

NOVA SCOTIA UTILITY AND REVIEW BOARD

**IN THE MATTER OF THE PETROLEUM PRODUCTS PRICING ACT
AND REGULATIONS**

- and -

IN THE MATTER OF the setting and establishment of the zones, fixed wholesale prices and retail prices under the *Regulations*

BEFORE: Wayne D. Cochrane, Q.C., Panel Chair
Murray E. Doehler, C.A., P. Eng., Member
John A. Morash, C.A., Member

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ULTRAMAR LIMITED
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SCOTIA**
Michael K. Power, LL.B.

**PROVINCE OF NOVA SCOTIA - SERVICE NOVA SCOTIA
AND MUNICIPAL RELATIONS**
Stephen T. McGrath, LL.B.

HEARING DATE: September 18 and 19, 2006

FINAL SUBMISSIONS: September 29, 2006

DECISION DATE: **October 16, 2006**

DECISION: **Recommendations made concerning a number of areas, including wholesale margins, maximum and minimum retail margins, defined zones, and frequency of prescribing benchmarks**

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I INTRODUCTION AND SUMMARY

[1] In 2005, the Province of Nova Scotia enacted the *Petroleum Products Pricing Act*, S.N.S. 2005, c. 11, permitting regulation, with certain exceptions, of the price of gasoline and diesel oil (“regulated petroleum products”). For simplicity, this type of regulation will be referred to in this decision as “gasoline pricing regulation,” and “regulated petroleum products” (including diesel) will simply be referred to as “gasoline.” While the statute was enacted in 2005, gasoline pricing regulation did not actually take effect in Nova Scotia until July 1, 2006. At that time, and to the present day, it continues to be administered by a department of the Provincial Government, Service Nova Scotia and Municipal Relations, and its Minister.

[2] The *Act* and *Regulations* establish a broad structure for gasoline pricing regulation in Nova Scotia, certain aspects of which will be explored in greater detail later in this decision. The legislation confers a wide range of powers upon the Minister, including, under s. 10 of the *Petroleum Products Pricing Regulations*: the power to divide the province into gasoline pricing regulation zones; the power to prescribe the fixed wholesale price; and the power to prescribe minimum and maximum retail prices. Included in the power to establish zones is the power to determine whether price differences between zones are fair and reasonable: s. 11(2)(c) of the *Regulations*.

[3] There is no mention of the Nova Scotia Utility and Review Board in the *Act*, but s. 14(1)(g) empowers the Governor in Council (referred to hereinafter as “the Cabinet”) to make regulations:

- s. 14** (g) establishing or designating a board to administer this Act and the regulations, or any part of this Act and the regulations, and determining the powers and duties of that board;

[4] In June 2006, Cabinet did make regulations designating the Board under s. 14(1)(g) of the *Act*, but giving it limited powers and duties: the Board has been designated simply to “. . . conduct public hearings respecting zones, fixed wholesale prices and retail prices set under these regulations.” [s. 21(1) of the *Regulations*]

[5] In short, the Board has no power under the existing legislation to do anything other than to hold a hearing on these three topics. More specifically, it does not have the power to change regulations, or to enforce regulations, nor does it have the power (nor would it be appropriate, in the Board’s view) for the Board to comment upon the practicality or usefulness, or lack thereof, of gasoline pricing regulation in general.

[6] The Government has announced its intent that the Board will be given most of the responsibility for gasoline pricing regulation, as of November 1, 2006. However, conferring any power upon the Board, other than the one enumerated above, will require the making of new regulations.

[7] The present decision is the result of the Board’s deliberations upon the evidence and submissions received by it in the course of a hearing which commenced on September 18, 2006. That hearing had been scheduled to last for up to three weeks; however, owing to a variety of circumstances (including withdrawal of a number of different intervenors), the hearing was concluded in less than two days.

Summary

[8] The intention of this decision is to provide the Government of Nova Scotia, the regulated industry and the public with the Board's views on the limited range of topics contemplated by the legislation. At present, the Board has no power in relation to gasoline regulation, except that it was empowered to hold the hearing which has led to this decision. This decision, unlike those usually made by the Board, does not culminate in an order. Instead, it consists of a number of recommendations and observations, including an outline of the manner in which the Board would proceed upon the transfer of regulatory authority.

These include:

the Board recommends that the wholesale margin continue to be set at 6¢ per litre;

the Board recommends that the maximum and minimum retail margins continue to be set at 5.5¢ and 4¢ per litre, respectively;

the Board does not recommend that the additional margin for full service of 2¢ per litre be increased;

the Board does not recommend any change in the defined zones, or in the price differential which is applied to the zones, but considers that exceptions may be needed, such as for particular gasoline retailers or wholesalers in rural, remote, or border areas;

the Board considers that the practice of setting prices for gasoline every two weeks should be changed to setting prices once a week: the Board notes that, in the five, two-week price setting schedules which occurred between July 1, 2006, and the Board's hearing on September 18 and 19, the Province used its interrupter power three times, meaning that a price which was supposed to stay the same for two weeks was changed during the first week of the two week period. In the Board's view, the setting of prices every two weeks also leads to complex issues respecting when the interrupter should, and should not, be used. If prices are set every week, these issues largely disappear, except for rare events, such as a hurricane damaging an oil field;

the Board considers that a forward averaging correction should be used each time prices are set. The Board recommends a specific formula for this calculation, so as to ensure maximum transparency for consumers and the industry. The Board also recommends that it be given power to adjust this formula in future, as experience may indicate, provided the Board gives prior notice to consumers and the industry of those adjustments;

given the Board's understanding that the Province intends that it (rather than the Board) enforce gasoline pricing regulation, including any enforcement of alleged infractions of any restrictions on promotions, the Board makes no recommendations in relation to the existing promotions policy;

the Board sees no evidence to support a change to the Government's present practice with respect to notifying wholesalers and the general public of price changes, except for a one hour reduction in the advance notification period to wholesalers;

the Board considers that, while further information and study could be undertaken about certain aspects of pricing regulation, there is no practical necessity for doing so right now;

the Province has based its pricing of gasoline (excluding diesel) on the Platts price for regular gasoline, and has not used the Platts prices for the mid-range and high octane gasoline. It has priced the mid and high octane grades by a fixed differential based upon the price of regular gasoline, rather than the actual Platts prices for the two higher grades. The Board makes no recommendation to change this practice at present.

II LEGISLATION

[9] Legislation which is of particular relevance to this decision includes:

Petroleum Products Pricing Act

Regulations

s. 14 (1) The Governor in Council may make regulations

(c) dividing the Province into one or more zones and prescribing

- (i) a fixed wholesale price or a maximum and minimum wholesale price,
 - (ii) a maximum retail price,
 - (iii) minimum and maximum retail mark-ups,
- for petroleum products for each zone;

Petroleum Products Pricing Regulations

Delegation of authority

- s. 10** Effective immediately after these regulations come into force, and subject to these regulations, all of the following powers under the Act are delegated to the Minister:
- (a) the power to divide the Province into zones as set out in clause 14(1)(c) of the Act;
 - (b) the power to prescribe the fixed wholesale price as set out in subclause 14(1)(c)(i) of the Act;
 - (c) the power to prescribe a maximum retail price as set out in subclause 14(1)(c)(ii);
 - (d) the power to prescribe minimum and maximum retail mark-ups as set out in subclause 14(1)(c)(iii).

