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October 8, 2019
File No.: 305706.00025/14797

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") Submission on BCUC Report

We enclose for filing Parkland's Submission on the BCUC's August 30, 2019 Report in the above-noted Inquiry.

Among other things, Parkland's Submission highlights:

- Parkland's agreement with the BCUC's findings regarding the detrimental effects of pipeline constraints on BC consumers;

- The evidence demonstrating that the BCUC's entire "unexplained" wholesale price differential with neighbouring jurisdictions can be explained by correcting for the BCUC's methodological errors and using more accurate cost assumptions;

- The additional evidence that land values alone could explain most or all of the retail margin differential; and

- Parkland's view that the Report has not sufficiently acknowledged the problems with market regulation that the BCUC had identified in prior decisions, or the BCUC's prior determination that regulation of markets like this one would not serve the public interest.

Yours truly,

FASKEN MARTINEAU DuMOULIN LLP

[Original signed by]

Matthew Ghikas
Personal Law Corporation

MTG/lh
Enclosure

BRITISH COLUMBIA UTILITIES COMMISSION

AN INQUIRY INTO GASOLINE AND DIESEL PRICES IN BRITISH COLUMBIA – PROJECT NO. 1599007

PARKLAND FUEL CORPORATION

SUBMISSION ON BCUC FINAL REPORT

October 8, 2019

Matthew Ghikas and Tariq Ahmed
FASKEN MARTINEAU DuMOULIN LLP

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A. EXECUTIVE SUMMARY

1. The August 30, 2019 British Columbia Utilities Commission ("BCUC") Report[1] (the "Report") highlighted the steps in the refined product supply chain, the detrimental effects of pipeline constraints on BC consumers, and the absence of any evidence of cartel-like behaviour in the retail market. Parkland Fuel Corporation ("Parkland") agrees with these findings. There are, however, many portions of the Report with which Parkland disagrees. Key findings, particularly with respect to the existence of "unexplained" price differentials with other markets, are either incorrect due to inaccurate assumptions or, at a minimum, in doubt due to uncertain assumptions. The "unexplained" differentials can, in fact, be fully explained by correcting the BCUC's methodological errors and using more accurate cost assumptions. With the benefit of new evidence submitted by independent third-party experts and other participants about how the market functions and the costs involved in providing wholesale gasoline and diesel, the BCUC should update its findings and highlight the residual uncertainty around them.

2. Parkland has been a full participant throughout the Inquiry. Given the compressed timeline for submitting further evidence (nine business days) and comments on the Report (28 days), Parkland's feedback on the Report is necessarily focused.[2] This Submission is organized around the following points:

- ***Adequate pipeline capacity is critical for BC consumers:*** The evidence supports the BCUC's finding regarding the importance to BC of pipeline infrastructure, and the favourable impact on BC consumers that the expansion of the Trans Mountain Pipeline ("TMPL") could have if some of the additional capacity is reserved to supply the BC market. Ready and reliable access to pipeline capacity

[1] British Columbia Utilities Commission Inquiry into Gasoline and Diesel Prices in British Columbia Final Report dated August 30, 2019.

[2] Rather than address every aspect of the Report, Parkland has focussed these submissions on certain key points. Accordingly, Parkland's silence on a particular finding or statement should not be interpreted as agreement.

for product destined for BC is vital to the BC fuel industry's ability to meet the fuel needs of customers across the province. (See Section B)

- ***The BCUC's entire "unexplained differential" can be explained by correcting for methodological errors and using more accurate cost assumptions:*** (See Section C) The errors include:

  - ***The BCUC's calculation of the "unexplained differential" was distorted by its use of an unrepresentative time period:*** The BCUC derived its 13 cent per litre "unexplained differential" relative to the Pacific Northwest ("PNW") spot price with reference to data from late 2018 and early 2019 - the months with, by far, the highest price differential during the five years covered by the Terms of Reference. Simply making use of an average of the last five years to eliminate this distortion - *even before correcting for the other issues Parkland has identified in this Submission* - reduces the BCUC's "unexplained differential" by one-third.

  - ***The BCUC used a flawed "apples to oranges" price comparison that overstated the differential:*** The BCUC derived the price differential with PNW by comparing a Vancouver <u>rack</u> price with a PNW <u>spot</u> price. This methodology is flawed for three reasons:

    (i) This comparison inherently overstates the differential because the PNW spot price reflects transactions involving volumes that are between 26 and 263 times larger.

    (ii) The comparison inherently ignores some costs because the gasoline and diesel available on the spot market is not in a usable state; rendering it usable comes at a cost.

(iii) It fails to account for discounts routinely provided on the Vancouver rack price, which would decrease the differential because spot prices reflect actual transaction prices (after any discount).

- ***Costs associated with complying with BC fuel regulations, transportation, and logistics can explain any remaining "unexplained" differential:*** The BCUC's derivation of the "unexplained differential" relied on assumptions regarding the costs of compliance with BC fuel regulations, transportation, and logistics. The Report notes that "there may be additional costs that were not considered…" due to the availability of information.[3] New evidence reinforces that the BCUC's assumptions understated the costs.

- ***Faulty economic and statistical analysis underpinned the BCUC's determination of PNW as BC's marginal (most costly) source of supply:*** The BCUC's analysis assumed that the relevant differential was between Vancouver and PNW as the marginal (most costly) source of supply, dismissing evidence of the influence of more distant (and costly) sources of supply that would contribute to a larger Vancouver-PNW price differential. There are two problems with this finding:

  (i) The BCUC's first reason for inferring that PNW spot prices are the marginal source of supply was that BC marketers refer to it (among other things) when setting prices. Dr. Kahwaty explains in his new evidence that drawing that inference represented a misapplication of economic theory.

  (ii) The BCUC's second reason for concluding that PNW was the marginal supply source was a strong price correlation between Vancouver and PNW. Dr. Kahwaty has demonstrated that the BCUC's statistical analysis

[3] Report, p. 78.

was invalid, and that the apparent correlation was a function of the common influence of crude prices and shipping costs on TMPL. The BCUC has also made the analytical mistake of inferring causation (i.e., that PNW prices determine Vancouver rack prices) from correlation.

The influence of more distant markets along with the PNW spot benchmark stands to reason given that BC also gets a material amount of its products from California, the US Midwest and the Gulf Coast. The Report itself talks of the high degree of integration in the North American market.

