TMPL constraints and new regulatory requirements.

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<sup>206</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 4. Deetken “Finding 7: The diesel market has not seen a material change in retail margin and whole price differentials in recent years, this may be in part due to different demand dynamics in the diesel market.” See also: Tr. 1, p. 32, ll. 9-13 (Lepine).

<sup>207</sup> Note that Deetken was actually analyzing wholesale price differentials, as opposed to refining margin differentials per se. The assumption inherent in that analysis is that crude prices would be the same across jurisdictions. While this is a reasonable proxy, it may or may not always hold true. Exhibit A2-1-1, Deetken Phase 2 Report, pp. 31, 84.

**(a) A Differential Is to Be Expected Given Geography and More Onerous Regulations**

163. There will always be a price and margin differential with BC's neighbouring jurisdictions by virtue of the fact that BC relies on imports, and the cost of the marginal barrel determines the equilibrium price in BC. There are transportation and logistics costs associated with moving supply from other jurisdictions to the relatively isolated (in market and infrastructure terms<sup>208</sup>) BC market. Both Deetken and Dr. Kahwaty agree on this point. Mr. Scammell of Imperial described the environment as follows:<sup>209</sup>

Logistics are strained as we talked to today, land is expensive and there are very high regulatory standards. And probably in my mind, in most markets I would put B.C. and Vancouver at the top end in terms of the regulatory standards we have to meet to do business here.

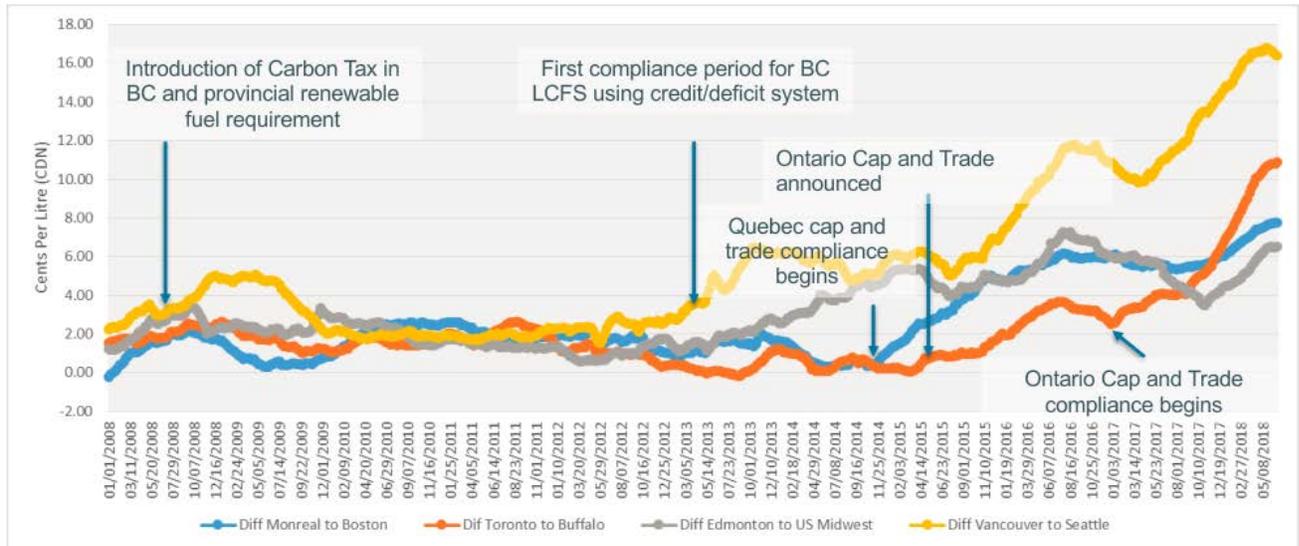
164. Moreover, as we explained in Part 4 above, BC has enacted a host of initiatives designed to reduce carbon emissions that are unique to BC. Regulatory-related costs are akin to the logistics costs, in that they must be incurred in order to make use of imported supply. When costs are imposed on BC-bound supply that are not incurred in another market, it is reasonable to expect that it will contribute to a price and margin differential.

165. It is notable that wholesale prices in BC diverged from those in Seattle when BC implemented its LCFS. This temporal link is shown in the following figure from Kent's Presentation to the BCUC, in which the differential between Vancouver and Seattle rack prices are shown in yellow (the top line). Parkland submits that this temporal link is not a coincidence. The figure below also shows that margins have widened in Ontario and Québec upon implementation of provincial initiatives aimed at reducing emissions that impose costs on parties supplying those jurisdictions.

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<sup>208</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para 5.2. Dr. Kahwaty also described the relative isolation of PADD 5 to the rest of the US, and the resulting higher prices. (See example: Kahwaty Report, para. 53 and Figures 18 and 19). BC shares similar characteristics to California in this regard, and the market tends to exhibit similar tendencies.

<sup>209</sup> Tr. 1, p. 267, ll. 8-13 (Scammell).



**(b) Deetken’s Analysis of Transportation and Regulatory Costs Left Only a Small “Unexplained” Differential in Limited Instances**

166. Deetken concluded that “[t]he transport costs of the marginal source of supply and the costs associated with regulation in BC are likely contributing to the differential.”<sup>210</sup> In fact, Deetken’s estimate of transportation costs and regulatory costs *fully* explained the differential in most instances, specifically:

- (a) between Kamloops and Edmonton in every year for which Deetken had a full year of data (2015-2018);<sup>211</sup>
- (b) between Kamloops and Seattle in two of the four years for which it had full-year data;<sup>212</sup> and
- (c) between Vancouver and Edmonton in three of the four years for which it had full-year data.<sup>213</sup>

<sup>210</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 2.

<sup>211</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 4.

<sup>212</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 4.

<sup>213</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 3.

167. Deetken’s figure below shows how its modeled delivered wholesale prices in Kamloops, Edmonton and Seattle “appear to align quite well”.<sup>214</sup>

**Chart 4.3.15: Kamloops Wholesale and delivered gasoline from Edmonton and Seattle**



168. In evaluating Deetken’s results, and in particular the existence of some “unexplained” differential in some years, it is important to recognize two points:

- First, the results depend heavily on Deetken’s transportation estimates. As discussed below, it is clear that they were too low.
- Second, the cost of moving the product includes not just the physical cost of transport (e.g., trucking price), but also the costs associated with any logistical challenges or other barriers. Deetken’s analysis included an assumption for transport costs, but did not include any costs for logistics.

These factors can explain fully the remaining “unexplained” differential in Deetken’s analysis.

<sup>214</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 48.

**(c) Deetken's "Unexplained" Differentials Can Be Readily Explained**

169. Deetken's "unexplained" differentials can be readily explained by using more accurate transportation costs and recognizing real logistical costs. It should also be recognized that general market dynamics - market friction and a fluid marginal source of supply - preclude perfect alignment with textbook economic principles. Markets continually respond to changing conditions; however, adjustments are not instantaneous and play out over time. Ms. Lepine essentially agreed that it is unlikely there truly was an unexploited arbitrage opportunity since 2015:

MR. GHIKAS: Q: And is it your view that despite all of that collective expertise, that that market hasn't figured out that there is money to be made and has been for the last seven years?