Zones

- s. 11 (1)** For the purpose of prescribing prices for each zone, the Province is divided into the following zones:
- (a) Zone 1 consists of all of the following:
 - (i) Halifax County,
 - (ii) Hants County,
 - (iii) the southern portion of Colchester County, as divided by a straight line running from Clifton in Colchester County to the intersection of the county lines of Colchester, Pictou, Guysborough and Halifax Counties;
 - (b) Zone 2 consists of all of the following:
 - (i) Kings County,
 - (ii) Lunenburg County,

- (iii) the eastern portion of Annapolis County, as divided by a straight line running northwest from the top section of the Queens-Lunenburg county line and extending to the Bay of Fundy;
- (c) Zone 3 consists of all of the following:
 - (i) Queens County,
 - (ii) Shelburne County,
 - (iii) Yarmouth County,
 - (iv) Digby County,
 - (v) the western portion of Annapolis County as divided in clause (b);
- (d) Zone 4 consists of Cumberland County;
- (e) Zone 5 consists of all of the following:
 - (i) Guysborough County,
 - (ii) Antigonish County,
 - (iii) Pictou County,
 - (iv) the northern portion of Colchester County as divided in clause (a),
 - (v) the Town of Port Hawkesbury in Inverness County,
 - (vi) an area of land bounded by a straight line extending along the prolongation of the eastern boundary of the Town of Port Hawkesbury to the Trans-Canada Highway (Highway 105) and then southwesterly along the Trans-Canada Highway to the Strait of Canso.
- (f) Zone 6 consists of all of the following:
 - (i) Cape Breton County,
 - (ii) Victoria County,
 - (iii) Richmond County,
 - (iv) Inverness County, except the Town of Port Hawkesbury and an area of land bounded by a straight line extending along the prolongation of the eastern boundary of the Town of Port Hawkesbury to the Trans-Canada Highway (Highway 105) and then southwesterly along the Trans-Canada Highway to the Strait of Canso.

Must charge prices for zone where point of sale located

- s. 12(3)** Despite subsections (1) and (2), the Minister may, on application by a wholesaler, wholesaler-retailer or retailer, and in order to preserve availability of a petroleum product in rural areas, to preserve the viability of markets in the provincial border areas or for another reason the Minister considers appropriate, set a different fixed wholesale price, a different retail mark-up or different minimum and maximum retail prices that the person may charge for a type of petroleum product at a particular point of sale.

Promotions

- s. 13 (1)** Despite Section 12, a type of coupon, promotion, discount, loyalty program or any other promotional consideration in existence for a petroleum product between May 1, 2005 and June 1, 2006 that has the effect of reducing the price for a petroleum product below the minimum retail price at the time of sale is permitted.
- (2)** On and after July 1, 2006, any enhancement of a promotional consideration described in subsection (1) or any new type of coupon, promotion, discount, loyalty program or other type of promotional consideration that would have the effect of reducing the price for a petroleum product at the time of sale is prohibited.

Benchmark Price

- s. 14(2)** On July 13, 2006 and on every 2nd Thursday afterwards, at a time the Minister considers appropriate, the Minister must prescribe a benchmark price for each type of petroleum product.

...

- (6)** If the Minister considers it appropriate, the Minister may prescribe a benchmark price at any time.

Wholesale Margin

- s. 15** When prescribing the wholesale margin for a type of petroleum product in a zone, the Minister may consider any of the following:
- (a) the wholesale margin for the petroleum product for the Province or for a zone, excluding taxes imposed under subsection 165(1) and 165(2) of the Excise Tax Act (Canada), over a period the Minister considers appropriate;
 - (b) whether the wholesale margins identified under clause (a) are fair and reasonable, taking into account any of the following:
 - (i) the distance from the refinery gate to a zone,
 - (ii) the volume of petroleum product sold to retailers during the period,
 - (iii) innovations within the industry;
 - (c) any additional factors the Minister considers relevant, including the factors set out in subsection 12(3).

Fixed wholesale price

- s. 16(1)** For each type of petroleum product, the fixed wholesale price in a zone is the sum of all of the following:
- (a) the current benchmark price as prescribed by the Minister under Section 14;
 - (b) the wholesale margin as prescribed by the Minister under Section 15;
 - (c) all taxes, excluding the taxes imposed under subsections 165(1) and 165(2) of the Excise Tax Act (Canada);
 - (d) if the Minister considers it appropriate, transportation adjustments and forward averaging corrections.
- (2)** In clause (1)(d), “forward averaging correction” means the difference between the benchmark price and the actual reported product price for a petroleum product since the last benchmark price adjustment for that petroleum product, adjusted for variations in the volume sold during that period.

Maximum and minimum retail mark-up

- s. 17(1)** When prescribing the minimum and maximum retail mark-ups for a type of petroleum product in a zone, the Minister may consider any of the following:
- (a) the retail mark-ups within the Province or a zone for the type of petroleum product, excluding taxes imposed under subsections 165(1) and 165(2) of the Excise Tax Act (Canada), over a period of time the Minister considers appropriate;
 - (b) whether the retail mark-ups identified under clause (a) are fair and reasonable, taking into account any of the following:
 - (i) the distance from a refinery gate to the boundaries of the zone,
 - (ii) the volume of petroleum product sold to consumers during the period,
 - (iii) innovations within the industry;
 - (c) whether the petroleum product is sold or purchased at a full-service retail outlet or a self-service retail outlet;
 - (d) any additional factors the Minister considers relevant.

Maximum and minimum retail price

- s. 18(1)** For each type of petroleum product, the maximum retail price in a zone is the sum of all of the following:
- (a) the fixed wholesale price;
 - (b) the maximum retail mark-up prescribed by the Minister under Section 17;
 - (c) all taxes.
- (2)** For each type of petroleum product, the minimum retail price in a zone is the sum of all of the following:
- (a) the fixed wholesale price;
 - (b) the minimum retail mark-up prescribed by the Minister under Section 17;
 - (c) all taxes.

Notice of prices

- s. 20(1)** The Minister must ensure that all wholesalers and wholesaler-retailers are informed of the fixed wholesale prices and maximum and minimum retail prices before they are to take effect.

Public hearings

- s. 21(1)** The Board is hereby designated under subsection 14(1)(g) of the Act to conduct public hearings respecting zones, fixed wholesale prices and retail prices set under these regulations.

III PARTICULAR MATTERS REVIEWED BY THE BOARD

Gasoline Pricing Regulation as Currently Administered by the Province

[10] The fixed wholesale price in a zone is defined in s. 16(1) of the *Regulations*, and has the following components: the current benchmark price, which is the average of the New York daily price for gasoline as reported in the Platts Report (“Platts price”); the wholesale margin which is defined in s. 15 of the *Regulations*; all taxes, excluding those taxes imposed under ss. 165(1) and (2) of the *Excise Tax Act (Canada)*; and, if the Minister

considers it appropriate, transportation adjustments and a forward averaging correction. The term “forward averaging correction” is defined in s. 16(2) of the *Regulations*.

[11] The maximum and minimum retail price is based on the fixed wholesale price as defined above, plus the maximum and minimum retail mark-up. The maximum and minimum retail mark-up is defined in s. 17(1) of the *Regulations*, and the maximum and minimum retail price is defined in s. 18.

[12] The Minister has accepted the zones as established in the *Regulations* and has determined a transportation cost delivery rate for each zone. These are:

Zone 1	\$0.003 per litre
Zone 2	\$0.007 per litre
Zone 3, 4 & 5	\$0.012 per litre
Zone 6	\$0.020 per litre

[13] The Minister has set the fixed wholesale margin at 6¢ per litre; the maximum retail margin at 5.5¢ per litre; and the minimum retail margin at 4¢ per litre. As well, an additional margin of 2¢ per litre has been established for full service gasoline sold at the retail sites. The formulae which appear in Appendix “A” reflect the Board’s understanding of the above regulations and its intended practice.

[14] The legislation refers to setting prices every two weeks, but the Minister can set prices more frequently, i.e., “interrupt” the two week cycle: s. 14(6) of the *Regulations*. The Minister has interrupted the cycle when the Platts price of gasoline has changed by more than 4¢ per litre since the last bi-weekly setting. The Minister, between the

implementation of gas regulation on July 1, 2006, and the date of the hearing, used the interrupter three times (twice for gasoline and once for diesel). The Minister also made use of forward averaging three times, but the details of these calculations are unknown.

Wholesale Margins

[15] The Minister's wholesale margin was based on the results of a study done in 2005 by Michael Gardner of Gardner Pinfold Consulting Economists Ltd. and MJ Ervin and Associates Inc. entitled "Economics of the Nova Scotia Gasoline Market" (the "study"). The study researchers could not obtain a complete set of data from all the gasoline wholesalers in the province (they were able to obtain data from the wholesalers which represented between 40% and 50% of the market).