- ***Attributing "unexplained differential" to market power is inconsistent with the evidence and economic theory:*** The Report suggests that concentrated ownership of primary terminals with blending capabilities may be contributing to higher wholesale differentials with other jurisdictions. This reasoning is unsustainable in the face of evidence that (i) the number of primary terminal operators in BC with blending capabilities is the same as, or greater than, the number of primary terminal operators with blending capabilities in all other provinces except for Québec, and companies that own the BC facilities also own facilities in other provinces, and (ii) ownership concentration in BC has been consistent over time, and (iii) the exercise of market power involves withholding supply from the market to drive up the price, and market participants are operating at capacity. The constraint on TMPL, not primary terminal ownership concentration or market power, is the key factor differentiating BC from other jurisdictions since 2015. (See Section D)

- ***Land values alone could explain most or all of the retail margin differential***: Dr. Kahwaty's new statistical analysis of retail margins and housing prices in 25 Canadian cities confirms Deetken's analysis that land values alone could explain most or all of the retail margin differential. The Report should be revised to give proper recognition to the impact of land values on retail margins. (See Section E)

- ***The Report has not sufficiently acknowledged problems with market regulation:*** (See Section F)

  - ***Economic (price / access) regulation cannot be reconciled with the BCUC's prior decisions:*** Although the Report acknowledges problems and risks associated with price regulation, it was silent on the BCUC's previous determinations that economic regulation should only be entertained where "natural monopoly" conditions exist. The Report's characterization of the BC wholesale market as having features of a "natural monopoly" is at odds with how economists and previous BCUC decisions define that term. The Report should be clearer that it has previously determined that the public interest is best served by not regulating markets like this one.

  - ***Requiring ongoing reporting would not address the underlying issue with constrained pipeline capacity***.

B. EVIDENCE SUPPORTS THE FINDINGS REGARDING THE IMPORTANCE OF PIPELINE INFRASTRUCTURE TO THE PEOPLE OF BRITISH COLUMBIA

3. The Report has helped to improve public understanding of the steps in the value chain, and how refined products get to retail station pumps. In particular, the Report makes clear the importance to BC of pipeline infrastructure.[4] Ready and reliable access to supply is vital to the BC fuel industry's ability to meet the fuel needs of customers across the province. The Panel pointed to this issue, noting that while BC fuel demand has declined slightly, the supply of product on the existing TMPL to serve the BC market has declined even more.[5]

4. The evidence supported those determinations. For example, the decline in the flow of refined products on TMPL since 2015 is shown clearly in the following figure. The increases in wholesale prices and refining margins coincided with the throughput declines on TMPL.

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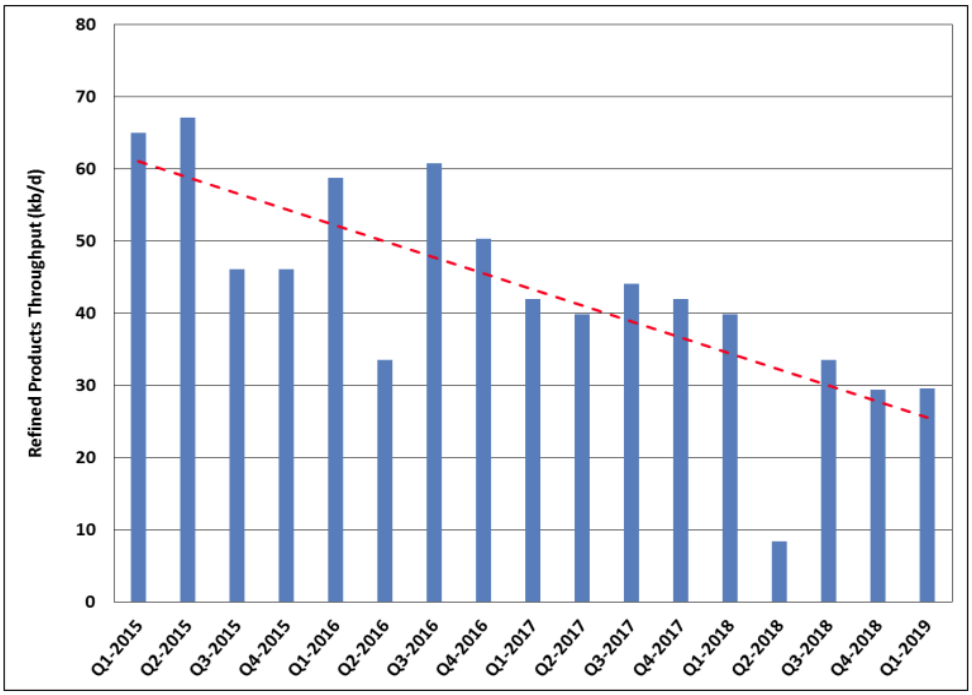
[4] Report, pp. 6, 26, 40-45, 113.

[5] Report, pp. 8-10, 40-45.

Trans Mountain Pipeline Average Quarterly Throughput Allocated to Refined Products 2015 – 2019[6]



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

5. The BCUC's findings on existing pipeline capacity constraints and the negative consequences of those constraints are also consistent with the Inquiry evidence of the National Energy Board[7] (now Canada Energy Regulator), the BCUC's consultant (Deetken),[8] Trans Mountain itself,[9] and users of the pipeline.[10]

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[6] Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 52, Figure 17. 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?=undefined&wbdisable=true.

[7] Exhibit C4-3, NEB Evidence, PDF pp. 4-5; Tr. 1, p. 81, ll. 12-18 (Charlebois); Tr. 3, p. 637, ll. 7-13 (Charlebois).

[8] Exhibit A2-1, Deetken Phase 1 Report, p. 14; Tr. 1, p. 53, ll. 17-23 (Lepine).

[9] Exhibit E-68, TMPL Letter of Comment, pp. 2-3.

[10] Exhibit C5-2, Parkland Evidence, pp. 15, 16, 27; Exhibit C5-2, Parkland Evidence Appendix A, Parkland Response to Questionnaire, Q. 2; Exhibit C2-2, Suncor Response to Questionnaire, Q. 11; Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 11.

6. The BCUC pointed to pipeline capacity expansion as one option to help get more supply to the BC market.[11] Parkland agrees that expanded pipeline capacity would contribute to BC industry participants' ability to ensure adequate refined fuel supply, but echoes the Panel's suggestion that if pipeline capacity is expanded, specific attention needs to be given to ensuring that some of this additional capacity is reserved to supply the BC market. Doing so would support the industry's ability to meet local fuel demand, and by extension support the BC and Canadian economies and the quality of life their residents expect.

C. THE BCUC'S "UNEXPLAINED" WHOLESALE DIFFERENTIAL ATTRIBUTABLE TO METHODOLOGICAL ERRORS AND UNREALISTIC COST ASSUMPTIONS

7. One of the key findings of the Report is that a portion - 13 cents per litre - of the observed differential between Vancouver rack prices and PNW spot prices was not explained by certain factors addressed in the Report. There are a number of fundamental problems with the BCUC's analysis, which are discussed below. The next iteration of the Report should correct the methodological errors, adopt more accurate cost assumptions where the evidence exists, and more clearly acknowledge the uncertainty around assumptions made based on inadequate evidence.

(a) The BCUC Used an Unrepresentative Time Period to When Calculating the "Unexplained" Wholesale Differential

8. The 13 cent per litre "unexplained differential" figured prominently in the BCUC's press release and press conference. The message heard by many stakeholders was that this differential, and the dollar amount calculated based on it, was representative of the five-year period covered by the Terms of Reference.[12] In fact, the months used by the BCUC in its calculations were not representative. The figures cited by the BCUC were derived with

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[11] Report, p. 113.