MS. LEPINE: A: No, I think the calling out of the arbitrage opportunity was more so to identify that there are other additional factors that have to be analyzed, more so than saying that there are folks who aren't taking advantage of an opportunity that exists.

MR. GHIKAS: Q: Okay, because after four weeks you've been able to discover this based on your analysis and you'd expect that industry experts having seven years to do it probably would have been able to do it as well?

MS. LEPINE: A: Correct.<sup>215</sup>

***Deetken's Assumed Transportation Costs Were Too Low***

170. At the oral workshop, Ms. Lepine acknowledged that it was possible that the estimated transportation costs used in the Deetken analysis could be too low.<sup>216</sup> The evidence bears that out.

171. In the absence of actual data, and in light of time constraints, Deetken had to make a variety of assumptions regarding transportation costs. There were three key shortcomings with the assumptions used:

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<sup>215</sup> Tr. 1, p. 36 to ll. 10-24 (Lepine).

<sup>216</sup> Tr. 1, p. 37, l. 6 to p. 38, l. 3 (Lepine).

- *Outdated*: Deetken’s estimates were based on 2011 data that Deetken escalated on a linear basis. Ms. Lepine agreed that trucking costs do not escalate in that manner, particularly with respect to the price of diesel fuel for the trucks;<sup>217</sup>
- *Unverified*: Deetken used truckersreport.com as a check on its estimates, but could not confirm the quality or currency of the information;<sup>218</sup> and
- *Not adjusted for cross-border transport*: Truckersreport.com appears to be aimed at truckers travelling within the US.<sup>219</sup>

172. The information filed in confidence by Parkland as to trucking costs from Alberta demonstrates that the Deetken estimates are much too low.<sup>220</sup> The trucking rates provided by Parkland explain essentially all of the remaining “unexplained” differential. Super Save Group’s (“Super Save”) evidence provides another estimate of the trucking costs:

So, the Edmonton rack, which we also have access to, will be as high as a 23 cent differential to Vancouver rack, and we've experienced that. And when we have that we have a fleet of trucks that we run. When we have a 23 cent spread we will run those from Edmonton to down here.<sup>221</sup>

***There Are Unrecognized Logistical Issues Associated With Exporting to BC***

173. Deetken’s analysis made the simplifying, and ultimately unrealistic, assumption that all logistics costs are the same across jurisdictions (and hence do not contribute to refining margin differentials). Logistics costs are very much part of the explanation of the “unexplained” differential identified by Deetken.

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<sup>217</sup> Tr. 1, p. 38, l. 9 to p. 39 l. 11 (Lepine).

<sup>218</sup> Tr. 1, p. 40, l. 19 - p. 42, l. 9 (Lepine).

<sup>219</sup> Tr. 1, p. 40, l. 19 - p. 42, l. 9 (Lepine).

<sup>220</sup> Exhibit C5-20, Parkland Confidential Undertaking No. 4.

<sup>221</sup> Tr. 4, p. 737, ll. 12-20 (Vanderkerkhove).

174. Ms. Lepine allowed that she “wouldn't be surprised if there were some delay” based on actual frictions in the market<sup>222</sup> and that formal or logistical barriers might impose additional costs.<sup>223</sup>

175. Mr. Scammell described the issue in this manner:<sup>224</sup>

So the market is working, but I don't know what the hurdle or that barrier is. I know that we tried to model trucking costs, I know we try to model rail costs. But what that tells me is there is something else that is making it difficult for that marginal layer to get in there. That's the only reason you could get a value sustained that high, and not be attracting other suppliers with an arbitrage.

176. Various market participants identified logistical issues, particularly when it comes to importing from the US. While those logistical issues do not necessarily prevent trade, they come with costs that need to be accounted for in the analysis of retail margin / wholesale cost differentials. The logistical issues identified include: Canadian fuel specifications,<sup>225</sup> and seasonal requirements.<sup>226</sup> Mr. Wallin of Suncor agreed that, due to logistical considerations, “you can't just take a tanker truck down to Washington, fill it up and come back...”;<sup>227</sup> some work is required to facilitate the supply. With reference to the “Deetken Diagram”, Mr. Wallin explained that “there is a chance that box 4 can't supply it. You have to go to box 5”<sup>228</sup> – if arrangements are not already in place.

***Theory vs. Practice: Friction and a Fluid Marginal Cost Can Cause “Unexplained” Differential***

177. It should also be recognized the large and dynamic markets like those for refined products are not as “clean” as textbook examples. We cannot expect that the economic theory (that the difference in prices between two markets will precisely equal the marginal cost of

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<sup>222</sup> Tr. 2, p. 402, ll. 13-14 (Lepine).

<sup>223</sup> Tr. 1, p. 34, ll. 8-11 (Lepine); Tr. 1, p. 37, ll. 12-25 (Lepine).

<sup>224</sup> Tr. 1, p. 285, ll. 3-10 (Scammell).

<sup>225</sup> Tr. 2, p. 323, l. 22 to p. 325, l. 2 (McLean).

<sup>226</sup> Tr. 2, p. 325, l. 3 to p. 332, l. 13 (McLean and Wallin). See also: Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 123.

<sup>227</sup> Tr. 2, p. 332, ll. 3-13 (Wallin).

<sup>228</sup> Tr. 2, p. 332, ll. 12-13 (Wallin).

moving supply between them) will play out perfectly in every instance because markets are continually adjusting to changes in conditions, and adjustments in actual markets play out over time.

178. A differential between Vancouver and another market (take Seattle, for illustration) can exist at any point in time if Seattle is not the source of the marginal barrel for the BC market. As discussed above, imports that are *infra*-marginal will fetch more in BC than what would be suggested by the cost of moving product to BC from that location (i.e., a differential will remain) because the wholesale price in BC is determined by a higher cost (i.e., the marginal) source of supply. The evidence discussed in Part 4 is clear that the marginal source of supply in BC is fluid and can be from as far away as California, the US Midwest or even the US Gulf Coast. There will also necessarily be some lag between when marketers identify an arbitrage opportunity between Seattle or Edmonton and Vancouver and when they could conceivably take full advantage of it and thereby causing market prices to converge. Perfect convergence may never happen in a dynamic market with inherent frictions and adjustment lags (e.g., the logistical issues described above), especially when markets in differing geographies are continually reacting to changes in supply and demand conditions.

***Market Power Can Be Ruled Out as an Explanation for “Unexplained” Differential***

179. Assuming there was even an “unexplained” differential at all after accounting for more realistic cost estimates, it is clear that it would not be attributable to the exercise of market power and an artificially inflated price in BC. As discussed in Part 4, Section G, prolonged artificially inflated prices would have resulted in marketers entering the market to exercise the arbitrage opportunity.