[16] The study determined that the wholesale margin, which is the difference between the Platts price and the wholesale price charged in the province before transportation charges, was trending towards 6¢ per litre. As was stated in the evidence from Mr. Gardner, who was retained as an expert witness for this hearing by Board counsel:

The current \$0.06/l wholesale margin does not mean that wholesalers realize this as their actual margin. Their actual acquisition costs could be anywhere from \$0.01 to \$0.03/l above the benchmark price [New York Harbour spot price], resulting in a correspondingly lower actual wholesale margin (in the \$0.03 to \$0.05/l range). If this estimate were accurate, it would place the actual wholesale margin in roughly the same range as the effective wholesale margin defined in Regulation. But in the absence of comprehensive acquisition cost and selling price data, it is not clear how close the two are. In other words, it is not clear whether the \$0.06/l leaves wholesalers with a higher or lower margin compared with the pre-regulation circumstances.

[Exhibit G-4, p. 10]

[17] Mr. Gardner, in his opening statement, said, “. . . the present six cents per litre is not unreasonable.” Upon being asked:

Q. So we don't have any evidence other than what we have so far whether the six cents is fair or not? So this is a best guess, in a way, based on the study that was done last year.

A. That's correct. How close it is to the - - to a province-wide average, I think is - - you know, there is - - whether that's a - - you know, a half a cent, a quarter cent, you know, I don't know, I don't know, and it certainly would vary from wholesaler to wholesaler as well. So the only - - the only comfort, I suppose, is that, to my knowledge, there has been, you know, some limited expressions of outrage by the wholesale sector, so either it's comfortable or they're simply making their interventions in a less public way, but - - -

Q. Or they're being very quiet - - -

A. They're being very quiet and waiting.

[Transcript, September 19, 2006, pp. 265-266]

[18] The post-hearing submissions received by the Board from Irving Oil Marketing Limited (“Irving”), the Province of Nova Scotia - Service Nova Scotia and Municipal Relations (the “Province”), and Ultramar Limited (“Ultramar”) all accepted the 6¢ per litre wholesale margin. As was stated by Ultramar:

It is the respectful submission of Ultramar, that the wholesale margin set by the regulator should be \$0.06/L.

[Ultramar Post-Hearing Submission, p. 2]

[19] On the evidence presently before it, the Board finds that the wholesale margin of 6¢ per litre is not unreasonable.

Minimum and Maximum Retail Margins

General Retail Margins

[20] As was done for the wholesale margin, the minimum and maximum retail margins were established by the Minister, consistent with some of the conclusions appearing in the study. The minimum retail margin was established at 4¢ per litre and the maximum retail margin at 5.5¢ per litre.

[21] During the hearing, the only information submitted as to the appropriateness of these retail margins was by Mr. Gardner:

. . . At the prescribed level of four to five and a half cents a litre for regular gasoline, it approximates the average margin realized by retailers in Nova Scotia based on information in the record . . .

[Transcript, September 18, 2006, p. 29]

[22] All three post-hearing submissions accepted these margins. As Irving put it:

[Irving] believes that the lack of expressed concern at this time with respect to the wholesale margin and retail mark-up, and the record in this proceeding, suggests that at present the wholesale margin and retail mark-up have been accepted in the marketplace and are reasonable . . .

[Irving Post-Hearing Submission, p. 9]

[23] This was further supported by Ultramar:

. . . Ultramar agrees with the evidence of Mr. Gardner in his assertion that the retail margin should be in the prescribed level of \$0.040-\$0.055/L.

[Ultramar Post-Hearing Submission, p. 2]

[24] On the evidence presently before it, the Board finds that a maximum retail margin of 5.5¢ per litre and a minimum retail margin of 4¢ per litre is not unreasonable.

Full Service Margin

[25] The province has allowed a 2¢ per litre margin to be charged to the customer if “full service” is provided, i.e., if gasoline is pumped by an attendant.

[26] Mr. Gardner in his evidence stated:

The industry has operated on the basis of a \$0.02/l price difference since the early 1990s when self-serve was introduced. At the time, and given the volumes sold at the full-serve price, this price difference was accepted as adequate to cover the incremental cost of providing full-service (mainly the costs associated with hiring a dedicated pump attendant).

...

Station formats and cost structures have changed considerably since the early 1990s . . .

...

If the price differential between self- and full-serve is intended to cover incremental costs in the current operating environment, then the price differential should be revisited. A greater difference is likely to be required . . .

[Exhibit G-4, p. 14]

[27] In response to a question about the current 2¢ per litre margin, Mr. Gardner responded:

If the objective were to ensure that full-serve were widely available or more widely available than it is today, then, you know, a higher allowance could provide the basis for that, but I think the reality is that, I think, perhaps in the order of 15 to 20 percent of sales are of -- at a full-serve and 80 percent or above 80 percent of the market is now at self-serve. So, I guess the question comes down to, you know, is the demand there, and, if so, what difference or what premium should be permitted to allow a station to capture the marginal cost of providing it.

[Transcript, September 18, 2006, p. 64]

[28] In its post-hearing submission, Irving submitted as follows:

As the record reflects, full service has been rapidly disappearing, and a 2¢/l margin does not appear to be sufficient to, in and of itself, cover the additional costs of providing the service. [Irving] respectfully submits that there is no reason for there to be a cap on the additional mark-up that a retailer should be entitled for full-serve. In fact, setting such a cap may serve

only to ensure that there is a more limited access to full-serve than would be the case if retailers were able to determine on their own what the appropriate margin would be to allow them to provide this service.

[Irving Post-hearing Submission, p. 11]

[29] Under cross-examination by the Province, Mr. Gardner stated as follows:

- Q. They may choose to do that but I guess what I'm asking you is would you agree with me that the stability of prices for full-serve products will be affected if you don't use some specific markup? Whatever that markup might be.
- A. Well, if you're controlling the markup and -- or rather what you're suggesting is there's one class of service and product, one -- yeah, where you're not controlling the markup. And that markup could move and it could move independently of the broad dynamics in the market. Then by definition it's less stable, yes.

Transcript, September 18, 2006, p. 173]

[30] The Province, in its post-hearing submission, states as follows:

If any adjustment is to be made for a full-serve mark-up, the Province submits that the minimum price for full-service should be the same as the minimum retail mark-up for self-service and that there should be some prescribed cap on the upper end. In other words, if it is not 2 cents, a definite mark-up should be specified (whether that be 3 cents, 4 cents, or whatever). Without any cap at all, there is a risk that the stability of full-serve prices could be impacted . . .

[Province Post-hearing Submission, p. 15]

[31] This evidence suggests that the additional 2¢ per litre margin for full service may not be sufficient to cover the actual additional costs incurred by retailers in providing full service, and that the small size of this margin is the reason that the proportion of retailers providing full service as an option has been declining. While the Province did not actually advocate an increase in the 2¢ figure provided for full service, it did at least imply that this option was open to the Board. Irving suggested that there be no cap at all on the

additional margin which a retailer could charge for full service, arguing that any limit on it might lead to still fewer retailers providing full service.

[32] The Board, however, notes that the 2¢ difference between full service and self service which exists under the gasoline pricing regulation program adopted by the Province is the same difference which existed in the free market prior to the adoption of gasoline pricing regulation. While it was suggested to the Board that, perhaps, it was simply tradition which kept the full service margin at 2¢, even under the free market, the Board considers that there may indeed have been other factors at work.

[33] In the course of the preparation of this decision, the Board considered the possibility of recommending that the Province, in crafting any regulations conferring responsibility upon the Board, include provision for a higher margin for full service. Having reviewed all the evidence, however, the Board has concluded that there is insufficient information before it upon which to base such a recommendation. The Board infers from some of the submissions that, by providing for a higher margin for full service, it would increase the proportion of retailers providing full service, or at least slow the decline in the proportion of retailers providing such service. In the view of the Board, however, it may be that there are reasons, other than a margin which is allegedly too small, which are leading to a decline in the proportion of retailers providing full service.

[34] For the moment, the Board makes no recommendation that the full service margin be increased. Should the Cabinet, after carrying out its review of gasoline pricing regulation as a whole, determine that the program is to continue, the Board may then —

depending upon the circumstances — wish to obtain more information on the point, including possibly engaging a consultant, reviewing the matter with stakeholders, and holding some form of hearing.