[12] For example, Gordon Hoekstra, The Vancouver Sun, August 30, 2019: "In releasing the report, BCUC chairman and CEO David Morton said: '(The public) should know they are paying at least 13 cents more a litre than they would otherwise pay if the market was more competitive.'" And "The commission estimated that discrepancy costs B.C. motorists $490 million annually." [Emphasis added.] Available online at: https://vancouversun.com/business/energy/gasoline-inquiry-finds-b-c-motorists-paying-at-least-13-cents-a-litre-too-much.

reference to data from the final months of 2018 and the first six months of 2019 - *the period with, by far, the largest price differential*. Market prices and margins fluctuate regularly in an active market such as exists in BC. Therefore, focusing on a single time period as representative of the differential is not accurate. The 13 cents per litre figure significantly overstated the differential in four of the past five years.

9. Parkland respectfully submits that, given the Terms of Reference cover a five-year period, a more accurate way for the BCUC to have presented its findings would have been to use a five-year average. This change alone, *even before making all of the other necessary adjustments discussed in the subsequent sections,* reduces the BCUC's 13 cent per litre "unexplained differential" by one-third (i.e., by approximately five cents per litre). This is shown in the table below, compiled by Dr. Kahwaty using the same data and assumptions used by the BCUC.[13]

Price/Cost	**Formula**	**2015**	**2016**	**2017**	**2018**	**2019**	**2015-2019 Average**
Vancouver Rack	**A**	66.56	61.31	74.28	87.88	86.66	74.53
PNW Spot	**B**	59.96	49.90	59.30	70.39	66.54	60.83
LCFS Cost	**C**	1.00	2.00	2.00	4.00	4.00	2.60
Federal Fuel Standard	**D**	0.50	0.50	0.50	0.50	0.50	0.50
Barge Transport	**E**	1.70	2.00	2.00	2.00	2.00	1.94
Differential	**A - (B + C + D + E)**	**3.40**	**6.91**	**10.48**	**10.99**	**13.62**	**8.66**

10. As Parkland understands it, one of the intended benefits of the Inquiry is public education. Respectfully, the Report failed in that regard when it came to conveying information to the public on the size of the "unexplained differential". The next iteration of the Report (and any external communications surrounding it) should clarify that the 13 cent differential cited in the Report (a) had been based on a non-representative portion of the five-year period, and (b) significantly overstated the differential in four of the five years covered by the Terms of Reference. The BCUC can improve the accuracy of the Report and public communications by not using the 13 cents per litre figure going forward.

[13] Exhibit C5-30, Kahwaty Supplemental Report, p. 39, Table 6.

(b) The BCUC's "Unexplained" Wholesale Differential Was Overstated Due to an "Apples to Oranges" Comparison to PNW Spot Price

11. The Report contains a significant methodological error - the BCUC compared a Vancouver rack price with a PNW spot price - an "apples to oranges" comparison - without adjustment. As described below, this error resulted in overstating the price differential between Vancouver and PNW. Correcting for this methodological error could be expected, on its own, to reduce the BCUC's "unexplained differential" materially.

12. Dr. Kahwaty, in his new evidence, explains how comparing a Vancouver rack price with a PNW spot price was methodologically incorrect and led to overstating the "unexplained differential" in three different ways.

- ***Different transaction sizes:*** First, a rack price is the price at which fuel can be obtained at a terminal rack at relatively small truck-size volumes. The PNW spot price is not a rack price. Rather, it is a price that reflects spot transactions that are between 26 and 263 times larger than rack transactions.[14] A rack price is inherently going to be higher than the spot price, simply by virtue of the much smaller volume transactions involved. As Dr. Kahwaty puts it: [15]

> The Commission finds a 13-cent unexplained wholesale price differential between PNW and Vancouver prices. Its analysis is based on an apples-to-oranges comparison of products, comparing large volume, bulk PNW purchases of between 210,000 gallons and 2,100,000 gallons to much smaller Vancouver purchases of 8,000 gallons. Differences in the scale of the transactions alone would lead to price differentials.

- ***PNW spot fuels are not ready for BC consumption:*** Second, the "apples to oranges" comparison results in the omission of processing and logistics costs necessary to make PNW spot fuels usable in BC. Dr. Kahwaty explains:[16]

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[14] Exhibit C5-30, Kahwaty Supplemental Report, para. 53.

[15] Exhibit C5-30, Kahwaty Supplemental Report, para. 4.

[16] Exhibit C5-30, Kahwaty Supplemental Report, para. 55.

> The BCUC Report explains the importance of primary terminal functions but no allowance for these functions is included in its price differential analysis. PNW spot price volumes transported into BC are not ready for distribution. In particular, no allowance is made in the Commission's analysis for primary terminal storage and processing. Bulk volumes stored on a barge are not ready for loading onto individual trucks for distribution to gas stations. Primary terminal storage and processing is not without cost, and by failing to include any costs for primary terminal distribution services, the Commission is implicitly assuming that product is brought into the distribution system in the Vancouver area and handled free of charge. A wholesaler in Vancouver could not support its operations if it were unable to markup this fuel to cover distribution costs. The Commission has not prepared an apples-to-apples pricing comparison and therefore its estimate of a pricing differential of 13 cents lacks economic merit. [Emphasis added.]

- ***BC wholesalers offer rack discounts:*** Third, the "apples to oranges" comparison further overstates the "unexplained differential" because it is not accounting for discounts given on the Vancouver rack price. When comparing rack prices in different jurisdictions (i.e., "apples to apples"), it is perhaps reasonable to "assume away" the impact of discounts on the basis that similar discounts might be available in both jurisdictions. That cannot be done when comparing a rack price ("apples") to a spot price that reflects actual transaction prices ("oranges"). Dr. Kahwaty explains:[17]

> In addition, rack prices are list prices. Most transactions occur at discounts to rack. Transacting at discounts to a list price is common in this and other industries. For example, hotels have list prices for rooms, but few hotel stays are actually priced at list. (Note that hotel room list prices are also called "rack" prices.) Automobiles have list prices, usually called manufacturer's suggested retail prices or MSRPs. Few cars are sold at MSRP, however. By comparing spot prices, which are transactions prices, to rack prices, which are list prices, the Commission's analysis is designed to find an unexplained differential even if none exists.

[17] Exhibit C5-30, Kahwaty Supplemental Report, para. 56.

There is ample evidence on the record, submitted confidentially, about the magnitude and prevalence of discounts to the Vancouver rack price. The Inquiry evidence was that discounts are common.[18] Parkland provided specifics *in camera,*[19] and we assume other participants did so as well. Another intervener has submitted new non-confidential evidence that suggests discounts as high as 3 to 6 cents per litre.[20] The "unexplained differential" is overstated by an amount at least equivalent to the discounts.

13. Dr. Kahwaty provides an *illustrative* analytical framework that would have to be used to restore the BCUC's analysis to an "apples to apples" comparison (in his illustration he uses hypothetical "plug" numbers simply for the purpose of showing the steps).[21]

14. It is clear that making the necessary adjustments could account for much, if not all, of the remaining "unexplained" differential.