**E. GASOLINE RETAIL MARGIN DIFFERENTIAL IS READILY EXPLAINED**

180. The larger retail margin differential with the Western Region<sup>229</sup> since 2015 can be explained by (a) a distortion resulting from the data set used to determine the differential,

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<sup>229</sup> Deetken defined the Western Region as a simple average of Calgary, Edmonton, Regina and Winnipeg.

(b) the disproportionate impact of rising land values and credit card costs in BC, and (c) the recent collapse of retail margins in the depressed Calgary and Edmonton markets. These factors reflect standard market dynamics, not anti-competitive behaviour.

**(a) The Data Set Used to Determine the Differential May Result in the Differential Being Overstated**

181. Parkland has identified a significant limitation in Kent's measurement methodology when used to examine retail price and margin differentials.<sup>230</sup> As described on Kent's website, "Kent gasoline and diesel pump prices are collected directly from retailers (gas stations) every weekday morning at 10:00 AM local". In certain BC markets, such as Vancouver, there is significant "price cycling" activity; meaning that retail street prices can decrease significantly throughout the day and increase overnight. As such, Kent's gross retail margin estimates in these markets could be significantly higher than actual retail gross margins averaged over the course of the entire day.<sup>231</sup> This data set will create a differential between these markets and the markets that exhibit a less pronounced or different *intra*-day pricing cycle.

182. Even leaving aside the data distortion, the entire differential can be explained by the two factors discussed next.

**(b) Deetken: The Entire Differential from 2015 to 2018 Can Be Explained by Land Values and Credit Card Costs Alone**

183. Deetken's analysis showed that, in every year for which it had complete data (2015 to 2018), the entire differential in retail margin between Vancouver and the Western Region (or, in some cases, more than the full differential) can be explained by a combination of real estate values and credit card fees.<sup>232</sup>

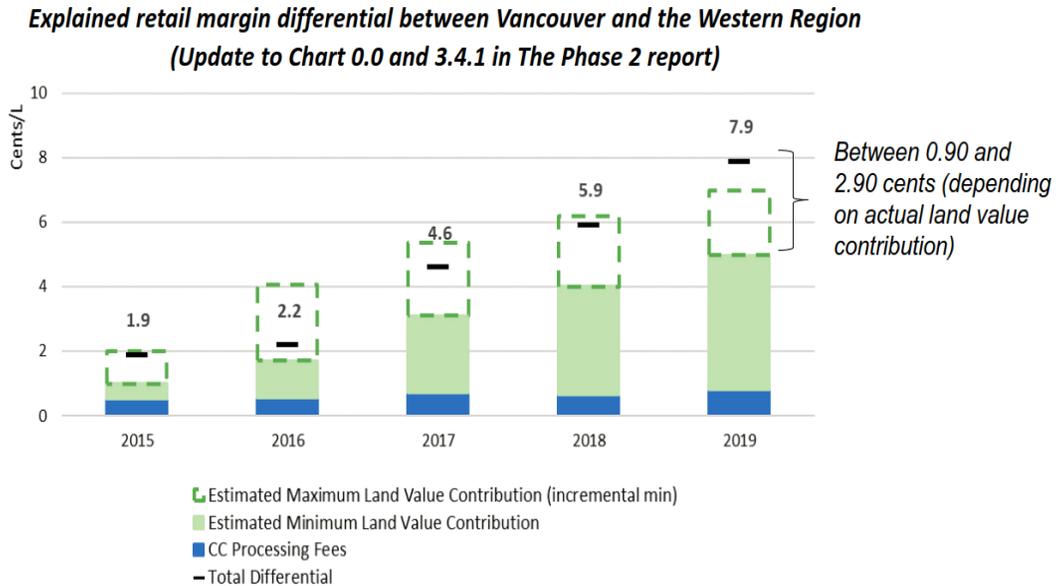
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<sup>230</sup> Confidential Tr. 4A, p. 2, l. 5 to p. 3, l. 10 (White).

<sup>231</sup> Exhibit C5-6-1, Confidential Parkland Supplemental Response to Questionnaire, Q. 29.

<sup>232</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 29. Credit card fees are charged on the entire retail price, inclusive of taxes. We have higher retail prices in BC compared to other jurisdictions to much higher taxes and other factors discussed in this Submission; therefore, credit card fees are disproportionately higher in BC. Tr. 1, p. 24, ll. 5-24 (Lepine).

184. Deetken’s 2019 differential reflected only six months of data. Deetken provided the following updated figure at the Oral Workshop in response to concerns about the impact of seasonality on the 2019 number.<sup>233</sup> It leaves only a very small portion of the differential “unexplained” by credit card fees and land values alone. As discussed next, that remaining portion can be explained by market dynamics in Alberta.

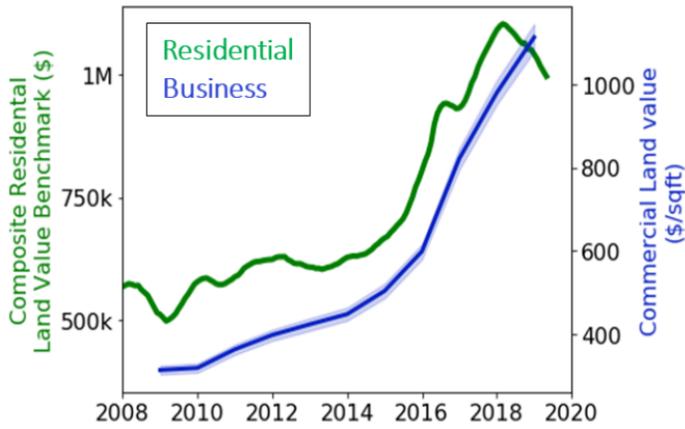


185. The contribution represented by land values in Deetken’s analysis remains reasonable for 2019, despite the widely publicized softening of the Vancouver residential real estate market. Commercial property values have not declined in recent months in the same way housing prices have come down. This is reflected in the following figure from Deetken’s Phase 2 Report:<sup>234</sup>

<sup>233</sup> Exhibit A2-1-3, Deetken Update for Oral Hearing, slide 11.

<sup>234</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 24.

Chart 3.3.1 Residential and commercial real estate values in Vancouver<sup>22</sup>



