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October 8, 2019

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VIA EMAIL

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

Attention: Patrick Wruck, Commission Secretary

Dear Mr. Wruck:

Re: British Columbia Utilities Commission ("BCUC")
An Inquiry into Gasoline and Diesel Prices in British Columbia ~ Project No. 1599007 ("Inquiry")

We act on behalf of Imperial Oil in respect of British Columbia Utilities Commission Project No. 1599007: An Inquiry into Gasoline and Diesel Prices in British Columbia.

Please find enclosed Imperial Oil's Final Submission to the above noted Proceeding. Should you have any questions or require any additional information, please do not hesitate to contact the undersigned.

Yours truly,

Thomas Gelbman

Encl.

cc: Brian Scammell, Daniel Dubois, *Imperial Oil*

BRITISH COLUMBIA UTILITIES COMMISSION

AN INQUIRY INTO GASOLINE AND DIESEL PRICES IN BRITISH COLUMBIA

PROCEEDING NO. 1599007

Final Submission of Imperial Oil
October 8, 2019

To: The Commission Secretary
British Columbia Utilities Commission
Suite 410, 900 Howe Street
Vancouver, BC V6Z 2N3

Introduction

Imperial Oil ("Imperial") makes this final submission to the British Columbia Utilities Commission ("Commission") Inquiry into Gasoline and Diesel Prices in British Columbia ("Inquiry"). Imperial continues to voluntarily participate in the Inquiry, having recently given public and confidential evidence.

Following the issuance of the August 30, 2019 Final Report of the Inquiry ("Final Report"), and by OIC No. 470/2019, approved and ordered on September 6, 2019, the Lieutenant Governor in Council amended section 3(3) of OIC No. 254/19 by adding the following paragraphs:

> c) the commission must receive comments from the public on the final report during a period of no more than 30 days set by the commission;
>
> d) the commission must submit to the Minister of Jobs, Trade and Technology a supplementary report summarizing the comments received during the period referred to in paragraph (c) and including its advice in relation to those comments no later than 30 days after the last day of that period;

Imperial makes this final submission in light of the mandate set for this phase of the Inquiry. In doing so, Imperial relies on the evidence it provided throughout the Inquiry, including its September 26, 2019 supplemental written evidence ("Supplemental Evidence"). Imperial appreciates the opportunity to make a final submission and provide evidence and insights relating to the important work of the Inquiry. Imperial believes that the opportunity to comment on the Final Report is a necessary and valuable contribution to the Inquiry's process, which has been constrained by limited evidence and short timelines.

The release of the Final Report enabled Imperial to view, for the first time, how the evidence gathered in the initial phase of the Inquiry was used, and provided an understanding of the potential gaps in evidence and analysis.

Imperial hopes that its submissions assist in closing any evidentiary gaps and explaining "the unexplained" elements of the Final Report. In particular, Imperial seeks to assist the Inquiry with evidence surrounding the costs and other evidence to which the Commission did not have access when calculating its 13 cent per litre (cpl) differential. While Imperial seeks to bring clarity to the issues before the Inquiry, in Imperial's view, the complexity and variability of the market dynamics for gasoline and diesel highlight the risks associated with market intervention of any kind.

Imperial will make submissions in respect of the following:

1. 13 cpl "unexplained" differential in Vancouver
2. Modelling the marginal layer for diesel
3. Imperial Profitability
4. The functioning of the market
5. Market Regulation
6. Recommendations to the Minster

In addition, in respect of its Supplemental Evidence, Imperial provides in Appendix A to this submission minor corrections and clarifications regarding its marginal gasoline supply import analyses.

A. 13 cpl "unexplained" differential in Vancouver

The Final Report models the marginal layer of supply, via marine shipping into Vancouver, concluding that there is a ~13 cpl "unexplained" differential in the price of gasoline between Vancouver and Pacific Northwest wholesale gasoline prices.

Imperial offers the following explanation:

In its Supplemental Evidence, Imperial outlines the following costs, which the Inquiry appears not to have assessed: terminalling, discounts, overhead (i.e. operational/support costs), and Renewable Identification Number (RINs) discounts. Imperial also notes that there are very likely costs, in addition to those Imperial has highlighted, that would be incurred by an importer, but are not captured here, such as: (i) the cost to create a 'boutique' Canadian specification product from a U.S. producer, (ii) the costs of setting up a new enterprise (e.g. permitting) for would-be new entrants, (iii) the incremental incentive often required to entice customers to switch suppliers, and (iv) managing environmental and liability risks as a new competitor.