(c) "Unexplained" Wholesale Differentials Also Explained by Unrealistic Cost Assumptions

15. The Report acknowledges that a price differential will exist in a functioning market due to the cost of moving product from other markets to Vancouver and rendering it usable in the BC market. Those costs include the marginal (i.e., most costly) transport costs, logistics costs, and compliance with BC regulatory fuel requirements. The BCUC had to make cost assumptions in the face of limited evidence. New evidence reinforces that the BCUC's cost assumptions were too low, thus contributing to the BCUC's "unexplained differential". The updated Report should reflect more realistic cost assumptions.

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[18] Report, pp. 101-102 and Appendix E.

[19] Exhibit C5-17, Parkland Confidential Undertaking No. 1.

[20] Exhibit C8-10, Imperial Comments on BCUC Report.

[21] Exhibit C5-30, Kahwaty Supplemental Report, para. 58. See also Dr. Kahwaty's response to Additional Panel IR No.1 Q5 (filed October 8, 2019).

There is Evidence that the BCUC's Assumed Trucking Costs Are Materially Understated

16. The BCUC derived the "unexplained differential" for Alberta-Kamloops using trucking cost estimates provided by Deetken. In doing so, the BCUC did not make any reference to the following evidence that called the cost assumption into question:

- The fact that Deetken's cost assumptions were based on a generic eight-year old study that Deetken simply extrapolated from and escalated in a linear manner. That type of approach would not account for the local supply of trucks, the higher fuel consumption in mountainous regions, or non-linear increases in trucking fuel prices.[22]

- Ms. Lepine's acknowledgement that Deetken's transportation cost estimates could be too low.[23]

- The testimony of Parkland's witnesses that, based on their experience, the Deetken estimates seemed far too low.[24]

- The quotes for trucking (obtained by Parkland in the ordinary course of business prior to this Inquiry) that showed trucking costs are significantly higher than the assumption made by the BCUC.[25]

17. The above evidence is important and should be recognized in the BCUC's updated Report. The trucking rates provided by Parkland explain much of the remaining "unexplained" differential between Alberta and Kamloops.[26]

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[22] See Parkland Final Submission, para. 171.
[23] Tr. 1, p. 37, l. 6 to p. 38, l. 3 (Lepine).
[24] Tr. 1, p. 220, l. 19 to p. 221, l. 9 (Krogmeier).
[25] Exhibit C5-20, Parkland Confidential Undertaking No. 4.
[26] Exhibit C5-20, Parkland Confidential Undertaking No. 4.

The BCUC's Use of Barging, Rather than Trucking, Costs Understated PNW-Vancouver Transportation Costs and Overstated "Unexplained Differential"

18. The BCUC chose to use barging costs, rather than trucking costs, as the marginal source of transport from PNW to Vancouver. Since barging costs are much lower (on a per litre basis) than trucking costs, this produced a much larger "unexplained differential". Parkland submits, for the reasons outlined below, that trucking costs ought to be used in the analysis.

19. The BCUC expressed its decision to use barging costs, rather than trucking, as follows:[27]

> In this regard, the Panel notes that one participant, Parkland, mentioned that it sometimes trucked refined products from the PNW. If a barrel trucked from PNW were to be the marginal barrel then Deetken's analysis, which compared the Vancouver rack to the tanker truck delivered wholesale from Seattle, would be of relevance. **That said, the Panel finds there to be sufficient evidence that the predominant mode of transport from the PNW is barge, and thus, the vast majority of the time, that will be the marginal barrel.**

20. The marginal transportation method is, by definition, the *highest cost* mode of transportation. It is not the "predominant" mode of transport. Dr. Kahwaty explains in his Supplemental Evidence that the BCUC's reasoning was inconsistent with economic theory and counterintuitive:[28]

> The Commission's analysis of wholesale market price differentials is based on barged product from the PNW because barged product is the predominant method of transport used to import PNW product into BC. Just because a method of transport is the predominant method used does not make it the marginal supply source. Indeed, one would expect predominant transportation methods not to be the marginal supply source because the marginal method of transportation should be used by market participants as sparingly as possible. If barged supply is not the marginal supply source, then the Commission's analysis of unexplained wholesale price differentials (which is built on barged product) is mis-specified and is not probative.

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[27] Report, p. 79 (emphasis in original, footnotes omitted).

[28] Exhibit C5-30, Kahwaty Supplemental Report, para. 51.

21. The BCUC ought to have accepted the evidence of its own expert (Deetken),[29] and market participants like Parkland,[30] that refined products are transported by truck from PNW to Vancouver. Trucking is a realistic transport option from Seattle. It is higher cost than barging. It should have been used as the basis for the marginal cost of transportation.

22. Imperial's new evidence suggests that trucking costs from Seattle, combined with other reasonable cost estimates, would account for essentially all of the differential in 2018.[31]

New Evidence Confirms that the BCUC Understated LCFS Compliance Costs

23. The Report acknowledges that producers incur costs to comply with BC's Low Carbon Fuel Standards ("LCFS"), and that those costs are uncertain.[32] The "unexplained" wholesale differential was based on assumptions as to those costs. New evidence shows those assumptions were too low, thus overstating the "unexplained differential".

24. The Report assumed - in the absence of evidence one way or the other - that LCFS costs did not increase after 2014.[33] Parkland was unable to complete its own analysis of LCFS costs in the time allotted. However, Suncor's new evidence indicates that, in its experience, "LCFS compliance costs have increased significantly between 2015 and 2019." It cited several compelling reasons for why that has occurred.[34]

25. The Report also assumed that the maximum regulatory impact of BC's Renewable and LCFS requirement regulation is the maximum cost of compliance credits. Parkland recognizes that the BCUC was trying to be conservative in using this assumption instead of using a lower cost compliance option. However, the cost of compliance actually exceeds the amount assumed.

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[29] Exhibit A2-1-1, Deetken Phase 2 Report, pp. 3 (footnote 3), 30, 44, 45, 62.

[30] Exhibit C5-2, Parkland Evidence, pp. 15 and 30; Tr. 1, p. 216, ll. 7-10 (Krogmeier).

[31] Exhibit C8-10, Imperial Comments on BCUC Report, Section IIB.

[32] Report, pp. 72-74, 78.

[33] Report, p. 79: "With regard to LCFS compliance costs, there is no evidence there are any changes since 2014."

[34] Exhibit C2-15, Suncor Additional Evidence, pp. 1-2.

26. The evidence of various parties in the Inquiry was that compliance credits are only available in limited quantities and may not be available in the quantities required to ensure compliance.[35] Parkland's witnesses spoke of the role that high cost HRD played in achieving compliance.[36] Suncor also indicates that it had provided similar evidence *in camera*.[37]

27. Suncor has now provided on the public record a specific estimate for HRD blending that is almost double the compliance cost assumption used in the Report:[38]

> Given the challenges with the liquidity of the credit market, fuel suppliers must rely increasingly on even higher cost options as the only viable means of achieving compliance with Part 3 of the Regulation. These options include investment in new technologies to produce lower carbon fuels and blending diesel fuel with high cost, hydrotreated renewable diesel ("HRD").
>
> By way of example, using HRD blending to meet the increasing Part 3 compliance obligations for both gasoline and diesel <u>could cost as high as 7 cents per litre, which is significantly higher on a cost/tonne or cost/Part 3 credit basis than the estimates made by Deetken and relied upon by the Panel</u>.