Zones and Price Differentials

[35] The *Act* permits Cabinet to make regulations dividing the province into zones and prescribing wholesale and retail prices, and retail mark-ups for each zone: s. 14(1). As noted above (para. 9), the regulations adopted by Cabinet divide the province into six zones: Zone 1 (Halifax and Hants Counties as well as the southern portion of Colchester County); Zone 2 (Kings and Lunenburg Counties, and the eastern portion of Annapolis County); Zone 3 (Queens, Shelburne, Yarmouth and Digby Counties, and the western portion of Annapolis County); Zone 4 (Cumberland County, which abuts New Brunswick); Zone 5 (Guysborough, Antigonish and Pictou Counties, the northern portion of Colchester County, the Town of Port Hawkesbury, which is in Inverness County, and an area just outside the Town); and Zone 6 (Cape Breton, Victoria and Richmond Counties, and Inverness County, except for the Town of Port Hawkesbury and a small area of land near the town).

[36] Under s. 10, the Minister has the power to establish new zones. It is expected that the Board may be given this power as well.

[37] In essence, the zones established areas in which (subject to certain possible exceptions) the retail price of gasoline (and the various components which ultimately yield that price) is set pursuant to the same rules. Within a zone, a very slight variation in price

is permitted under the *Regulations* (within a range of 1.5¢ per litre) but, according to the evidence before the Board, retailers generally charge at the top end of the permitted range. The practical end result of this is that, subject to the very slight variation in price which is permitted within a zone, the price of a given grade of gasoline will be the same throughout a zone.

[38] In general, the evidence before the Board indicates a reasonable level of satisfaction upon the part of retailers and wholesalers generally with respect to the configuration of these zones. Problems, however, were pointed to in the evidence. Most, if not all, of those problems are, in the view of the Board, related to the price and cost differentials (related to transportation and delivery rates) which are applied by the *Regulations* to each zone.

[39] Thus, while Counsel for Ultramar, in his closing submissions, indicated that his client did “. . . not object to the zones as presently delineated . . . ,” he then said that his client “strongly” objected to the transportation mark-up, saying (in apparent contradiction of his first statement) that Zones 3 and 6 are “too large.” Zone 3 (Queens, Shelburne, Yarmouth, Digby Counties, and the western portion of Annapolis County) were the subject of repeated discussion during the hearing. Included within Zone 3 is Liverpool, at the eastern most end of the zone, and Yarmouth at the extreme westernmost end, with the assumed transportation costs being the same.

[40] The Board considers that many of the difficulties pointed to are fundamentally rooted in transportation costs as they relate to particular retail locations which may be far

apart (but still in the same zone), or close together (but in different zones). Part of the problem can be explained by the following hypothetical example, involving three gasoline stations (Stations A1, A2 and B1). Stations A1 and A2 are located in hypothetical Zone A, and Station B1 is located in hypothetical Zone B. Assume: that Station A1 is the station closest to the refinery, and that it is on the eastern edge of Zone A; that Station A2 is also located in Zone A, but on the western edge, i.e., on the side opposite from Station A1, at a point 100 kilometres from Station A1; that Station B1, while located in Zone B, is only one kilometre from Station A2 in Zone A.

[41] Because Stations A1 and A2 are both in Zone A, the transportation costs, and the price of gasoline charged, will be the same for Stations A1 and A2 — even though Station A1 is 100 kilometres closer to the refinery than Station A2. On the other hand, Stations A1 and B1, which are only 1 kilometre apart, will have different prices for gasoline, due to having differing levels of compensation for transportation from the refinery, even though the cost of transportation is essentially the same.

[42] Mr. Gardner's report suggested that concentric circles, with increasing radii (of, for example, 100 kilometres), and all centred on the refinery in Dartmouth, would be a more efficient way of determining zone configuration and transportation delivery rates for each zone. None of the intervenors in this matter, however, saw this suggestion as being a significant improvement. Some (including the Province) indicated that they felt it would cause confusion with respect to whether a station fell within one circle or another (as

opposed to, for example, whether a station was located in a particular county or not, a matter which would be of more general knowledge).

[43] Underlining the view that confusion as to which concentric zone a particular station was in could be a source of difficulty, Counsel for the Crown also made a point of saying that a mistake as to which zone a station was in would lead to the wrong price or cost being charged by wholesalers or retailers or both:

. . . it is important that retailers and wholesalers understand precisely where a retail location is situate, otherwise they risk charging a price in contravention of the **Act** and Regulations. Such a contravention is a summary offence, subjecting a person to the possibility of prosecution, and the possible imposition of fines upon conviction.

[Province Post-hearing Submission, p. 16]

[44] In the Board's view, the use of concentric circles, as suggested by Mr. Gardner, may avoid some inequities in how transportation costs are imposed. Nevertheless, it would not avoid the fundamental problem illustrated by the hypothetical example above. Further, it could lead to confusion in the implementation of the pricing regime, as noted by the Province.

[45] The Board considers that the evidence in the present hearing does not support a finding that a change is necessary, at present, to the zones as defined in the *Regulations*.

[46] Likewise, the Board considers that the evidence before it in the present hearing does not justify making a change to the existing transportation cost delivery rates for each zone.

Wholesalers and Retailers Servicing Remote or Rural Areas

[47] For the Board to say that the price differentials for various zones should, on the evidence before the Board, remain unchanged, at least for the moment, is not to say that exceptions should not be granted in relation to particular retailers or wholesalers for their operations in a particular zone. As the Board understood the positions of all of the intervenors, including the Province, there was general support for this.

[48] Indeed, the Board considers that the *Regulations* as presently drafted specifically contemplate just that. *Section 12(3)* of the *Regulations* allows the Minister to set different figures for wholesalers or retailers in rural areas, or near the border with New Brunswick, or, in essence, for whatever reason the Minister thinks appropriate:

s. 12(3) Despite subsections (1) and (2), the Minister may, on application by a wholesaler, wholesaler-retailer or retailer, and in order to preserve availability of a petroleum product in rural areas, to preserve the viability of markets in the provincial border areas or for another reason the Minister considers appropriate, set a different fixed wholesale price, a different retail mark-up or different minimum and maximum retail prices that the person may charge for a type of petroleum product at a particular point of sale.

[49] All of the parties, as noted, made submissions on this particular point. To illustrate, Wilson Fuels Ltd. (which was an intervenor prior to its withdrawal) said (in one of its letters of comment) that it feared that the existing retail margin could drive rural gasoline retailers “. . . out of business more quickly than the open market would.” For its wholesale operations, Wilsons referred to “remote sites” with “. . . exceptionally high distribution costs . . . Without some adjustment . . . we will have to cease supply to these remote sites . . . because [of] negative cash flow . . .” in delivering fuel to them.

[50] In its closing submission, the Province suggested that, under its gasoline pricing regulation scheme, it would be best to set a reasonable zone average, and then deal

. . . with anomalies arising from more remote locations by way of site specific applications. On a site specific application, it would be expected that the transportation costs of the wholesaler, in the zone, could be addressed on a more holistic level and adjustments made where it is demonstrated, by the evidence, that they are essential. Although some information on transportation costs in certain zones was provided by certain wholesalers to the Board in this proceeding [Exhibits G-1 and G-3], that information is not sufficient to give the Board a complete picture of the financial situation facing those wholesalers.

[Province Post-hearing Submission, p. 20]

[51] The Board agrees with this position, and would entertain applications from wholesalers who serve rural, remote and border areas.

[52] Assuming the Province confers upon the Board the same power which the Minister has under s. 12(3), the Board will be able to hear applications relating to particular wholesalers or retailers whose circumstances are (in their opinion at least) sufficiently different that they must have their own special transportation margins in order to make them financially viable.

Weekly and Bi-weekly Setting of Prices

[53] While the Board indicated at the outset of the hearing that it would generally avoid making observations in relation to policy matters embodied in the *Regulations*, the Board considers the evidence before it with respect to the advantages of setting prices every two weeks, versus setting prices every week, merits offering some observations.

[54] The *Regulations* provide that the price be set every two weeks. Moreover, Counsel for the Crown, in his closing submissions, recommended prices continue to be set every two weeks. He pointed to the “significant policy objective of stabilizing prices,” and argued that shortening the period from two weeks to one week would impede the achievement of this objective.