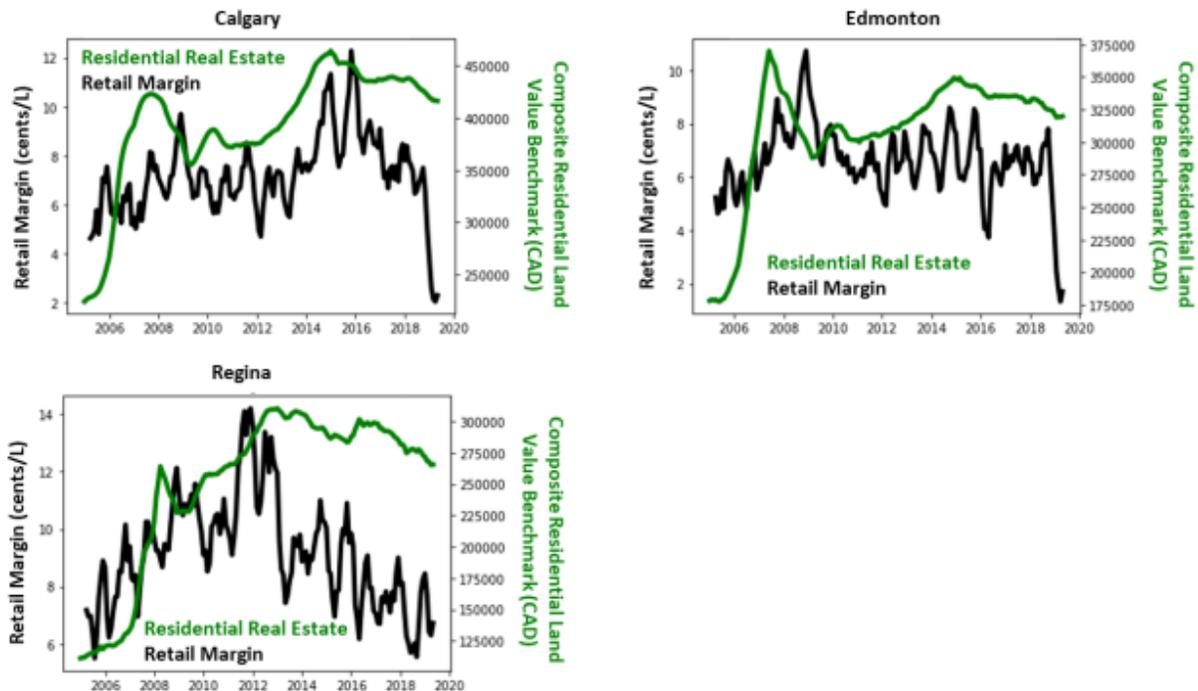
Counsel for 7-Eleven put several documents to Ms. Lepine, all of which supported the data suggesting that the commercial real estate market remains tight.<sup>235</sup>

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<sup>235</sup> Exhibits C9-3, C9-4 and C9-5.

**(c) The Additional 2019 Differential is Due to Collapse of Alberta Retail Margins**

186. The increase in the differential between 2018 and 2019 is actually attributable to a precipitous drop in the margin in the Western Region, as opposed to an increase in the margin in BC.<sup>236</sup> Calgary, Edmonton and Regina have all seen significant declines in their retail margins in 2018 and 2019, as reflected in the black lines in the following charts from Deetken.<sup>237</sup> These cities are experiencing a glut of landlocked crude.<sup>238</sup>



<sup>236</sup> Tr. 1, p. 68, l. 7 to p. 71, l. 21 (Lepine).

<sup>237</sup> Exhibit A2-1-1, Deetken Phase 2 Report, p. 27, Chart 3.3.6.

<sup>238</sup> Tr. 2, p. 346, ll. 18-24 (Wallin).

**PART SIX: GOVERNMENT INTERVENTION IN COMPETITIVE MARKETS SHOULD BE AVOIDED**

**A. INTRODUCTION**

187. The Terms of Reference require the BCUC to inquire into “the mechanisms the Province could use to moderate price fluctuations and increases”, and the “measures used in other jurisdictions in Canada and North America to enhance transparency about how gasoline and diesel fuel prices are determined”.<sup>239</sup> Dr. Kahwaty’s Report discusses several steps that government could take to impact prices favourably, all of which are consistent with continued reliance on market forces. Parkland submits that price controls and reporting requirements would be detrimental to the public interest.

188. In this Part, Parkland makes the following points:

- First, regulating gasoline and diesel markets would contradict the BCUC’s relatively recent determinations that competition is superior to regulation, and that economic regulation should be limited to circumstances where natural monopoly conditions are present.
- Second, Bonbright, a commonly cited authority on regulation, concurs with the BCUC’s assessment.
- Third, only four of the 63 provincial/territorial and state jurisdictions in Canada and the United States rely on price caps to determine gasoline and diesel prices, and that regulation does not appear to have yielded lower prices for consumers.
- Fourth, capping prices or margins in BC will have unintended, but entirely predictable, negative consequences for consumers.
- Fifth, price regulation aimed at smoothing out price volatility imposes additional costs on consumers.

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<sup>239</sup> Exhibit A2, Appendix B, Order in Council No. 254, pp. 2-3.

- Sixth, the reporting framework envisaged by Navius would be unique in North America, would be costly, and would provide no real benefit to consumers.

## **B. REGULATING GASOLINE AND DIESEL PRICES WOULD CONTRADICT THE BCUC'S PRIOR DECISIONS**

189. The BCUC has addressed the proper role of regulation in several proceedings in recent years. As discussed below, the BCUC has determined that (1) competition is superior to regulation; (2) regulation should be limited to circumstances where natural monopoly conditions are present; (3) regulation should not impede competitive markets; and (4) the Competition Bureau of Canada, not provincial economic regulators, properly addresses anti-competitive concerns. It would be impossible to reconcile price regulation of gasoline and diesel in the BC market with the BCUC's prior determinations.

### **(a) BCUC Determination: Competition is Superior to Regulation Except Where a Natural Monopoly Exists**

190. In 2011, the BCUC initiated an *Inquiry into FortisBC Energy Inc. regarding the Offering of Products and Services in Alternative Energy Solutions and Other New Initiatives*. A specific purpose of the Inquiry was to determine the proper extent and scope of economic regulation. In its Inquiry report ("AES Inquiry Report"), the BCUC articulated the following "Key Principles" and "Guideline" for determining whether or not economic regulation is required. The BCUC's "Key Principles" and "Guideline", along with the BCUC's accompanying discussion, are unequivocal: competition is preferable to regulation, such that regulation is only appropriate in the absence of competition to protect against the exercise of monopoly power:<sup>240</sup>

#### **Key Principles:**

- i) Only regulate where required.

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<sup>240</sup> AES Inquiry Report, BCUC Order G-201.12, pp. 6-7 and 14. See also: p. 71 where the BCUC repeated that "competitive forces are accepted as providing societal benefits more efficiently and effectively than economic regulation." It also determined that "economic regulation of Discrete Energy Systems is not warranted given the lack of natural monopoly characteristics and the lack of a need for consumer protection in light of the presence of a functioning competitive marketplace."

ii) Regulation should not impede competitive markets.

### Guideline

- Regulation is required when:
  - natural monopoly characteristics are present and there is a need to regulate to protect the public interest; and/or
  - legislation (such as the *Utilities Commission Act* or the *Clean Energy Act*), requires an activity to be regulated.

...

Regulation exists to protect consumers against the abuse of monopoly power but, in the Commission Panel's view, the superior protection for consumers is the competitive marketplace. The Commission Panel accepts Dr. Jaccard's statement that "[t]he underlying principle of economic regulation is that monopoly should only exist where it is not possible to replace it with competition." This is consistent with the first principle outlined in this Section, to only regulate where required. Competitive forces are generally accepted as providing societal benefits and consumer protection more efficiently and effectively than economic regulation. The Commission Panel further notes that this premise is not disputed by FEU's expert, Dr. Ware, who takes the position that, subject to certain safeguards, it is possible for a monopoly service provider to enter a market and compete fairly in a way that will generate benefits for all customers.