28. At a minimum, Parkland respectfully submits that the BCUC's next iteration of the Report, and any associated external communications, should (a) reflect more accurate assumptions as to these costs, and (b) highlight the residual uncertainty around all of the cost assumptions.

(d) "Unexplained" Vancouver-PNW Wholesale Differential Can Also Be Explained by the Price Influence of Even More Costly Imports

29. The BCUC stated that, in a functioning market, prices are determined with reference to the marginal source of supply, i.e., the highest cost source of supply required to meet the last unit of demand in the market.[39] The BCUC determined that the PNW spot price is the marginal

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[35] Exhibit C2-5, Parkland Evidence, p. 8: "compliance credits are not readily available in a liquid market to purchase, often exceeding $200 / MT (i.e., 1.5 cpl) when they are available at all." See also, Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, para. 60.

[36] Tr. 1, p. 112, l. 21 to p. 113, l. 1 (Krogmeier).

[37] Exhibit C2-15, Suncor Additional Evidence, p. 2.

[38] Exhibit C2-15, Suncor Additional Evidence, p. 2.

[39] Report, p. 53.

supply source for the Vancouver market, and drives Vancouver rack prices.[40] These findings were critical to the BCUC's derivation of the "unexplained differential" because it caused the BCUC to essentially rule out the influence of more costly sources of supply as an explanation for some or all of the differential it found between PNW spot and Vancouver rack prices.[41] Parkland submits that the BCUC's two reasons for ruling out the influence of more costly sources of supply - (i) market participants' use of PNW as a point of reference on a day-to-day basis, and (ii) a Vancouver-PNW price correlation - were unsound. As discussed below, the Report misapplied standard economic principles relating to marginal pricing and relied on faulty statistical analysis. It stands to reason, given the level of integration of North American markets, that more costly sources of supply are impacting the BC market.

The Report Has Misapplied Economic Principles Related to Marginal Pricing

30. The BCUC's first line of reasoning was to emphasize that market participants observe PNW spot prices and reference them when setting rack prices.[42] The Report states that market participants "generally don't know what the global marginal barrel is at any particular time", and asks the rhetorical question "How does the rack price match the cost of the marginal barrel - the barrel from the most expensive supply source - if there is no knowledge of what that supply source is?"[43] The Report, in effect, suggested that this evidence was incompatible with anything other than PNW being the marginal source of supply for BC.[44] This reasoning reflects the misapplication of economic theory.

31. Before turning to how the Report applies economic theory, it is worth repeating the evidence as to how market participants set prices. Market participants gave evidence that, in addition to looking at PNW spot prices, they also look to other benchmarks and respond to

[40] Report, pp. 68, 78.

[41] See Parkland Final Submission, para. 178 for further discussion.

[42] Report, p. 68.

[43] Report, p. 66.

[44] Report, pp. 66, 68.

additional market signals (including direct feedback from customers).[45] For example, Suncor, Imperial and Parkland all reference Chicago prices as benchmarks.[46] These other price benchmarks are more distant and can be expected to be associated with higher transportation costs than PNW. The source of BC's imports, which include imports from those more distant markets, shows why this would be the case.

32. With respect to the Report's approach to applying economic theory, there are two inter-related problems. Dr. Kahwaty explains in his Supplementary Report that the fact that PNW spot prices are a reference point in day-to-day price setting does not make it the marginal source of supply: "The Commission's analysis of the relationship between PNW spot prices and Vancouver rack prices focuses too much on the mechanics of the price setting behaviour of market participants and not on the fundamental economic factors driving prices in the market."[47] Dr. Kahwaty elaborated:[48]

> The economic analysis of wholesale pricing based on the cost of the marginal barrel should not be viewed as a precise calculation that market participants make daily but rather as indicating the dynamics driving price in one direction or another. Unlike financial instruments where arbitrage can occur nearly instantaneously, arbitrage across gasoline markets may play out over time as firms make production, purchase, and shipping decisions.
>
> Individual firms can make pricing decisions in the manner described by Imperial Oil, Parkland, and Suncor's evidence while at the same time market pricing adjusts toward the cost of the marginal source of supply. Reference prices and rules of thumb are the starting point for decision-making on pricing, but they are not the determinants of actual market prices. Prices that are "out of line" will generate incentives for market participants to change production or shipping patterns to take advantage of the profit opportunities that arise. These profit opportunities relate to the "marginal barrel". For example, Parkland's evidence is that it brings in crude oil by rail if necessary to meet its demand for feedstock but that if the costs of transport by rail or of secondary market shipping on TMPL

[45] Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 17; Exhibit C5-2, Parkland Evidence, Appendix A, Parkland Response to Questionnaire, Q. 18; Exhibit C2-2, Suncor Response to Questionnaire, Q. 17; Tr.1, p. 276, ll. 5-11 (Scammell); Tr. 2, p. 340, ll. 18-24 (McLean).

[46] See Parkland Final Submission, p. 46. Exhibit C8-2, Imperial Oil Response to Questionnaire, Q. 17; Exhibit C2-2, Suncor Response to Questionnaire, Q. 17.

[47] Exhibit C5-30, Kahwaty Supplemental Report, para. 4.

[48] Exhibit C5-30, Kahwaty Supplemental Report, paras. 37-38.

> are too high to make additional production profitable, it will decline to bring in that additional crude oil. It is decisions like these that tie pricing dynamics in gasoline and diesel markets to marginal sources of supply and the costs of those marginal sources.

33. The second related issue (and possibly the root cause of the first problem described above) is that the BCUC is misinterpreting the economic concept of "marginal barrel" as a literal product unit (litre/barrel) that is capable of being identified by any market participant at any given point in time as being the most expensive unit entering the BC market, to which it can then refer when determining its rack price. This misperception is reflected in the Report's emphasis that market participants, due to confidentiality, "hav[e] no knowledge of what that supply source is". It is highlighted again in a series of BCUC follow-up questions recently posed to Dr. Kahwaty on this point:[49]

> 3.1 Please explain over what time frame would a supply source be considered marginal. (i.e. a day, a week, a month?)
>
> 3.1.1 Consider an example where only one barrel per day is trucked from the PNW (at a higher cost) while all other barrels from the PNW were barged (at a lower cost). Would that one barrel shipped by truck be considered the marginal source of supply every day for the purpose of setting the wholesale price in the BC market? Please explain.
>
> 3.1.2 Consider another example where barged product from the PNW is sufficient to balance supply and demand for most days of a given month except for a few days when trucked product is also needed to balance the market. Would trucked product be considered the marginal source of supply for the whole month or only on those days that it is required to balance the market? Please explain.
>
> 3.1.3 Which of the two above examples best represents the BC situation? Please elaborate.
>
> 3.1.4 If one barrel shipped by the marginal method of transportation (highest cost) is all it takes to set the wholesale price for the BC market, why would it not become an incentive to have recourse to such transportation method strategically once a day, rather than as sparingly as possible?