[55] In the view of the Board, however, the preponderance of the evidence, and the bulk of submissions (with the exception of those from Counsel for the Crown) suggest that it would be preferable to set prices once a week, rather than every two weeks. On the evidence before it, the Board considers that this is particularly so in relation to the likely effects of gasoline pricing regulation upon small rural gasoline stations and small independent wholesalers serving them — two types of businesses which the Province has indicated a particular wish to protect through gasoline pricing regulation.

[56] In its post-hearing submission, Irving said:

In this regard, with respect to the interrupter formula, it is clear from the record that concerns with the interrupter formula would be significantly resolved by a move to a weekly resetting of the benchmark price (thus adjusting the fixed wholesale price, and ultimate retail price, on a weekly rather than bi-weekly basis).

. . .

[Irving] concurs that this was the balance sought to be achieved by the interrupter formula, and as Mr. Gardner notes the interrupter formula is meant to ensure that there are not “supply disruptions” (i.e., there is not such an exceptional change that wholesalers may be forced to consider cutting off supply).

. . .

The stability being sought for the consuming public would be fully maintained in a regime with weekly price setting. [Irving] believes that the record strongly supports that the dual goals of stability and predictability (as well as the third goal of transparency, which will be discussed further below) are most appropriately achieved by weekly price setting. Current experience suggests that weekly changes have been occurring in any event, however without any measure of predictability . . .

...

[Irving] is not advocating the removal of the interrupter formula, but rather an adjustment to a weekly, rather than bi-weekly, cycle which would significantly eliminate the underlying issues, while still allowing the interrupter formula to address the exceptional issues which may still occasionally occur within the one-week periods. One week price setting would be more predictable for the consumer, as well as other market participants, as it would significantly limit the application of the interrupter formula.

[Irving Post-hearing Submissions, pp. 4, 5, 6, and 7]

Irving's post-hearing reply argument says:

... [Irving] notes that in its Closing Argument it did not argue that wholesale and retail margins should be expanded to account for this issue at this time, but rather that the move to a one-week price setting approach would significantly reduce this concern. [Irving's] suggested approach would not require a change in the wholesale and retail margins at this time ...

[Irving Post-hearing Reply Argument, p. 2]

Ultramar's post-hearing submission says:

It is our respectful submission that the forwarding averaging correction and the Interrupter formula are both the result of a flawed attempt to compensate for the error in setting the price of petroleum products on a bi-weekly basis. It is the respectful submission of Ultramar that the price of petroleum products should be set weekly.

...

It is the respectful submission of Ultramar that setting the price of petroleum products on a weekly basis will significantly diminish the requirement of the forwarding averaging correction and the Interrupter formula. ... It will allow all participants in the market, wholesalers, retailers and consumers, to know that the price of petroleum is likely to only change on a weekly basis. Stability will be available ...

[Ultramar Post-hearing Submission, pp. 5 and 6]

[57] With respect to the assertion by Counsel for the Crown that a two week period provides greater price stability, the Board notes that the 11 week period between July 1, 2006 (when gasoline pricing regulation came into force in Nova Scotia) and September 18 (when the Board's hearing commenced), contained five complete two-week

periods, in each of which the price of gasoline was supposed to remain constant. The Crown, however, applied the price interrupter three times during those five periods. The Crown suggested that the summer of 2006 was one marked by particular price volatility, but there is, in the view of the Board, no evidence before it which establishes that proposition; moreover, the veracity of that proposition was challenged by at least one of the intervenors, Ultramar.

[58] As the Board has indicated elsewhere in this decision, it is the Board's intention to adopt explicit formulae for the forward averaging correction and for the interrupter. Nevertheless, it is the view of the Board that (even if it applies clear and transparent formulae, the details of which will be made known to the industry and the public), the reality is that most members of the public will be unaware of the details of their operation, or of the current trends in the Platts price for gasoline upon which the regulated price is based. Therefore, they will be uncertain as to whether or not the interrupter is likely to be invoked in a given week.

[59] The Board notes that, on the three occasions that the Province used the interrupter formula, it did so to reduce prices. Over the long-term, however, it is just as likely that the interrupter formula will be used to increase prices as to decrease them.

[60] Submissions by Counsel for the Province suggested that, over the long-term, things will average out for wholesalers and retailers. With respect to wholesalers, he says [para. 50]:

In the long term, it is expected that bi-weekly periods of over or under recovery will offset each other and that margins actually realized by wholesalers and retailers in the Province will be close to regulated margins . . .

[Province Post-hearing Submission, p. 22]

[61] In effect, Counsel for the Province acknowledged that, under gasoline pricing regulation, wholesalers and retailers will sometimes sustain losses as a result of the Government having fixed the wholesale and retail prices when, at the same time, a sharp change in the international price of gasoline (represented for our purposes by the Platts price) occurs. He suggests that the losses which occur in the short-term will be balanced out by the same retailers and wholesalers at other times taking larger profits than would otherwise be allowed, because of a shift in the price of gasoline in the opposite direction. On the evidence before it, the Board has no reason to disbelieve this assertion, i.e., it is reasonable to assume that, over the long-term, periods of over or under recovery will balance out.

[62] However, the Board is conscious that the Government has expressed a concern about small independent retailers in rural or remote locations, as well as the smaller wholesalers who may be a principal source of gasoline for such retailers. The ability of a retailer, or of a wholesaler, to sustain a short-term “under recovery” is, in part, directly related to the size of the retailer or wholesaler. Larger organizations have larger resources, and a consequent greater ability to sustain short-term, sharp negative adjustments. Smaller businesses may lack the resources to absorb such losses. This is likely to be true not just of small independent retailers, but also of the smaller wholesalers

supplying them. Apart from the harm which may thereby be caused to such businesses, there is increased risk of a resulting supply shortage in a rural area: for example, a wholesaler could simply decide to stop delivering gasoline when the resulting losses (even if short-term) would be greater than the wholesaler was willing to sustain.

[63] In the view of the Board, the adoption of a one week, as opposed to a two week, price setting cycle is, paradoxically, more likely to achieve the Government's stated objective of greater price stability for consumers than is a two week cycle.

[64] The two week cycle is more likely to be subject to use of the interrupter, the apparently arbitrary nature of which (even if the Board uses, as it intends, specific formulae which it will make known to the public) may be troubling to consumers.

[65] Further, in the Board's judgment, a two week price cycle (with its potential use of the interrupter) is more likely to cause difficulty for small retailers or wholesalers than is a one week cycle.

[66] In summary, prices set under a one week cycle are much more likely to remain unchanged than are prices set under a two week cycle. While noting the Province's expressed wish that prices be set every two weeks, the Board recommends that the Province, prior to conferring authority upon the Board, either adopt one week as the cycle, or give the Board the authority to do so.

Forward Average Correction

[67] The *Regulations* allow for the regulator to apply a forward averaging correction if it is considered appropriate. The rationale for this correction is to adjust for the

price swings that occur over the period of setting, such that they are revenue neutral. The price setting mechanism is based on the anticipation that historical data will have similar characteristics to those of the following period. As prediction of the future and, in particular gasoline pricing, is very difficult, and often incorrect, a mechanism must be provided that will adjust the price to make all parties “whole,” insofar as may be practicable.

[68] For instance, the price on a Thursday is based on what the average Platts price has been for the previous two week period. Let us assume for illustration purposes it is set at \$1.03 per litre. Now, if the actual price drops in the succeeding two-week period to \$1.00 per litre, that means the public has paid 3¢ a litre too much, and the wholesalers have gained a windfall of 3¢. Given the volume of gasoline sold in a period, this could be a substantial amount. What the forward averaging correction does is to reimburse the public for the overcharge by reducing the price for the following period by 3¢ per litre.

[69] The alternative to a forward averaging correction is to assume that the price swings will cancel each other out. This is based on the assumption that the price swings will vary over a long period of time around one neutral average. As explained by Mr. Gardner in his evidence:

A widely held view is that, over a period of several months, the revenue gains and losses would even out, more or less . . .

[Exhibit G-4, p. 15]

[70] It is unlikely this will occur over a reasonable period of time. Consequently, a rather large offsetting correction may be required at year end. To minimize this amount and the long-term effect of such a large adjustment at year end, Mr. Gardner suggested:

. . . Frequent corrections would obviate the need for such potentially large adjustments . . .