Imperial modeled what the marginal marine import supply economics look like *as the driver of wholesale price*. Imperial does not structurally import via marine and this is analysis was not a calculation of Imperial's profitability.

After accounting for these missed costs, Imperial observed the marginal layer marine import economics:

1. were likely money losing or near break-even in 2015; and

2. are estimated to lie between 3.3 to 7.7 cpl before tax in 2018 (using 2018 as the last full calendar year) versus the 13 cpl initially concluded by the Commission.

The Commission analysis describes the result of its calculations as "unexplained"; however, Imperial submits that the result represents the unidentified costs not captured in Imperial's analysis and the potential profit available to an importer.

The after-tax[1] potential profit (excluding costs not captured) Imperial arrives at for an estimated third-party import in 2018 is between 2.2 cpl and 5.2 cpl, or 3% to 6.5% of a reference 80 cpl wholesale price. This same analysis can be done for other regions of B.C., such as Kamloops.

B. Modelling the Marginal Layer for Diesel

Imperial urges caution when modelling the marginal layer for diesel. If the Commission were to apply the same analysis as modelled with gasoline to diesel, the conclusion may be incorrect, or at least incomplete:

1. Gasoline consumption generally follows population concentration and as such Vancouver will have a high concentration of the gasoline demand in B.C. Consequently, Imperial feels it is reasonable to assume that Pacific Northwest gasoline marine imports into Vancouver is a likely source of the marginal barrel.

[1] Imperial has used a placeholder tax rate of 33% (a more detailed analysis of potential profit should include the true actual tax incurred for an import transaction into British Columbia).

2. Diesel tends to follow industrial, resource sectors and/or commercial transportation movements which are dispersed and, for industrial and resources, tend to be concentrated through the B.C. interior and northern regions of the province.

3. These interior geographies largely fall under and Edmonton/Chicago price 'orbit' rather than Vancouver/Pacific Northwest.

4. As such, it *less* reasonable to (i) assume that the majority of diesel movements into B.C. from the U.S. would be from a marine import into Vancouver[2] (as it would be for gasoline) and (ii) to assume import economics on a Pacific Northwest marine import basis are reflective of *all* diesel import economics.

5. While gasoline specifications are sufficiently different between Canada and the U.S. to require specialty blending by a U.S. producer selling for export, diesel specifications provide much more flexibility and likely less cost on the part of the producer to provide a Canadian compliant fuel.

C. Imperial Profitability

Imperial profitability is separate and distinct from the marginal layer economics discussed above. The marginal layer, assumed by Imperial to be a U.S.-based import, will set the wholesale price for all competitors, including Imperial. The comments regarding Imperial's own profitability should **not** be confused with the discussion on marginal supply economics.

Many of the commentators during the Inquiry assumed or argued that the rise in wholesale/retail price results in a commensurate rise in profits to producers and marketers. This is a common misconception but fails to account for the potential shifts in the costs to provide that product. For example, Imperial's experience, as detailed in its initial evidence, is that the Vancouver area has unique challenges and high costs of transport and delivery.

[2] Imperial notes that Chart 3.2.4 of the Deetken Group's Phase 1 Report (reproduced as Figures 4 and 17 in the Final Report) provides a table of diesel imports into B.C; however, on inspection, Imperial noticed that the definition of diesel used by the Deetken Group includes jet fuel volumes (as defined by the Ministry of Finance). As such, Imperial believes Chart 3.2.4 includes jet fuel volumes. Given there are material imports of jet fuel into Vancouver reliance on this chart could lead to incorrect conclusions on the source and amounts of diesel being imported into B.C. In addition, given each product's different uses, it is inappropriate to include jet fuel volumes in an analysis of diesel supply and demand dynamics in B.C. Independent Consultant Report by the Deetken Group - Phase 1: Primer On BC's Market For Refined Petroleum Products, Exhibit A2-1, June 20, 2019, p. 12 and Final Report pp. 9 & 36.

Imperial sought to test this misconception in the context of Vancouver pricing by analyzing its Vancouver business relative to its Edmonton business over time (Imperial has modelled its Vancouver revenue (sale price) versus cost-to-serve relative to that in Edmonton) and submitted the following in its Supplemental Evidence:

1. After netting cost-to-serve from revenue, Vancouver is roughly equal to Edmonton; and

2. There has been no appreciable change in Vancouver vs Edmonton profitability over the past five years.

In other words, for Imperial, the Vancouver wholesale price increases have been generally offset by increases in the cost-to-serve (e.g. movements by higher cost rail vs. pipeline).