Regulation is costly, time-consuming, and limited by informational asymmetries. It is only in natural monopoly situations where consumer protection is needed that these limitations are outweighed by the benefits of regulation.

Based on the above, the Commission Panel finds as a fundamental principle that regulation is only appropriate where required and is driven by the inability of competitive forces to operate with greater efficiency and effectiveness than a sole service provider.

While the Commission does not regulate competition *per se*, the Panel accepts that it should not act to hinder competition, where competition is feasible. In this regard, the Commission Panel confirms that there must be no cross-

subsidization when a utility purports to enter a competitive market. [Emphasis added.]

191. In the AES Inquiry Report, the BCUC drew support for its position that only natural monopolies require regulation from examples of other regulators (the Ontario Energy Board and the CRTC) that abstain from economic regulation where competition exists.<sup>241</sup>

192. The BCUC went on to emphasize that regulation is something that is undertaken when it is required because of the presence of “monopoly characteristics”, not due to preference for regulation: “The Panel finds that customer preference does not determine the need for regulation. Regulation itself is not a choice. The need for regulation is determined by natural monopoly characteristics, the resulting need for consumer protection and/or the relevant legislation.”<sup>242</sup> This determination is apt in the present context because ideological preference for government intervention appears to underlie some advocacy for regulation of gasoline and diesel prices, despite the existence of functioning markets. The BCUC should, in this Inquiry, continue to resist regulation for the sake of regulation.

193. The BCUC has recently (2016) reiterated its reasoning in the AES Inquiry Report, framing abstention from regulation when natural monopoly characteristics are absent as upholding the public interest:<sup>243</sup>

In the AES Inquiry Report, the Commission concluded that regulation is required when “natural monopoly characteristics are present and there is a need to regulate to protect the public interest...” We agree with this public interest consideration and find it to be an appropriate public interest test. Therefore, if monopoly characteristics are not present, or are somehow mitigated, for example by an alternative regulatory body, an exemption from regulation under the UCA may be warranted.

194. Parkland submits that the BCUC’s strong statements favouring competition to regulation are compelling. The BCUC should be guided by those statements in this Inquiry.

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<sup>241</sup> AES Inquiry Report, pp. 9-10.

<sup>242</sup> AES Inquiry Report, p. 15.

<sup>243</sup> BCUC Order G-175-16, *Spirit Bay Utilities Ltd. Application for an Exemption Pursuant to Section 88(3) of the Utilities Commission Act or Declaration Pursuant to Section 72*, Reasons for Decision, pp. 8-9.

**(b) “Natural Monopoly Characteristics” Are Absent from these Markets**

195. As described above, the BCUC’s “Guidelines” in the AES Inquiry Report identified “natural monopoly characteristics” as being a precondition for regulation. The BCUC, under the heading “What Constitutes a Natural Monopoly?” described natural monopoly conditions in a way that is fundamentally incompatible with the characteristics of the gasoline and diesel market in British Columbia. The BCUC stated, in part:<sup>244</sup>

In a market with natural monopoly characteristics, the lowest cost to provide a service can only be achieved by a single firm, and the presence of competition, or entry of other firms, would only serve to increase costs to society. (Bonbright et al., 1988: 8, Exhibit B-11, BCUC 1.149.0)

Because a public utility tends to represent a single supplier of an essential product or service, its customers are basically captive, lacking the ability to readily change providers, and the demand curve is “inelastic”, such that a change in price will not result in an equivalent change in demand.

Public utilities are typically natural monopolies because their fixed costs, as determined by their technology and demand, are lower, such that it is a more efficient use of society’s scarce resources for a single firm to supply the market than multiple firms. (ATCO, para. 36)

**(c) Gasoline and Diesel Regulation Would Be Incongruous With BCUC Finding that CNG / LNG Retail and Electric Vehicle Charging Service Regulation Is Inappropriate**

196. In the AES Inquiry Report, the BCUC determined that “CNG/LNG [Compressed Natural Gas and Liquefied Natural Gas] fuelling infrastructure has no natural monopoly characteristics”.<sup>245</sup> It declined to regulate retail sales of CNG and LNG.<sup>246</sup> Parkland submits that it would be impossible to reconcile the BCUC’s position on regulation of CNG and LNG retail sales with the regulation of the wholesale or retail market for gasoline and diesel. The BCUC had concluded that competition in CNG and LNG retail sales was sufficient to make regulation

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<sup>244</sup> AES Inquiry Report, pp. 7-8.

<sup>245</sup> AES Inquiry Report, p. 52.

<sup>246</sup> Today, the BCUC only regulates gas utility participation in retail CNG / LNG activities. This is only done to protect traditional natural gas utility ratepayers from cross-subsidization and to avoid public utilities undercutting other retail market participants.

contrary to the public interest, despite limited market players and few retail stations in a nascent market. There are, by contrast, over 1300 retail gasoline and diesel stations in BC and dozens of players in the wholesale space.

197. Notably, Government has since amended the *Utilities Commission Act* to exempt retail LNG/CNG sales from economic regulation.

198. Similarly, in its very recent Phase One Report in its Inquiry into the Regulation of Electric Vehicle Charging Service, the BCUC relied on the AES Inquiry Report, holding that economic regulation is not a regime that should be imposed by the regulator if a free market exists.<sup>247</sup> The BCUC also held that “the BCUC should only regulate where necessary, and that regulation should not impede competitive markets.”<sup>248</sup>

**(d) BCUC Recognized that the Competition Bureau Oversees Functioning Markets**

199. In the AES Inquiry Report, the BCUC recognized that the role of overseeing competition falls to the Competition Bureau of Canada, not provincial regulators like the BCUC.<sup>249</sup> The BCUC cited with approval a paper prepared by the Competition Bureau of Canada that discussed when a market can be deemed to have sufficient competition to protect the public interest. The BCUC stated:

The Competition Bureau of Canada “believes that a market can be deemed subject to sufficient competition to protect the public interest if no firm operating in it has sufficient market power to unilaterally and profitably impose a significant and non-transitory price increase.” Its view, as outlined in a paper prepared by one of its members in respect of deregulation of portions of the electricity market, is that regulation should be avoided where there is sufficient competition to protect the public interest. (AES Exhibit A2-30, p. 7)

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<sup>247</sup> BCUC, *An Inquiry into the Regulation of Electric Vehicle Charging Service* Phase 1 Report (“EV Inquiry Phase 1 Report”), p. 32.

<sup>248</sup> EV Inquiry Phase 1 Report, p. 33.

<sup>249</sup> AES Inquiry Report, pp. 12-14.

**C. BONBRIGHT (AN AUTHORITY ON ECONOMIC REGULATION) WOULD OPPOSE REGULATION IN THIS CONTEXT**

200. Bonbright *et al.*, *Principles of Public Utility Rates*, (“Bonbright”) is a well-recognized authority on regulation and rate setting that has been cited on many occasions by economic regulators including the BCUC. Bonbright is unequivocal that competition is superior to regulation, and warns against regulation motivated by politics.