[49] Exhibit A-33.

> 3.2 Please state which supply source and which transportation method should be considered the marginal source of supply for the BC market. Please provide data to support your response and indicate whether this marginal source of supply is Parkland's marginal barrel or BC's marginal barrel.

34. Dr. Kahwaty explained at length in his response why the questions posed, and the Report's approach of definitively identifying the PNW spot market as the highest cost import, represented a misapplication of economic theory. He stated for instance:[50]

> Questions 3.1 and 3.2 relate to marginal sources of supply and ask specific questions, for example, regarding the time frame necessary for a supply source to be considered the marginal source of supply. <u>These questions imply a focus by the Commission on a literal unit of supply as being the marginal unit to which pricing is tied instead of using the marginal source of supply in the way that concept is understood by economists.</u> Below I explain what the concept of the marginal source of supply means in economic analysis and apply it to the study of gasoline and diesel markets.
>
> …
>
> The models of supply and demand are highly stylized, but even so, they offer insights into market processes and outcomes. In the Kahwaty Report I discussed the basic concepts of supply and demand, along with the idea of marginal supply, to provide some context regarding how equilibrium wholesale gasoline market prices could be reached in BC. <u>The marginal unit of supply is not a unit the market participants are necessarily aware of but rather is a concept used by economists to understand market behavior, especially how market prices change over time.</u> Markets adjust to changes in supply and demand conditions, and these adjustments include increases or decreases in prices. Prices adjust by moving in the direction of what economists call "equilibrium prices". In the Kahwaty Report, I used the common concept that equilibrium prices are set by market forces, and one such market force is the marginal supply source.
>
> The model of supply and demand and the price movements it predicts are simplifications of the day-to-day operating and pricing decisions made in the BC wholesale gasoline and diesel markets. I elaborate upon this point in paragraph 37 of my supplemental report [quoted above] as well.
>
> …
>
> The wholesale prices for gasoline and diesel change often – typically daily – as they react to changes in supply and demand. Some market factors tend to push

[50] Exhibit C5-31, Parkland Response to Panel IR No. 1 (Kahwaty).

> prices up, others tend to push prices down. Some adjustments occur more rapidly than others depending upon the nature of the forces to which the markets are reacting. Market prices move in the direction of the equilibrium price, but may not ever achieve that price because, as the adjustment process occurs, other changes in supply or demand yield a new equilibrium price, leading to further pressure for price adjustments. The marginal source of supply – and the costs of that source of supply – are one factor that impact the equilibrium price in the market, and as the marginal source of supply changes, so too does the pricing pressure that flows from the marginal supply source. [Emphasis added.]

35. Dr. Kahwaty went on to provide examples of how these dynamics play out in practice.

36. In short, the evidence that the Report treated as precluding higher cost supply sources from influencing BC wholesale prices was entirely compatible with that outcome.

The Price Correlation Between Vancouver and PNW is Indicative of Common Cost Drivers, Not Evidence that PNW Prices Drive Vancouver Wholesale Prices

37. The BCUC's other stated basis for concluding that the PNW spot market is the marginal supply source was statistical analysis that the BCUC concluded showed a strong price correlation between Vancouver rack prices and PNW spot prices. The BCUC concluded on this point: "The PNW spot price influence is significant as observed in the regression results of the Vancouver rack prices and the PNW spot price for both gasoline and diesel." [51] Dr. Kahwaty identifies two related errors with this analysis.

38. First, Dr. Kahwaty has demonstrated that the regression methodology was itself invalid,[52] and was not accounting for the common influence on PNW and Vancouver prices of crude prices and shipping costs on TMPL. Dr. Kahwaty stated in part:[53]

> The BCUC Report's Figure 26, therefore, shows that average wholesale prices in Vancouver and PNW spot prices are closely related to each other. This is not a surprise because both are driven by oil prices, which the Commission acknowledges is traded in a global market. Elsewhere, the BCUC Report finds

[51] BCUC Report, p. 66.

[52] Exhibit C5-30, Kahwaty Supplemental Report, paras. 46-47. The explanatory variable was not independent or exogenous to the Vancouver rack price, which is a necessary precondition of such regression analysis.

[53] Exhibit C5-30, Kahwaty Supplemental Report, para. 42.

> that the Vancouver wholesale market is integrated with other wholesale markets, and therefore price movements would be expected to be similar (but not necessarily identical) across the two. Another reason to expect common price movements between Vancouver rack and PNW spot prices is that the Burnaby refinery and the PNW refineries receive crude from Alberta transported on the TMPL. They, therefore, share related or common input costs.

39. Second, Dr. Kahwaty explains that the BCUC also erred by inferring from the purported correlation that PNW prices "influence" Vancouver price changes, i.e., that a causal relationship exists. Dr. Kahwaty states:[54]

> …the Commission's regression analysis does not show that prices in the PNW gasoline and diesel wholesale markets affect or influence prices in the Vancouver gasoline and diesel wholesale markets. It is a common statistical error to confuse correlation with causation. Correlation or simple regression analysis only shows that a linear relationship exists between two variables. It does not explain how or why a relationship exists between those two variables. The Commission's simple regression analysis has no ability to deduce a cause-and-effect relationship between the two variables analyzed solely on the basis of an observed association or correlation between them.

The maxim that correlation is not causation is particularly important when there are other compelling reasons for the apparent correlation, i.e., common cost drivers.

The Price Influence of More Costly Supply is to Be Expected Given North American Market Integration

40. The price influence of more distant markets along with the PNW spot price stands to reason given that BC also gets a material amount of its products from California, the US Midwest and the Gulf Coast.[55] The Report itself talks of the high degree of integration in the North American market.[56] Although it may not be possible to discern with precision the *extent* of the impact of more distant markets on BC wholesale prices, it is possible to conclude with certainty that a portion of the "unexplained differential" could be readily explained by competitive market dynamics predicted by economic theory.

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[54] Exhibit C5-30, Kahwaty Supplemental Report, para. 49.

[55] See Parkland Final Submission, para. 55.

[56] Report, pp. 22-24, 72.

D. ATTRIBUTING "UNEXPLAINED DIFFERENTIAL" TO MARKET POWER IS INCONSISTENT WITH THE EVIDENCE AND ECONOMIC THEORY

41. The BCUC determined that the wholesale price differential with neighbouring jurisdictions is due to wholesale market participants having joint or group market power in BC.[57] It labelled the market an "oligopoly".[58] The Report attributes this market power to (a) ownership of the primary terminals in BC is concentrated in only six different companies, and (b) "… there is no way that any party other than the companies that own the existing terminals can import gasoline into the wholesale system, unless they sell it to one of the five existing wholesalers."[59] There are several problems with this assessment, discussed below. The evidence demonstrates that it is constraints on TMPL, not the exercise of market power, that accounts for differentials.

(a) BC Has as Many, or More, Primary Terminal Operators than Every Province Save Québec

42. Attributing an "unexplained" price differential to concentrated primary terminal ownership in BC is impossible to reconcile with the fact that the number of primary terminal operators in BC with blending capabilities is the same as (or greater than) the number of primary terminal operators with blending capabilities in all other provinces except for Québec. This is shown in the table below:

[57] Report, pp. 79-80.