[Exhibit G-4, p. 15]

[71] As has been suggested by Mr. Gardner:

If one of the desirable outcomes of regulation were that wholesalers would be left in a revenue-neutral position over time, then it would be pure coincidence if bi-weekly price adjustments alone achieved this result, particularly in a period of extended price increases or decreases . . .

[Exhibit G-4, p. 15]

[72] The Province agrees that this is what the forward averaging correction should accomplish, saying:

. . . [The forward averaging correction] permits the regulator to account for the difference between the benchmark price and the actual reported product price for petroleum products since the last benchmark price adjustment for that petroleum product. Pursuant to this mechanism a wholesaler may be able to recover deficiencies or repay any surpluses realized because of a variance of actual costs from regulated prices.

[Province Post-hearing Submission, p. 23]

[73] The forward averaging correction, as applied up to now, may have been perceived as somewhat arbitrary. Michel Samson (the interim leader of the Nova Scotia Liberal Party) suggested:

. . . It is simply a subjective guess as to potential activity, not an objective reflection of actual market activity . . .

[Transcript, September 19, 2006, p. 229]

[74] The concern is that, if it is not known how or when the forward averaging correction will be instituted, forward averaging simply creates one further element of unpredictability. As has been explained by Irving:

. . . Market participants simply cannot sit around waiting to see if the interrupter formula or forward-averaging will protect them . . .

. . .

. . . Issues of predictability and transparency are equally of concern with respect to the forward-averaging mechanism as with the interrupter formula.

[Irving Post-hearing Submission, p. 7]

[75] There is further support for this view from Mr. Gardner:

Some certainty with respect to the timing and extent of a forward averaging correction would facilitate management of the terms and conditions of the trade in petroleum products.

[Exhibit G-21, IR-12, p. 15]

[76] This is emphasized in the following evidence of Mr. Gardner:

Q. Mr. Gardner, I can tell you I don't know if there is a formula or if so, what it is for the forward averaging correction. I take from you that that's the same for you. If this Panel uses a forward averaging correction, should there be a formula, and if so, should it be transparent so that the public and all the industry players can see it and understand it?

A. Ideally, there would be a formula, for the reasons you give, transparency and understanding, predictability and so on . . .

[Transcript ,September 18, 2006, p. 95]

[77] The intervenors suggested that there is a potential cost that may be incurred in order to hedge the change in fuel prices and whether or not the forward averaging correction will be applied. Irving stated:

However, the record clearly indicates that such costs exist, and in particular that the hedging and financing costs are new costs created by regulation (See Wilson Fuels' Direct Evidence (converted to a Letter of Comment), Exhibit G-5, at pages 3, 4 and 6, and Wilson Fuels' Response to [Irving] IR-3).

[Irving Post-hearing Reply Argument, p. 1]

[78] Irving further submits that

. . . Service Nova Scotia's comments suggesting that the risk highlighted by Wilson Fuels is "speculative and premature" [para. 53] [Province of Nova Scotia Post-hearing Submission, p. 23], is simply not the case. The creation of a regulatory regime where the price is set and held for a two-week period in and of itself creates the exact situation described in the Wilson Fuels' evidence. Market participants now face a new risk that did not exist prior to regulation, a risk that requires a significant cost to manage.

[Irving Post-hearing Reply Argument, p. 3]

[79] In response to this, the Province has restated Mr. Gardner's evidence that

. . . a wholesaler operating in the Nova Scotia market, who was trying to minimize their costs or minimize their risks would weigh the actual performance of regulation against the cost of trying to account for it before making a decision to incur costs to guard against the claimed risks.

[Province Post-hearing Reply Argument, pp. 4-5]

[80] The Province also goes on to state that

No wholesaler has come forward in this proceeding and suggested that they have actually incurred increased costs to address the claimed risks arising from the fact of Regulation.

[Province Post-hearing Reply Argument, p. 5]

[81] These potential new costs arise from the unpredictability of when and how the forward averaging correction will be applied. As Ultramar stated:

. . . If Forward Averaging Correction is used, it is the respectful submission of Ultramar that Forward Averaging Correction must be transparent, reasonable and fair. There should be a clear and obvious formula. The Forward Averaging Correction should **not** be a discretionary remedy available for the benefit of wholesalers, retailers, or the consumer. . . To avoid either negatively impacting market participants or positively enhancing market participants to the detriment of other participants, the Forward Averaging Correction, if used at all, must be clear, transparent, fair and reasonable for all participants.

[Ultramar Post-hearing Submission, p. 7]

[82] Because it is dealing with future consumption patterns, the determination of a forward averaging correction formula may be seen to be speculative if it is not based on verifiable historical data. As has been stated by Mr. Gardner in his evidence:

. . . The difficulty, of course, is that your -- you'd be plugging in a speculative element into that formula, because it is averaging forward, so that you're looking at an unknown and anticipating what -- at what point or how long a series of price changes might last . . .

[Transcript, September 18, 2006, p. 95]

[83] Upon questioning, Mr. Gardner further goes on to reiterate that

. . . Well, I think you can make this open and transparent, but ultimately there's some judgement involved in what -- what measure is used to correct, you know, looking into the future.

[Transcript, September 19, 2006, p. 277]

[84] The Board agrees that the formula to calculate the forward averaging correction should be open, transparent and fair. It should be as predictable as possible, and known to consumers and the industry.

[85] The formula for the forward averaging correction has two components: the price differential, and a volume adjustment. Since the volume of gasoline will vary, and does vary from season to season and from period to period, the forward averaging adjustment price differential needs to be further adjusted for the anticipated change in volumes. Ideally, the adjustment will be based on the volume in the prior period (of one or two weeks) adjusted for the anticipated volume for next period. Since future events are unknown, a proxy of prior years' historical data could be used to estimate this volumetric adjustment for each one week or two week period. Verifiable historic data for regulated

gasoline by grade can be obtained from Statistics Canada. The data is gathered, and reported upon, on a monthly basis. Accordingly, the volumetric adjustment component for each period will be the prior year's monthly variation.

[86] There may be times, however, when the forward averaging correction, as described above, cannot be mechanistically applied. These could come about because of unexpected, unforeseen, unusual, or rare events (all of which are referred to hereinafter in this decision as "rare events"). The regulator needs to reserve the right to make such an adjustment. In so doing, it will notify the parties of the determination it has made and its rationale.

[87] The evidence supports the view that the forward averaging correction should be applied each time there is a price change, be that weekly or bi-weekly. The intervenors did not offer any evidence to support their contention that a weekly setting would obviate the need for such an adjustment.

[88] If the Board is given the authority to regulate this component of product pricing, it will apply the forward averaging correction each time the prices are set. The forward averaging correction would be calculated, except when responding to rare events, as outlined above.

[89] The Board considers that experience with actually applying this formula may lead the Board to conclude that the formula should be adjusted. The Board recommends that it be given authority to adjust the forward averaging correction formula (and the

interrupter formula as well, which is discussed elsewhere). No such adjustments would take effect without prior notice to consumers and the industry by the Board.

The Interrupter

[90] By way of clarification, the Board notes that most of the following section regarding the use of an “interrupter” relates to its use if prices are set every two weeks, rather than every week. Elsewhere in this decision, the Board recommends that prices be set weekly. The various details and complexities involving an interrupter which the Board explores in this section are, in essence, only relevant when prices are set every two weeks. If prices are set weekly, the Board intends that it would use the interrupter only on the occasion of rare events that cause rapid price fluctuations which might ensue, for example, in the wake of a hurricane damaging an oil field, such as Hurricane Katrina.

[91] The *Regulations* do not specify any parameters for an interrupter; however, s. 14(6) of the *Regulations* provide the Minister with the authority to prescribe a benchmark price at any time. One purpose of doing so is to prevent disruption in the supply of gasoline, in the circumstances described by Mr. Gardner:

A supply interruption could occur if a sharp rise in the acquisition cost of petroleum products were not reflected in an immediate and commensurate rise in the benchmark price . . .

[Exhibit G-4, p. 16]

[92] The interrupter also protects the consumers as again stated by Mr. Gardner:

Wholesalers could earn windfall gains if a sharp drop in the acquisition cost of petroleum were not reflected in an immediate and commensurate drop in the benchmark price . . .