**(a) Bonbright: Regulation Is “a Very Poor Substitute Indeed” for Competition**

201. Bonbright observes that price regulation falls short relative to competitive forces in terms of promoting quality, efficiency, innovation and cost. In particular, regulation cannot set prices below an industry’s costs, however much people might consider them to be excessive. Competition pushes companies to discover means whereby its costs can be reduced. Bonbright’s view is exemplified in the following passage:<sup>250</sup>

**REGULATION: AN IMPERFECT SUBSTITUTE FOR COMPETITION**

**Regulation and Competition Compared**

Most economists in the United States prefer competition to regulation based on the normative standard of allocative and internal efficiency. It is believed that competition will generally serve to minimize the private and social costs of providing service to consumers who are willing and able to pay the cost of rendition. However, there are conditions under which private and social costs diverge, and in those instances regulation may be warranted. Thus, regulatory economists probably agree with Shepherd (1974, p.22) that: “Regulation is like growing old: we would rather not do it, but consider the alternative.”

If the decision is made to substitute regulation for competition, the question then shifts to what form regulation should take. Many economists would like firms to carry production to the point where consumers at the margin are just willing to pay the costs of rendition at the margin (i.e., practice marginal-cost pricing when conditions are of natural monopoly -- see Chapters 17 and 18). But to do so would require public subsidies. Regulation designed to carry production only to the point where consumers as a whole cover costs as a whole (i.e., average cost pricing -- see Chapter 19) is a compromise solution that creates a

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<sup>250</sup> Exhibit C5-2, Parkland Evidence, Appendix C, Bonbright, pp. 29-30.

whole range of problems, important ones to be sure, that are the primary subject of this book.

However, as will be shown later in this chapter, regulation is a questionable substitute for competition under conditions of natural monopoly and is a very poor substitute indeed when an industry is naturally competitive. Regulation carries with it the potential for anticompetitive effects even when there is a true natural monopoly, and this is why economists have such a strong bias favoring competition. Wilcox (1966, p. 476) put it this way:

Regulation, at best, is a pallid substitute for competition. It cannot prescribe quality, force efficiency, or require innovation, because such action would invade the sphere of management. But when it leaves these matters to the discretion of industry, it denies consumers the production that competition would afford. Regulation cannot set prices below an industry's costs however excessive they may be. Competition does so, and the high-cost company is compelled to discover means whereby its costs can be reduced. Regulation does not enlarge consumption by setting prices at the lowest level consistent with a fair return. Competition has this effect. Regulation fails to encourage performance in the public interest by offering rewards and penalties. Competition offers both.

There are many economists who continue to share Wilcox's preference for competition over regulation, when, and if, it is possible. [Emphasis added.]

**(b) Bonbright Warns Against Regulation for Political Reasons**

202. Bonbright is particularly contemptuous of regulation imposed for political purposes (euphemistically referred to as regulation by "governmental habit"), which is a worthwhile point given the impetus for this Inquiry:<sup>251</sup>

According to Scherer (1980, p. 482), following Jonathan Hughes, regulation may be imposed through well-established American tradition. It is "a governmental habit" of those who hold the political reins to attempt to express displeasure with the pricing and allocation of market processes, regardless of their actual efficacy, or to consider the service too important to be left at the farrago of purposed advantages of free and option competition.

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<sup>251</sup> Exhibit C5-2, Parkland Evidence, Appendix C, Bonbright, p. 56.

**D. PRICE REGULATION IN THIS SECTOR IS RARE, AND HAS A DUBIOUS TRACK RECORD**

203. There are 63 provincial/territorial and state jurisdictions in Canada and the United States. Only four – New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland – use price caps to regulate gasoline and diesel prices.<sup>252</sup> After examining the history of price regulation in the Atlantic provinces, as well as a failed experiment in Hawaii that was abandoned after a few months of runaway prices, Navius concludes: “The weight of evidence indicates that the price ceiling regulations have not resulted in lower prices for consumers, though the conclusions are not unanimous.”<sup>253</sup> Add to Navius’ unflattering verdict the cost to taxpayers / consumers of involving a regulator on an ongoing basis, and the case for abstaining from interference with competitive markets is very compelling.

**E. CAPPING PRICES OR MARGINS WOULD HAVE UNINTENDED (BUT ENTIRELY PREDICTABLE) NEGATIVE CONSEQUENCES**

204. It appears that some of the calls in letters of comment and from Allan/Eliesen for price regulation are prompted by a distaste for oil company profits.<sup>254</sup> Echoing the decisions of the BCUC and sentiments of Bonbright, Dr. Kahwaty observed that this would be a poor justification for regulation. He put it this way:<sup>255</sup>

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<sup>252</sup> The price regulation regimes in the Atlantic Provinces involve setting both price floors and price ceilings. Québec only imposes a price floor. Kent explains that the intended purpose of a price floor is protectionism: “to protect smaller marketers from being forced out of the market due to insufficient/negative margins.” Kent states: “potential drawbacks: may inhibit entry of price discounters, or the exit of inefficient competitors, resulting in higher retail margins than otherwise might be.” None of the industry participants in this proceeding is calling for protectionism of this nature, and there is no evidence in this Inquiry that would support its introduction. Exhibit A2-3, Kent Presentation, PDF p. 172. See also: Exhibit A2-12, “Price Controls: Atlantic Institute for Market Studies: What is Still Missing From Your Wallet? How Regulation Continues to Distort Gasoline Prices in Atlantic Canada”, Marcos Navarro-Genie, August 2017, p. 12.

<sup>253</sup> Exhibit A2-2, Navius Report, p. 8. Note that the Executive Summary of the Navius Report similarly states, “The evidence on the impact of the Canadian regulations mostly indicates that the price ceilings have not resulted in lower prices for consumers” (Navius Report, p. i). Comparable language is used in the Navius Report’s Summary and Conclusion section (Navius Report, p. 25).

<sup>254</sup> It should be noted that the profitability of operating in BC will not be uniform. Returns on capital will tend to differ for various market participants, depending on whether they enjoy a competitive advantage (i.e., the providers of the marginal source of supply will earn lower returns on product destined for BC than *infra*-marginal sources of supply). Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 191.

<sup>255</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 192.

In general, high returns are not a justification to regulate in a market economy. Some products or investments are successes and earn a greater rate of return. That is how markets work. Regulation is justified in certain settings not by high returns but rather the structure of the market (e.g., natural monopoly in certain specific industries such as local electric power distribution).

Regardless, the expert evidence in this proceeding is that capping gasoline or diesel prices or margins in British Columbia would have unintended, but entirely predictable, negative consequences for consumers. We address below the evidence on the distortions associated with (a) price capping and margin limits, (b) limiting volatility, and (c) price floors.

**(a) Capping the Wholesale Price or Refining Margin Would Reduce Supply and Increase Retail Prices**

205. Dr. Kahwaty and Deetken are in full agreement regarding the expected outcomes of capping wholesale prices or margins below what they would otherwise be in the absence of regulation. The negative results are a predictable product of basic market economics.