[58] Report, pp. 12, 57.

[59] Report, pp. 79-80.

Province	Number of Primary Terminals	Number of Primary Terminals with Biofuel Blending Capabilities	Number of Owners of Primary Terminals with Biofuel Blending Capabilities	Number of Bulk Terminals
Quebec	17	9	6	29
Alberta	9	6	5	166
British Columbia	13	8	5	54
Ontario	20	13	5	69
Nova Scotia	5	0	0	26
Newfoundland	5	0	0	9
Saskatchewan	3	3	3	76
Manitoba	3	2	2	37
New Brunswick	3	1	1	13
Prince Edward Island	1	0	0	4

43. Dr. Kahwaty explains how this new evidence undermines the BCUC's analysis, in part, as follows:[60]

> The Commission's theory is that collective dominance or the joint exercise of market power is the reason why the wholesale market in BC appears to the Commission not to be operating in a competitive fashion. The refining margins in Alberta, Saskatchewan, and Manitoba (compared to BC) cast doubt on this conclusion. There are the same number of primary terminal-based operators in Alberta and BC, yet the refining margins in Alberta are significantly and systematically lower than in BC. There are fewer wholesale market participants with primary terminals in Saskatchewan and Manitoba than in BC. Indeed, in Manitoba there are only two primary terminal owners, and these two primary terminal operators (Imperial Oil and Shell) are also active in BC. Yet in both provinces, refining margins are significantly and systematically lower than in BC. <u>These findings are strikingly at odds with the Commission's theory and illustrate its implausibility.</u> For example, in BC the Commission's theory requires Imperial Oil and Shell to be effective at exercising market power jointly with Parkland, Husky Energy, and Suncor, but not effective at jointly exercising market power amongst just themselves in Manitoba. <u>This suggests that something other than the number of firms owning primary terminals with biofuel blending capabilities is elevating BC's refining margins relative to those in these other provinces.</u> [Emphasis added.]

44. Dr. Kahwaty's analysis suggests that the prevalence of more efficient forms of transportation of refined products - i.e., available pipeline capacity - plays even more of a

[60] Exhibit C5-30, Kahwaty Supplemental Report, para. 18.

significant role in shaping market prices than the BCUC is recognizing. Dr. Kahwaty elaborated:[61]

> If market power were a concern with the wholesale market structure in BC, it should be an even bigger concern in Manitoba. The refining margin data, however, show that this is not the case. The availability of sufficient low-cost transportation to facilitate imports of refined products from Edmonton for local consumption distinguishes Manitoba from BC. Devoting more capacity on TMPL to serve local needs or allocating some potential expansion capacity to serve the wholesale market in BC would result in lower wholesale prices and margins in BC.
>
> The increase in refining margins found by the Commission is coincident with the reduction in BC supply via TMPL. The use of TMPL to import refined products into BC for local consumption was greater in 2015 than in any of the prior seven years and has fallen by about half since then. As lower-cost products are removed from the market due to pipeline constraints, BC is forced to rely on ever more expensive alternative sources of supply to meet provincial demand.

(b) Ownership Concentration Has Not Changed Since 2015

45. The Deetken group dismissed wholesale market concentration as a reason for changes in wholesale margins since 2015, because ownership concentration had not changed.[62] This is re-emphasized in new evidence.[63] Deetken's logic is intuitive and it undermines the Report's findings.

(c) The Report Overstated the Barriers to Entry

46. The evidence, now augmented, does not support the BCUC's assessment that "… there is no way that any party other than the companies that own the existing terminals can import gasoline into the wholesale system, unless they sell it to one of the five existing wholesalers."[64] It is possible with some intermediate storage to blend and certify truck-size quantities to Canadian specifications.[65] There are many retailers in BC that sell unbranded gasoline that

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[61] Exhibit C5-30, Kahwaty Supplemental Report, paras. 27-28.

[62] Exhibit A2-1-1, Deetken Phase 2 Report, p. 62.

[63] Exhibit C8-10, Imperial Comments on BCUC Report, PDF p. 7.

[64] Report, pp. 79-80.

[65] Exhibit C8-10, Imperial Comments on BCUC Report, PDF p. 4.

does not need to be mixed in a primary terminal in BC. For example, Super Save trucks refined products all the way from Alberta to Vancouver.[66]

47. Moreover, other market participants have now provided tangible examples of third parties other than the "Oil Companies" developing terminal facilities - the Vancouver Wharves Terminal, the Vancouver Airport Fuel Facilities Corporation infrastructure, and the Ashcroft Terminal. The development of these facilities, irrespective of whether they are used for refined fuels, speaks to the feasibility of developing substantial petroleum product distribution infrastructure in this province. Interveners have also described how transloading (a low-cost process whereby a truck loads from a railcar) has proliferated.[67]

(d) Exercising Market Power Requires Withholding Supply, and Parties Are Operating at Capacity

48. The fourth flaw with the BCUC's "market power" hypothesis for the "unexplained differential" is that the BCUC is failing to distinguish between *having* market power and *exercising* market power. Even if we were to assume for the sake of argument that BC wholesale market participants *have* market power, there is no evidence that market power is being *exercised*. The hallmark of exercising market power - withholding supply to drive-up prices - is absent in this case. Attributing an "unexplained differential" to market power in the absence of evidence that market participants are withholding supply is untenable.

49. Dr. Kahwaty emphasized in his Inquiry evidence that market power is exercised by withholding supply to drive up prices.[68] He reiterates this point in his Supplemental Evidence, stating for instance:[69]

> These results highlight a point discussed in my report and testimony: the importance of addressing the conduct by which market power is exercised. The

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[66] Tr. 4, p. 743, ll. 3-6 (Vanderkerkhove).

[67] Exhibit C2-15, Suncor Additional Intervener Evidence, p. 3. Exhibit C8-10, Imperial Comments on BCUC Report, PDF p. 6. Parkland discussed transloading and the practice of independent marketers importing using the smaller volume exemption from LCFS requirements at Exhibit C5-2, Parkland Evidence, p. 33.

[68] Exhibit C5-2, Parkland Evidence, Appendix B, Kahwaty Report, paras. 5, 89-90, 99, 102, 181-184; Tr. 1, p. 116, l. 21 to p. 120, l. 22 (Kahwaty).

[69] Exhibit C5-30, Kahwaty Supplemental Report, para. 29.

> Commission's findings are that wholesale prices are 13 cents above a competitive level because wholesale market participants have joint or group market power in BC. Assuming that the Commission's calculation of the 13 cent figure is correct, for it to be the result of an exercise of market power, Parkland, Imperial Oil, Shell, Suncor, Husky, and FCL must have taken actions that restricted the supply available in the marketplace. Parkland and Husky, for example, own within-market refineries that have high rates of capacity utilization. An entity cannot be said to exercise market power when it operates at economic capacity because it is producing as much as it can and is not restricting supply in the market. Capacity limitations may lead to higher prices, but such higher prices are not a result of an exercise of market power. [Emphasis added.]