D. The Functioning of the Market

The Commission concluded that, following 2015, the gasoline market began to function improperly, pointing primarily to a high concentration of wholesale suppliers and the inability of new competitors to develop or access logistics.

Imperial's position on this view is as follows:

1. There are relatively the same logistics and competitor concentration in the diesel space as gasoline, yet the Commission makes no conclusion of improper market function for diesel. If lack of competition and logistics access are the two primary factors cited as root cause of improper market function it would be expected to find the same result for diesel as for gasoline, which is not the conclusion reached by the Commission.

2. Imperial's Supplemental Evidence shows no structural change in the concentration of wholesale competitors before and after 2015, which does not support 'concentration of competitors' as a reasonable explanation for a shift following 2015.

3. Imperial faces the same number or more competitors in Vancouver as it does in virtually all other Canadian markets; this fact is incongruous with the Commission's conclusion that wholesale concentration in Vancouver can explain higher prices than other regions.

4. Imperial agrees Vancouver is a challenging market to serve; however, it strongly disagrees with the assertion that new competitors cannot develop or access logistics independently from the refiner/producer assets if they so choose. The examples provided by Imperial and other intervenors include:

    I. The Vancouver Airport Fuel Facilities Corporation has received approval for, and is building, new petroleum marine import facilities for jet fuel including tanks and pipelines in the Vancouver area. This is an example that it is possible to overcome regulatory hurdles and develop logistics if the economics are justified.

    II. Transloading (terminal facilities where the rail cars themselves serves as the tankage) are cost effective, efficient and have relatively short installation timelines. They can be

developed and accessed by any competitor using a third party (i.e. they do not need to go through a refiner/producer to access) – a few examples include:

- Ashcroft Terminals (located in B.C.) has an existing transloading facility (which is not just for export);
- North Thompson Rail Terminals Inc. is proposing a new facility in Kamloops to "make the transfer of commodities more efficient in B.C. through the movement of shipments from one mode of transportation to another" and is to "provide railcar storage, switching, trans-loading and intermodal and container stuffing for a variety of prospective clients." (https://www.kamloopsthisweek.com/news/10-million-rail-yard-project-will-be-connected-to-cn-line-on-tk-emlups-land-1.23575334);
- Sands Bulk Fuel (sandsbulk.ca): "...transports more than 300 million litres of bulk fuel a year – mainly to mining, logging and other commercial operations throughout northern B.C. We provide rail to truck transloading services…";
- Arrow Reload Systems Inc. (https://reload.arrow.ca/) operates and provides "Truck-to-Rail and Rail-to-Truck Transloading" in B.C.;
- Greenergy, a non-producer, has publicly stated they successfully used these logistics to enter the Toronto market using U.S.-based imports (greenergy.ca).

III. Kinder Morgan provides 248,000 barrels of liquids (petroleum products) storage at the Burrard Inlet with rail and shipping capacity and is completing a large scale diesel expansion to be completed by late 2020 (https://www.kindermorgan.com/content/docs/terminalbrochures/W-C-VancouverWharves.pdf); (https://www.vanwharves.com/pages/project.aspx)

E. Regulation

Imperial firmly believes B.C./Vancouver is a functioning free market and intervention may result in unintended consequences that can never be fully anticipated. Government regulation introduces uncertainty, business risk, additional administrative burden and ultimately may disincentivize infrastructure investment needed to sustain reliable fuel supplies in future.

Price regulation runs the risk of inadvertently eliminating the incentive needed to attract the supply required to balance the demand. As an example, the oft-cited concept that a supplier should be selling at its cost plus a margin is generally incompatible with free market economic theory of supply and demand: if the most efficient competitor in a market were to sell its product above its cost but below a less efficient competitor's cost, the less efficient competitor becomes unprofitable and likely leaves the market, resulting in shortage.

As highlighted in Imperial's Supplemental Evidence and repeated earlier in this submission, attempting to model the marginal layer of supply as a means to regulation also runs a high risk of error with the same result. It is nearly impossible to understand all the costs and complexities from all supply sources as the

basis for a marginal supply model in price regulation and incorrect application could result in the loss of supply and shortage.

The Commission has also suggested that supply chain regulation may be a consideration as access to logistics is largely held by refiners (i.e. regulate access to logistics) – an assertion Imperial refutes. Imperial has described numerous examples of logistics already existing, or planned, available or being developed by non-refiner third parties. It would be unprecedented in Canada for a local or provincial government to interfere in this type of free commercial enterprise. Further, this type of regulation is likely to lead to less investment in the logistics needed to serve the market as new competitors that are currently building these facilities no longer have the knowledge that their investments can be underpinned by the free market and their ability to cultivate their own profitable client base (rather their client base being mandated to them by the government).