[Exhibit G-4, p. 16]

[93] Mr. Gardner then goes on to describe the factors which should be considered when designing such a formula. In particular:

An interrupter formula is designed specifically to accommodate market volatility. By volatility is meant the combined effect of the size of unpredictability of price swings . . .

. . .

The longer the period between benchmark price adjustments, the stronger the case for an interrupter . . .

. . .

The need for an interrupter diminishes the more frequent and lower the price swings . . .

. . .

The size and duration of the price swing needed to trigger a price interruption is key to the relevance of the interruption formula. The interrupter should be triggered only in circumstances where a price swing is substantial and likely to be prolonged — a swing that could result in supply disruption . . .

[Exhibit G-4, pp. 16-17]

[94] The same arguments which have been made for the forward averaging correction as to fairness, transparency and openness (i.e., predictability) are equally applicable to the interrupter. Mr. Gardner confirmed that predictability and transparency are important:

Q. And you've acknowledged in your IR responses -- and again I think you might have said it again today in your opening statement -- that predictability is particularly important in the petroleum market and business due to its many sources of volatility and uncertainty, correct?

A. That's correct.

Q. And transparency as well as predictability is important in order to have an effective regulatory regime, correct?

A. Yes.

[Transcript, September 18, 2006, p. 75]

[95] The frustration of unpredictability is described as follows in the post-hearing submission of Irving:

. . . One would now have to have a crystal ball to determine whether or not the interrupter formula or forward-averaging would be used in any two-week period.

[Irving Post-hearing Submission, p. 6]

[96] In its post-hearing submission, Ultramar commented on the complexity of these formulae:

. . . difficult and complex Forward Averaging Correction formulas and Interrupter formulas must be utilized, with significant margin of errors, to try and compensate for bi-weekly price setting.

[Ultramar Post-hearing Submission, p. 6]

[97] These unknowns create greater risk in the industry. Risk has a cost. As Counsel for Irving stated:

Simply put, market participants must be actively managing this new risk on a regular basis. In a regulatory regime with significant elements of discretion and lacking full transparency market participants would be remiss if they did not manage the risks the new regime has brought to their business.

[Irving Post-hearing Reply Argument, p. 3]

[98] Counsel for Ultramar stated:

The Forward Averaging Correction Formula and Interrupter Formula should be transparent and fair to all participants in the industry . . .

[Ultramar Post-hearing Submission, p. 8]

[99] The Minister appears to, in general, use two parameters to determine when to interrupt the present two week price setting: the size of the price change and the rate of change. Of those two parameters, the one which received the most attention in the evidence was the size of the price change. As stated by Mr. Gardner:

"The formula currently in place seems reasonable. The trigger price of \$0.04/l would appear to achieve a balance between avoiding supply disruptions and making adjustments too frequently."

[Exhibit G-4, p. 17]

[100] The trigger amount (currently reported to be 4¢) was explored in questioning from Counsel for the Crown of Mr. Gardner:

... A price change is automatically triggered if price rises or falls by an average of \$0.04/l or more over a five-day period. The adjusted price would stay in effect until the next programmed benchmark adjustment, when the price would change to that resulting from the prescribed benchmark adjustment formula.

[Exhibit G-4, p. 17]

[101] As has already been stated, the Minister has used the interrupter three times in the five bi-weekly settings which had occurred before the hearing. Counsel for Ultramar questioned Mr. Gardner as follows:

Q. Do you have any comments or opinions to offer to the Panel on the selection of four cents (\$0.04) for the interruptor [sic] formula in Nova Scotia?

A. It will be triggered less frequently.

...

Q. So, at four cents (\$0.04) -- at the four cents (\$0.04) triggering, there's more opportunity for consumers to pay too much, or wholesalers to lose too much?

A. Well, too much or -- is a kind of a value laden observation or quantum, but they would be, by point five cents (\$0.05) out or gaining, relative to four cents (\$0.04), yes.

Q. If you were setting the trigger to the interruptor [sic] formula, what would you set it at?

A. Well, that's a hypothetical question, but I expect I would set it in the three to -- and a half of four cent (\$0.03-1/2 - \$0.04) range. Now, where exactly, I don't know . . . Whether that's at three and a half or four or even four and a half cents (\$0.04-1/2), it would be a question of judgment.

[Transcript, September 18, 2006, pp. 91-92]

[102] Under further questioning by Mr. McGrath:

Q. And have you done any sensitivity analysis around the use of a 3.5 cent or 4 cent figure for the interrupter mechanism?

A. Well, it -- in response to one of the questions, one of the IR's I did go back and array the relationship of the Halifax rack price and the New York Harbour price just to see how frequently that relationship or how many times the New York Harbour price might have jumped sufficiently to trigger it. But did I do a sensitivity analysis where I tried three cents, four cents, five cents, six cents, no. Strictly speaking I was looking for the four cent variation rather than the sensitivity analysis.

Q. And if I recall your evidence correctly you thought that the four cent figure did strike an appropriate balance?

A. Yeah, that's a question of judgment . . .

[Transcript September 18, 2006, pp. 164-165]

Ultramar disagreed with the setting of the interrupter trigger at 4¢, and suggested a trigger of 3¢ so as to reduce the requirement of either wholesalers bearing a loss of 3.9¢ per litre for up to two weeks, or consumers paying 3.9¢ more for the same period. It believes that a

“ . . . trigger of three cents will significantly reduce these unwanted outcomes.”

[Ultramar Post-hearing Submission, p. 7]

[103] Irving, in both its post-hearing submissions, has stated that it supports the 4¢ interrupter trigger.

[104] The Province also supports the 4¢ trigger amount in its post-hearing submission, but further states:

Experience over a longer term may be more useful in more precisely defining a trigger that balances the need to provide a cap on the extent to which actual prices can vary from controlled prices under regulation and reducing consumer volatility.

[Province Post-hearing Submission, p. 26]

[105] If the Province decides to continue with its existing policy of having prices set every two weeks (as opposed to the Board's recommendation of setting prices once a week), the Board would use a trigger of 4¢ to interrupt the routine cycle of setting gasoline prices.

[106] The Board agrees that the discretion to use the interrupter should be defined in as clear and precise terms as possible.

[107] The Minister is empowered to adjust prices if a rare event occurs without reference to a fixed trigger amount. As has been stated by the Province:

... in worst case scenarios, such as Hurricane Katrina, the regulator has the ability to change the regulated price on a daily basis.

[Province Post-hearing Submission, p. 23]

The Board believes that it, upon becoming the regulator, should also be able to reserve the right to alter the price upon the occurrence of a rare event. In so doing, it will notify the parties that it has done so, and state its rationale.

[108] The Board considers that experience with actually applying the interrupter (if the Province decides to stay with a two week price cycle) may lead the Board to conclude

that it should be adjusted. It would be the Board's intention that it would do so only after prior notice.

The Effect of Promotions in a Regulated Market

[109] The *Regulations* contain a reference to restriction on promotions, but one which contains exceptions, and which is further, in the Board's judgment, ambiguous. The Board considers that the evidence and submissions it has with respect to the scope of these exceptions were limited and conflicting. The Board also considers that the Crown provided practically no information as to its intentions with respect to which types of promotions it actually wants to permit and those which it wants to prohibit.

[110] It is the Board's understanding that the task of enforcement (including enforcement relating to alleged breaches of the promotions provisions) will nevertheless remain the sole responsibility of the Province. Given this, and given the limited nature of the submissions and evidence before it on the point, the Board makes no observations whatever in relation to this topic.

Appropriate Notification Processes

[111] Presently, the Province, for its bi-weekly setting of petroleum products prices, notifies all wholesalers, *via* a secure website, by 9:00 a.m. Wednesday. The general public is notified of the price change at 12:01 a.m. Thursday. This gives wholesalers 15 hours notice of a price change, so they can make whatever suitable arrangements and

notifications they must do for their retailers. It is presumed that the same advanced period of 15 hours is used if the interrupter formula is invoked.

[112] No evidence was submitted in the pre-filed evidence, or in the hearing, or in post-hearing submissions, to suggest that this notification period was inappropriate. The only comments received were in support of the present process for notification.