50. The essential role that withholding supply plays in the exercise of market power is also reflected in the BCUC's own definition of an "oligopoly", which the BCUC has misapplied to the wholesale market.[70] The Report states: "Oligopolies differ from price-takers in that they do not have a supply curve. Instead, they search for the best price-output combination."[71] [Emphasis added.] In other words, economic theory holds that an oligopoly will withhold supply to achieve a higher price, rather than automatically increase output to expand market share to the fullest extent possible. Oligopolistic behaviour is absent in the BC market. The evidence shows market participants maximizing their output and their use of primary terminals, not withholding supply.[72]

E. LAND VALUES CAN EXPLAIN THE "UNEXPLAINED" RETAIL MARGIN DIFFERENTIAL

51. The BCUC's independent expert, Deetken, concluded that land values could explain much of the retail margin differential.[73] The Report recognized some role for the opportunity cost of land in the analysis of retail pricing; however, it did not support the Deetken approach to estimating the effect of these opportunity costs because land values are not a direct input into the setting of retail prices by market participants.[74] The BCUC should revisit this conclusion.

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[70] Report, p. 57.

[71] Report, p. 58.

[72] See Parkland Final Submission, paras. 53, 130-131, 136.

[73] Exhibit A2-1-1, Deetken Phase 2 Report, pp. 26-29, 70.

[74] Report, p. 102.

52. Dr. Kahwaty explains that the BCUC's approach "confuses daily price setting behavior with long-term market dynamics."[75] He states that pricing "can reflect the opportunity costs of land even if it is not a factor considered when making day-to-day pricing decisions."[76] He elaborated:

> As facilities exit the market, remaining gasoline and diesel retailers may – when making day-to-day pricing decisions – increase prices because the facilities that have exited the market no longer place competitive pressure on them. Therefore, even if the effects of opportunity costs are not factored into day-to-day pricing decisions, over time they are reflected in market prices. Detailed opportunity cost estimates provide information on the types of price changes to be expected in the market over time and should be included in the Commission's analysis.

53. Dr. Kahwaty's observation is well-founded in economic theory - the same theory that underpinned the Deetken evidence of the impact of land values on retail margins. Dr. Kahwaty has undertaken another statistical analysis of retail margins and housing prices in 25 Canadian cities to supplement the analysis of Deetken. His regression analysis shows that housing prices can explain the entire differential in Victoria and all but two cents of the differential in Vancouver. This is before accounting for the impact of credit card fees, which the BCUC has acknowledged can explain some of the differential.[77]

F. THE REPORT SHOULD BE CLEARER ABOUT THE PROBLEMS WITH MARKET REGULATION

54. The Report addresses potential options for regulation. Although the Report acknowledges problems and risks associated with regulation, the updated Report should be clearer on the following two points.

(a) The BCUC Should Acknowledge its Previous Determinations that the Public Interest Is Not Served by Regulation of Markets

55. Parkland's Final Submission in the Inquiry included lengthy passages from previous BCUC decisions, in which the BCUC spoke of the importance of limiting regulation to

[75] Exhibit C5-30, Kahwaty Supplemental Report, para. 77.

[76] Exhibit C5-30, Kahwaty Supplemental Report, para. 79.

[77] Exhibit C5-30, Kahwaty Supplemental Report, para. 84.

circumstances where a "natural monopoly" exists. The BCUC had stated, for instance: "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."[78] The Report did not acknowledge the BCUC's previous (and forceful) pronouncements. Instead, it characterized the BC wholesale market as having characteristics of a "natural monopoly", citing ownership of primary terminals by five companies and barriers to entry.[79] This characterization is, with respect, untenable.

56. The BCUC, in an earlier decision (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. It identified the essential feature of a "natural monopoly" as being where delivery is most efficient when done by *a single company*, i.e., not multiple competitors. The BCUC, citing a well-recognized economics text, stated: [80]

> 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)

57. Dr. Kahwaty, in his new evidence, provides additional references to literature that define "natural monopoly" in the same manner. He opines that the Report's characterization of the wholesale market as having features of a "natural monopoly" is unsupported by economic theory. He distinguished the wholesale refined products market as follows:[81]

> This fundamental characteristic of a natural monopoly – that a single firm can supply a good or service to an entire market at a lower cost than could two or more firms – does not describe the wholesale market for gasoline and diesel in BC. BC has five owners and operators of primary terminals. The BCUC Report indicates that several of these terminals operate at capacity. Having multiple

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[78] See paragraphs 189 to 194 of Parkland's Final Submission.

[79] Report, pp. 12, 14, 59, 74.

[80] Inquiry into FortisBC Energy Inc. regarding the Offering of Products and Services in Alternative Energy Solutions and Other New Initiatives, BCUC Order G-201-12, pp. 7-8.

[81] Exhibit C5-30, Kahwaty Supplemental Report, paras. 32-33.

> terminal operators does not result in excessive and duplicative capital investment, which would be the case if, for example, there were multiple firms distributing electricity in an area with each using only their own wires. Instead, increasing the volume of gasoline and diesel handled at a primary terminal requires additional storage and mixing tanks, among other facilities. These could be added to an existing facility or to a separate facility. I am aware of no reason why gasoline and diesel in BC could be distributed at a lower cost if the province was served by only one, large primary terminal.
>
> The basic technological requirement for a natural monopoly – substantial economies of scale – is not present in gasoline refining and distribution. The economic logic typically used to support the regulation of a natural monopoly has no relevance to the wholesale gasoline and diesel markets in British Columbia.

58. While those involved regularly in BCUC proceedings will be well aware of the BCUC's previous pronouncements, a purpose of this Inquiry has been to educate the public generally. To that end, the BCUC should expressly acknowledge its past decisions when it updates the Report. The public and government should know that the BCUC has previously concluded that the public interest is not served by price regulation in circumstances like these.

(b) Reporting Requirements Would Not Address the Underlying Pipeline Capacity Issue

59. The BCUC's Report, and the evidence in the Inquiry, make clear that capacity constraints on TMPL have created the conditions for higher prices in BC since 2015. The Report also makes clear that greater access to pipeline capacity on TMPL could have a favourable impact on the BC market. Additional reporting, which comes with cost to consumers, is not required to highlight that situation.

G. CONCLUSION

60. The Report correctly identified the importance of pipeline capacity and the absence of coordinated conduct in the retail market. Ready and reliable pipeline transport for product destined for BC is vital to the BC fuel industry's ability to meet the fuel needs of customers across the province. However, the BCUC made errors in its price differential analysis, and reached definitive conclusions when shortcomings in the evidentiary record precluded doing so. The public, government and industry participants would be well served by the BCUC updating

its Report to correct the identified errors and articulate more clearly the high degree of uncertainty around the assumptions that were the basis for the "unexplained differentials" identified in the Report.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Dated: October 8, 2019 ***[original signed by Matthew Ghikas]***

Matthew Ghikas
COUNSEL FOR PARKLAND FUEL CORPORATION

Dated: October 8, 2019 ***[original signed by Tariq Ahmed]***

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