206. Dr. Kahwaty described extensively the distortions that would occur by either restricting prices to be below the levels that would otherwise prevail, or regulating margins.<sup>256</sup> He summarized:<sup>257</sup>

An alternative to retail price regulation would be to regulate the wholesale prices charged by refiners or to regulate refiner profit margins directly. The effects of such a policy on refiners would be similar to the effects of retail price regulation, including reduced incentives to produce and supply fuels to customers in the short term and reduced incentives to maintain capital and invest in their businesses over the long term. Reductions in refinery production would lead to higher consumer prices, reduced volumes of consumer purchases, and reduced retailer sales.

207. While it may seem counterintuitive, Dr. Kahwaty explained that wholesale price or refining margin controls would actually increase prices for consumers at the pump.<sup>258</sup>

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<sup>256</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, starting at para. 148.

<sup>257</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, paras. 5.7 and 158.

<sup>258</sup> Exhibit C5-2, Parkland Evidence, Appendix B, paras. 160-161. See also: Tr. 1, p. 193, l. 3 to p. 195, l. 3 (Kahwaty).

Economic theory suggests that the regulation of wholesale prices would lead to reduced domestic supply either in the form of reduced production or supply diverted to outside the province. Any reduction in the volume of refined products produced and sold to consumers in British Columbia must lead to an increase in the prices paid by consumers, not a reduction in these prices. Market demand curves slope downward, and therefore reductions in supply lead to higher prices for consumers, not lower prices for consumers. Therefore, lower, regulated wholesale prices would not be passed-on as savings to consumers. Instead, with a decline in wholesale prices and an increase in retail prices, increased retail margins would result, though retailers would earn these increased margins on a reduced number of litres of gasoline and diesel actually sold.

Wholesale price regulation in British Columbia would also have the perverse effect of making sales in British Columbia less attractive for refiners in British Columbia, and therefore provide these refiners incentives to sell gasoline and diesel outside of the province instead of to their local customer base. Any such diversion of volumes from British Columbia would put upward pressure on the retail prices paid by consumers in British Columbia.

208. At the Oral Workshop, Ms. Lepine similarly advised that all else being equal, the expected effect of price caps on supply would be a shortage of supply.<sup>259</sup> Ms. Lepine also agreed that to the extent that there is an arbitrage opportunity because of a price differential between the capped price in BC and a non-capped price anywhere else in the region of the United States, you would find people buying gas in BC and selling it in the United States, providing an arbitrage opportunity for American wholesalers.<sup>260</sup> Ms. Lepine also agreed that resulting reduction in supply from a wholesale price cap could be expected to result in increased pump prices and retail margins.<sup>261</sup>

209. The theory discussed above has actually played out in past, unsuccessful experiments with price caps. Gas price controls in the 1970s resulted in rationing and

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<sup>259</sup> Tr. 1, p. 56, l. 5 to p. 58, l. 5 (Lepine); Tr. 2, p. 421, ll. 8-20 (Lepine).

<sup>260</sup> Tr. 1, p. 61, ll. 2-12 (Lepine).

<sup>261</sup> Tr. 1, p. 62, ll. 2-19 (Lepine).

consumer queues.<sup>262</sup> Mr. Wolinetz gave evidence regarding the unpleasant experience in Hawaii:

And as is often found with caps, they become more of a target than a cap. It's -- the literature indicates capping prices is a difficult thing to do. That it often ends up as a ceiling and prices are generally riding at or just below the ceiling. And so because the cap went up, then prices, wholesale prices went up as well. That resulted in a backlash, which ultimately ended with the removal of that price cap.<sup>263</sup>

**(b) Retail Price or Retail Margin Caps Ultimately Harm Consumers**

210. The expert evidence is that capping retail prices or retail margins below what it would otherwise be in the absence of regulation would also harm BC consumers.

211. Dr. Kahwaty summed up as follows:<sup>264</sup>

In sum, retail price regulation in British Columbia that held retail prices artificially low would generate excess demands for motor fuels. With an excess demand, there would need to be a mechanism to ration supply to consumers, leaving some consumer demand to go unmet while also leading consumers to bear the costs that would flow from insufficient supply, such as waiting in queues to purchase motor fuels. In addition to being inconvenient, queuing or otherwise needing to search for a gas station with available supply imposes real costs on consumers. Retailers, who already operate at relatively thin margins, would see diminished sales volumes, increased costs, and reduced revenues and profitability. Holding prices artificially low would also harm the profitability of refiners while adversely affecting their incentives to maintain their capital stock and otherwise invest in their businesses.

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<sup>262</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 151.

<sup>263</sup> Tr. 3, p. 626, ll. 12-20 (Wolinetz).

<sup>264</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 157.

212. Kent echoed the potential drawbacks of price caps in its presentation to the BCUC:<sup>265</sup>

- Potential drawbacks:
  - may discourage investment in that market;
  - may also inhibit competition below the regulated price
  - a regulated price below a certain point may result in site closures

213. A price ceiling that is intended to mimic market retail prices, rather than artificially suppress them raises the question: “What is the point?” Moreover, Dr. Kahwaty identified studies which showed that caps can tend to become a target for suppliers, resulting in higher prices.<sup>266</sup> This was the experience in Hawaii, as recounted by Mr. Wolinetz in the passage quoted above in the previous section.

**(c) A Functioning Market Avoids the Need to Engage in the Hopeless Exercise of Trying to Pinpoint the Marginal Supply Cost**

214. The Inquiry Panel, at times, appeared troubled by how market participants know what the marginal source of supply cost is, given that it is constantly changing. Parkland respectfully submits that competitive market forces are called the “Invisible Hand” for good reason – the price is determined by price signals that may not be readily apparent to an observer. Ms. Lepine told the Panel that, as an economist, her expectation is that the market would be better at identifying the marginal supply source than would a regulator.<sup>267</sup> She also told the Panel that to the extent that regulation did not keep pace with the changes that currently occur in the market, regulation would introduce distortions and arbitrage opportunities.<sup>268</sup>

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<sup>265</sup> Exhibit A2-3, Kent Presentation, PDF p. 173.

<sup>266</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 154.

<sup>267</sup> Tr. 2, p. 418, ll. 7-12 (Lepine).

<sup>268</sup> Tr. 2, p. 422, ll. 10-16 (Lepine).

215. This line of inquiry only underscores the importance of relying on the market, rather than a regulator, to determine prices. Without signals from market participants that come with competition, the odds are very high that the regulator will get things wrong.

**F. REGULATING TO REDUCE VOLATILITY COMES AT A COST FOR CONSUMERS**

216. The Inquiry Panel asked about the merits of a form of regulation that is intended to smooth out price volatility (such that regulated prices would lag behind a notional market price as it rises and falls), as opposed to artificially capping retail prices below the prevailing price on a sustained basis. The evidence is that this type of price regulation ultimately comes at a cost for consumers, and has other negative implications.

217. Regulation that aims to reduce the volatility of such changes has the effect of shifting greater risk of input cost changes on to the wholesaler or retailer. Shifting additional risk to retailers and wholesalers would come at a cost to them, typically reflected in financing costs.