Last, the Commission discusses, at high level, 'transparency measures'. Presumably this is taken to mean collection and reporting of the costs associated with providing finished product. Supply of finished product is highly complex. Products that are ultimately sold at different prices (gasoline vs. diesel) often have interwoven logistics making it impossible to 'unwind' the exact costs to serve each product. A similar argument would hold for production where gasoline and diesel are both produced from crude using a variety of sometimes shared, sometimes independent processes. Further, supply sources can vary daily and, as the Commission notes, can be sourced from across North America on various types of logistics. Attempting to manage a reporting structure designed to track this level of complexity would be exceptionally burdensome, costly, and unlikely to yield a level of accuracy that would be useful.

F. Recommendations

1. Advocate for a Higher Proportion of TransMountain Pipeline for Refined (Gasoline/Diesel) Products

In 2015, the National Energy Board (now Canada Energy Regulator ("CER")) implemented a new nomination process for access to the Trans Mountain Pipeline, which carries both crude and refined product (gasoline/diesel) into the B.C. market and beyond.

The NEB ruling structurally changed the ability of B.C. to access low-cost gasoline and diesel from Alberta, increasing reliance on higher cost and less reliable supply sources.

At that time, Imperial stated the following:

"….There is also a seasonal pattern to refined product shipments on Trans Mountain, with demand higher in the winter and late summer.

The establishment of Verification Limits based on historical average monthly volumes delivered to a Land Destination would be particularly punitive for the refined products shippers. Using a historical average to limit their nominations would ignore the variability in their nominations and would understate what their nominations would be roughly half the time. During such periods, refined product shippers would be precluded from nominating the full volumes for which they need Trans Mountain capacity. It would not be

fair for Trans Mountain, as a common carrier pipeline, to favour shippers with constant monthly volumes [crude] over shippers with variable monthly volumes."[3]

The CER process is now based on historical shipping volume. This new process heavily favours crude because crude ships more consistently at all times of the year whereas gasoline and diesel are highly seasonal. For example, gasoline demand is far higher in the summer than the winter but since the historical averages include winter demand months the lower winter demand brings down the average and consequently shippers do not have the space needed to meet summer demand.

Increasing the allocation of refined products on the Trans Mountain Pipeline would allow for lower cost gasoline and diesel supply from Alberta. Imperial believes the B.C. government could serve as a powerful advocate to help resolve this fundamental issue.

2. Investment, Permitting and the Ease of Business

Imperial believes one critical role of the government is to promote business growth and competition.

To that end, Imperial believes that the local and regulatory framework that governs new permitting and investment slows the process and creates an unnecessarily administrative burden to new infrastructure and the streamlining of such processes could encourage new development.

Imperial also believes that environmental concerns are of critical importance to all Canadians and should be addressed in a reasonable and responsible way. However, B.C. biofuels and carbon policies have begun to move out of step with Federal and other provincial frameworks at a pace that is becoming increasingly difficult to manage. This is creating an environment where fuel suppliers are requiring unique compliance strategies for B.C. alone which has, and will, continue to accelerate the cost to serve B.C. One option available to the Government to reduce the cost to serve B.C. would be to align B.C.'s biofuels and carbon policies more closely with those applicable in the rest of Canada.

[3] Imperial submission as part of NEB proceeding RHW-001-2013.

Appendix A: Corrections and Clarification to Supplemental Evidence

1. Imperial used 2019 June year to date information for its Example 2: Truck Import Seattle Direct to Site marginal analysis ("Truck Analysis"). This was inconsistent with Imperial's Example 1: Marginal Gasoline Supply Estimate – Marine Import analysis ("Marine Analysis", and together with the Truck Analysis, the "Analyses") which used 2018 information. For consistency Imperial has done the Truck Analysis using the 2018 information and the conclusion of that analysis is 1.1 to 5.0 cpl rather than 1.7 to 5.6 cpl.
2. Imperial failed to note the source of its Renewable Identification Number (RIN) information in the Supplemental Evidence. The source of that information was "Argus RIN Argus Renewable Volume Obligation year – Houston close"
3. Imperial included "Federal LCFS" in the Analyses – there are two clarifications:
    a. This should be labelled as Federal Renewable Fuel Standard (RFS); and
    b. Imperial included this cost in the Analyses. An independent third party importer may or may not incur this cost depending on how they are complying with provincial standards. For example, if an importer is buying credits to comply with BC LCFS only they may need to also pay/consider Federal RFS (whereas if they are blending they may be complying with both).