[113] The Board agrees that the notification period should allow for an adequate lead time to wholesalers before the prices come into effect. Nevertheless — taking into account the time which the Board may need to do final checks on prices, as well as consideration of any special factors which may be relevant, and any resulting calculations — the Board believes that a 15 hour lead time might sometimes compromise its ability to consider the most recently available data and to make an informed decision, and that a lead time of 14 hours would be preferable. This means that for the regular setting of the prices on Thursday (whether every week or second week), the wholesalers would be notified, *via* secure website, by 10:00 a.m. Wednesday and the general public would be notified at 12:01 a.m. Thursday. The Board notes that a lead time of 14 hours mirrors that used in New Brunswick, and is only a minor deviation from current practice.

IV OTHER MATTERS

Obtaining Additional Data

[114] Mr. Gardner pointed to certain areas in which additional detailed information might be gathered through a study, which might be useful with respect to the regulation of

the price of gasoline. The evidence is clear that the data currently before the Board is limited on a number of points. Moreover, the evidence is also clear that additional data could be gathered in relation to those points. On the question whether such data should be gathered, however, the Board considers that the bulk of the evidence does not support the large-scale gathering of such information, at least at the present time. The Board interpreted the evidence as a whole (including that of Mr. Gardner) as indicating that there is no practical need to gather such information at the present time.

[115] The Board considers that there are a number of reasons for this. First, to engage a consultant to gather information on all the various points discussed before the Board would involve a significant amount of time, and a not insignificant sum of money. That sum would ultimately be paid for by consumers, in the price differential which is appended to the cost of gasoline in order to support its continued price regulation.

[116] Secondly, a cost which, under gasoline pricing regulation, is imposed upon consumers (through the price differential just referred to) is not the only cost which the gathering of such information would impose. The Board concludes from the evidence before it that there would also be significant costs (although they may be in large part hidden) imposed upon refiners, wholesalers, and retailers (independent and otherwise), which would be required to supply information.

[117] The required information may be difficult for them to supply, or information they are reluctant to disclose. Additionally, the information sought may be information which refiners, wholesalers, or retailers do not ordinarily retain for their own use. They

would then be required to review their accounts and other files, to find it. Alternatively, the information sought may be information which the refiners, wholesalers, or retailers have, but which they would be required to convert into a different format in order for it to be useful to the consultant.

[118] With respect to the latter category, the information being sought may be information which they regard as “proprietary,” i.e., information which they have developed, and upon which they rely to give them a competitive advantage — an advantage which they may, rightly or wrongly, consider would be lost if that information is disclosed to the Board, and either directly or indirectly referred to by the Board in a decision.

[119] Mr. Gardner himself considered that the cost (both for consulting, and that absorbed by the industry in responding to requests for information) to obtain and analyze information on the various points would be disproportionately greater than any benefit which would likely be obtained.

[120] Finally, the Board notes that Cabinet has stated as its policy an intention to review the entire program of gasoline pricing regulation, beginning in January, 2007. For the Board to recommend spending significant sums on additional study and data collection and to impose upon those in the industry whatever costs (as described) they might incur in providing the information, when the underlying policy rationale for the program as a whole may be under consideration, seems to the Board to be inappropriate.

Individual Product Pricing

[121] The *Regulations* require that the Minister must prescribe a benchmark price for “each type of petroleum product.” These are defined in Schedule “A” of the *Regulations* as follows:

s. 2(1) The following types of petroleum products are subject to these regulations:

- (a) gasoline;
- (b) low sulfur diesel oil;
- (c) ultra low sulfur diesel oil.

[122] While the Board is aware that the supply of low sulfur diesel oil is being phased out in North America, there is still some available. Hence, it will still need to be priced until that product is no longer available at the retail outlets.

[123] At present, unleaded gasoline has three grades, namely regular (octane 87); mid-grade (octane 89); and premium (octane 91). The Platts Report includes the prices for not only regular gasoline, but also for the other two grades.

[124] The Minister, in regulating the price of gasoline, disregards the Platts prices for all grades of gasoline except regular. Instead, the Minister has chosen to apply what he has deemed to be the “historical differences” in determining the price of the other two grades of gasoline. Thus, the Minister, in regulating the gasoline prices, starts with the price of regular gasoline based on the Platts price, and then adds a 3¢ premium to the regular gasoline price to determine the mid-grade price and a further 6¢ upon the regular gasoline price to determine the premium gasoline price. An analysis of the Platts price for the month of September shows that the differential between regular and premium gasoline

varied from less than 2¢ a litre to more than 6¢ a litre. This could indicate that the “historical differentials” may not be appropriate in a regulated gasoline market.

[125] This product pricing differential was not identified as an issue in this hearing, nor were any evidence or comments solicited for it. Accordingly, at this time, the Board will not make any finding concerning the price differentials used by the Minister. Instead, the Board will monitor this differential and may, or may not, depending on the circumstances, invite submissions on this issue at a future date.

Transition Issues

[126] Assuming the Board is authorized to regulate the price of petroleum products as of November 1, 2006, there could be some variations between the procedures employed by the Minister and the procedures to be employed by the Board. In particular, the Board intends to apply established open and transparent formulae to the forward averaging correction and to the interrupter if the Province chooses to stay with the two week cycle. As the Board has noted elsewhere in this decision, if a one week cycle is adopted, the Board intends that, while it will still be possible for it to interrupt the price in the course of a week, this will rarely occur (in, for example, a Hurricane Katrina type catastrophe).

[127] In its first regular price setting, assumed to be on November 2, 2006 (assuming the appropriate regulations have been put in place prior to November 2, 2006), the Board will notify the wholesalers on its own secure website at 10:00 a.m. Wednesday, November 1. The public will be notified *via* the Board’s website at 12:01 a.m. Thursday, November 2.

[128] In performing its conversion calculations from US gallons to litres, the Board will use a slightly different conversion factor than the one used by the Province, at least in some of its calculations. The Province used 3.788408 litres per US gallon. The number commonly used in the industry is 3.7854118, which is the result when one converts directly from US gallons into litres. The number used by the Province appears to have resulted from two factors: first, the Province converted from US gallons to Imperial gallons, and then converted to litres; second, in carrying out the two conversions, the Province used formulae which were limited in the number of decimal places. The result is that the computation is off by 0.1¢ per litre. While this is a small per unit difference, the Board estimates that it grosses up to around \$40,000 per month for gasoline sold in the province.

V CLOSING SUMMARY

[129] While the Government has announced that the Board will take over administration of gasoline pricing regulation on November 1, 2006, no legislation exists at present which confers upon the Board the authority to regulate the price of gasoline as of that date. To confer authority upon the Board, it will be necessary for Cabinet to make new regulations.

[130] Accordingly, this decision can be seen as a series of recommendations, mainly relating to those regulations. The decision also sets out how the Board would proceed upon receiving the appropriate legislative authority.

[131] The Board recommends to Cabinet that it adopt regulations consistent with the positions explored in this decision, and summarized in the Introduction [para. 8].

DATED at Halifax, Nova Scotia, this 16th day of October, 2006.

Wayne D. Cochrane

Murray E. Doehler

John A. Morash

APPENDIX “A”

Gasoline Pricing Formulae

$\sum P_{av_k}$	=	The average Platts price of regular gasoline for the period “k”
WM	=	Wholesale Margin = \$0.06/litre
RM _{min}	=	Minimum Retail Margin = \$0.04/litre
RM _{max}	=	Maximum Retail Margin = \$0.055/litre
T _x	=	Appropriate taxes
HST	=	Health & Service Tax
T	=	Transportation adjustment
V _{av}	=	Forward averaging correction
WGP _{k+1}	=	Wholesale Gasoline Price for the subsequent period “k+1”
RGP _{k+1}	=	Retail Gasoline Price for the subsequent period “k+1”

WGP _{k+1}	=	$\sum_k P_{av} + WM + T_x + T + V_{av}$
	=	$\sum P_{av_k} + 0.06 + T_x + [0.3 \text{ to } 2.0] + V_{av}$
RGP _{min_k+1}	=	WGP _{k+1} + RM _{min} + HST
	=	WGP _{k+1} + 0.04 + HST
RGP _{max_k+1}	=	WGP _{k+1} + RM _{max} + HST
	=	WGP _{k+1} + 0.055 + HST

The above formulae do not include the allowed 2¢ per litre more for those who offer full service at their pumps.