218. In a response to a Panel undertaking, Dr. Kahwaty described in detail the potential effects of regulation to reduce price volatility.<sup>269</sup> He explained that policies that reduce price volatility have the potential to soften rather than intensify price competition. The net impact of a market intervention, therefore, may be to raise average prices relative to the level achieved with price cycling. This negative net impact of intervention may be especially pronounced if it is the case that some appreciable fraction of consumers can exploit price cycles to their advantage.

219. Dr. Kahwaty noted that price-sensitive consumers may gain significantly from the presence of price cycles if they can optimize their purchases to coincide with the trough of these cycles and therefore make purchases when retail margins are very low.<sup>270</sup> He explained that:<sup>271</sup>

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<sup>269</sup> Exhibit C5-19, Parkland Undertaking No. 3 (Kahwaty).

<sup>270</sup> Exhibit C5-19, Parkland Undertaking No. 3 (Kahwaty), p. 7.

<sup>271</sup> Exhibit C5-19, Parkland Undertaking No. 3 (Kahwaty), p. 7.

If lower income consumers place an enhanced value on their ability to make gasoline or diesel purchases at low points in the price cycle, then removing this option may have a disproportionate negative impact on lower income consumers. Consumers likely vary in the degree to which they are prepared to tolerate price volatility. There is a trade-off between the opportunity to purchase at lower prices and enhanced price certainty. If lower income consumers are willing to tolerate greater volatility in exchange for the opportunity to make some or all their purchases at the trough of the cycle, forcing them to purchase at the cycle average price might make them worse off and reduce their consumption. This would have regressive consequences because it would raise the average purchase prices for lower-income consumers.

**G. A “TRANSPARENCY FRAMEWORK” WOULD BE UNIQUE, COSTLY AND PROVIDE NO BENEFIT TO CONSUMERS**

220. This Inquiry has accomplished the objective of enhancing transparency about how gasoline and diesel fuel prices are determined. The Inquiry Panel has received and heard a prodigious volume of evidence from voluntary participants and independent experts including Deetken and Dr. Kahwaty. Adopting detailed ongoing reporting and transparency measures in the context of a competitive market would be unique, put upward pressure on retail prices, and deliver no benefit to BC consumers.

221. The only instances that Navius identified of price transparency in the context of gasoline and diesel sales are three US states (Hawaii, Washington and California). The reporting forms (or reports in the case of Washington) of these jurisdictions are in evidence in this Inquiry. None of those three states have reporting that is as involved as what Navius listed in its report. For instance, the State of Hawaii collected data from the industry and some of these data are made available publicly (though in an aggregated and redacted form). Navius conceded in its report that, in the case of Hawaii “the data still did not provide an understanding of the overall costs of doing business for various actors within each segment of the market (i.e., to calculate net margins, profits or return on capital with certainty)”.<sup>272</sup> The

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<sup>272</sup> Exhibit A2-2, Navius Report, p. 12.

same is true for Washington and California.<sup>273</sup> Navius told the Panel that price transparency in BC is largely speaking the same as elsewhere on the continent.<sup>274</sup>

222. Dr. Kahwaty characterized the Navius concept as “extraordinary”, both in the context of gasoline and diesel markets and for other products as well.<sup>275</sup>

The highlighted gaps in information availability, list of unknowns, and focus on understanding returns on capital “with certainty” show the tremendous breadth of data and information the authors of the Navius Report think is required to address any issues with price transparency in wholesale and retail markets for gasoline and diesel. The authors do not point to a single market where such information is collected and analyzed. Even if certain amounts of data are collected by regulators of natural monopolists (e.g., electric power distribution infrastructure), the collection of such detailed data in a market with numerous suppliers is extraordinary. In what industries are data on the discounts in supply agreements or the details of the “specific slate” of inputs used collected and analyzed? The request to understand the “business cost” of each stage in the pipeline is mentioned without any analysis of the extent of information required to meet the request, the burden on parties to collect it, the benefits from having it, or the ability of any “suitably skilled analyst” to analyze it. Information such as this is not collected and analyzed in markets for grocery items, over the counter drugs, or other consumer products.

223. The collection of information for its own sake is pointless, and it isn’t immediately clear what value consumers would see from this type of regulation.

- Dr. Kahwaty pointed out, and Navius agreed “whole-heartedly”, that sharing the detailed information with the public would go against typical policies designed to ensure fair-competition.<sup>276</sup>

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<sup>273</sup> Exhibit C5-14, C5-15 and C5-16.

<sup>274</sup> Tr. 3, p. 578, ll. 16-19 (Wolinetz).

<sup>275</sup> Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 179. See also: Tr. 1, p. 244, l. 9 to p. 245, l. 23 (Kahwaty).

<sup>276</sup> The Competition Bureau takes the view that a market participant making the type of information discussed by Navius available to competitors raises issues under the Canadian *Competition Act*. Dr. Kahwaty (Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 195) quoted from the Competition Bureau of Canada’s Submission to the 2010 OECD Policy Roundtable “Information Exchanges Between Competitors under Competition Law,” p. 119, available at <<http://www.oecd.org/competition/cartels/48379006.pdf>> (citation omitted). Tr. 3, p. 594, ll. 11-19 (Wolinetz); Ms. Lepine also agreed that competitors are not usually in the practice of exchanging this type of information: Tr. 1, p. 20, ll. 7-11 (Lepine).

- The three jurisdictions identified by Navius prepare reports for public consumption that provide only very general information about how the markets function or aggregated data. BC consumers already have access to that type of information today. The Washington Quarterly Gasoline Reports look very much like the FAQs and information sheets currently published by the Competition Bureau of Canada to educate consumers.<sup>277</sup> Companies in BC already report imports and exports to the Provincial government, which reports that information to the public. Moreover, services like GasBuddy.com provide detailed information on gasoline prices. Kent makes a significant amount of information available as well.

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<sup>277</sup> Tr. 3, p. 614, ll. 17-24 (Wolinetz).

**PART SEVEN: CONCLUSION**

224. This Inquiry is an opportunity for the BCUC to educate the public about how the wholesale and retail markets for gasoline and diesel work, based on the voluntary testimony of market participants and informed economic analysis. British Columbians will be better off for a realistic appraisal of the evidence by the Inquiry Panel. The evidence demonstrates that there are functioning competitive wholesale and retail markets in BC, and that the price changes seen since 2015 are the product of taxes, crude prices and market forces.

225. The Inquiry Terms of Reference raise the prospect of introducing price regulation and reporting. The conditions precedent previously identified by the BCUC as justifying regulation are absent in the present case, and the BCUC should recommend against introducing economic regulation into a functioning competitive market. The public interest will be well served by continued reliance on market forces.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Dated: August 8, 2019 ***[original signed by Matthew Ghikas]***  
Matthew Ghikas  
Counsel for Parkland Fuel Corporation

Dated: August 8, 2019 ***[original signed by Tariq Ahmed]***  
Tariq Ahmed  
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