New Brunswick Energy & Utilities Board
IN THE MATTER OF a review of the maximum margins, maximum delivery costs and the maximum full service charge conducted under the authority of Section 14(1) of the Petroleum Products Pricing Act (S.N.B. Chapter P-8.05)

Held at the Delta Hotel, Fredericton, N.B., on October 6th, 2008

Henneberry Reporting Service

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Undertakings

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Held at the Delta Hotel, Fredericton, N.B., on October 6th, 7th 2008

BEFORE: Raymond Gorman, Q.C. - Chairman
Cyril Johnston - Vice-Chairman
Edward McLean - Member
Robert Radford - Member
Steve Toner - Member

N.B. Energy and Utilities Board - Counsel - Ms. Ellen Desmond
- Staff - Doug Goss
- Dave Keenan
- Dave Young

Secretary of the Board - Ms. Lorraine Légère

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CHAIRMAN: Good morning everyone. Today's hearing of the EUB is being conducted in order to review the maximum margins, maximum delivery costs and the maximum full service charge currently authorized under the Petroleum Products Pricing Act to ensure that they are justified. This review is being conducted under Section 14 of the PPPA.

Today's Panel consists of Robert Radford, Edward McLean, Steve Toner, Cyril Johnston and myself, Raymond Gorman.

You may have noticed when you come in that simultaneous translation devices are available throughout the proceedings. These listening devices are available at the back of the room in order to allow everyone to hear the presentation in either English or French.

Accordingly, I would encourage everyone present today to participate in the official language of their choice.

At this time I am going to ask the Vice-Chair, Cyril Johnston to deliver the same message in the other official language.

VICE-CHAIRMAN: Bonjour tout l'monde et eh bienvenue à cette audience de la Commission de L'Énergie et des Services Publics N.-B.

Eh, cette audience est dans l'affaire d'une révision des marges bénéficiaires maximales des placements des coûts de livraisons et des plafonds des frais de services complets.

Eh, selon la loi sur la fixation des prix des produits pétroliers. Comme le président vient de dire en anglais, nous avons la traduction simultanée ici aujourd'hui et ça va continuer durant toute l'audience. Alors, eh, nous sommes eh prêts eh à attendre des soumissions dans les deux langues officielles et nous vous encourageons de, de participer dans la langue de votre choix.

Nous prévoyons avoir deux témoins, Monsieur Gardner et Monsieur Irvine. Ces deux témoins ont présenté des rapports qui sont disponibles en anglais et en français sur notre site web et peut-être ici dans la salle, je l'sais pas.

Eh, ces témoins vont témoigner dans la langue anglaise mais vous avez certainement la droit, le droit de, de poser vos questions dans la langue officielle de votre choix. Merci.

CHAIRMAN: At this time I'm going to take the appearances. And I believe we have 24 Intervenors who have pre-registered. So I'm going to go through the list of Intervenors and ask the parties to identify themselves as to who they are as representing each party.

And as well perhaps if you could identify for me where you are sitting. Some of the people that are participating today may not be people that have appeared before the Board in the past. So I may not recognize you. So when it is your turn, if you could stick your hand up so the court reporter and I could locate you.

And also to benefit the court reporter I would ask that you spell your full name when you identify yourself. So these are listed alphabetically. These are the Intervenors who have pre-registered.

Accommodation Victoria Enr. et Les Immeubles ROBO. Anybody present?

And could I ask you to say your name and spell it please?

MR. BOSSE: Benoit Bossé.

VICE-CHAIRMAN: Oui, juste à côté-là.

MR. BOSSE : Mon nom est Benoit Bossé. Je représente eh Accommodation Victoria Enr. Et Les Immeubles ROBO Ltée. d'Edmundston, Nouveau-Brunswick. My name is Benoit Bossé. I represent Accommodation Victoria Enr. et Les Immeubles ROBO Ltee., Edmundston, New Brunswick.

CHAIRMAN: Okay. And I'm going to check with each of the Intervenors at this point as well as to whether or not you will be cross examining the witnesses or making presentation or both.

MR. BOSSE: À ce stage ici, je n'suis pas prêts à faire une présentation et j'suis pas familier tellement à la façon que vous allez procéder donc eh j'aimerais me familiariser un peu plus avant de faire un « inaudible » de faire la présentation.

CHAIRMAN: Thank you. Canadian Federation of Independent Business? Nobody here.

Okay. I do believe they filed a written submission. It was my belief that they would probably be here. So we will see. Perhaps they may show up later.

Canadian Independent Petroleum Marketers Association?

MS. SAVAGE: My name is Jane Savage, President of Canadian Independent Petroleum Marketers Association. And I will be making a presentation here today.

CHAIRMAN: And will you be doing any cross examining?

MS. SAVAGE: No.

CHAIRMAN: Thank you.

MS. SAVAGE: Thank you.

CHAIRMAN: Canadian Oil Heat Association and Canadian Oil Heat Association/Clark Oil?

MR. GOULD: William Gould, Canadian Oil Heat Association. And I would like to make a short presentation.

CHAIRMAN: Thank you, Mr. Gould.

MR. CLARK: Peter Clark, Canadian Oil Heat Association. And I will be making a presentation.

CHAIRMAN: Thank you. Cooke's Quik Mart? Nobody here. Co-op Atlantic?

MR. ZED: Yes, Mr. Chairman. Peter Zed representing Co-op Atlantic. And I'm joined by Stephen Davies, V-P Real Estate and Energy Division and Mr. Daniel Chaisson, the Director of Wholesale and Development.

CHAIRMAN: Mr. Zed, will you be both cross examining and making a presentation?

MR. ZED: Yes.

CHAIRMAN: Thank you. Department of Energy?

MR. P. ERVIN: Patrick Ervin of the Department of Energy. With me are Alain Bilodeau with the Department of Energy and Michael Ervin, President of M.J. Ervin & Associates.

CHAIRMAN: And Mr. Ervin, you will be both cross examining and making a presentation?

MR. P. ERVIN: We would like to reserve that option, yes, Mr. Chairman.

CHAIRMAN: Thank you. Everett's Car Care? Nobody here. Oh, sorry. I guess if we had a few more microphones it might be easier. But I guess we will have to share.

MR. M. EVERETT: Mr. Matthew Everett. Just to observe.

CHAIRMAN: Mr. Everett, will you be cross examining or making a presentation or both?

MR. M. EVERETT: No.

CHAIRMAN: You will be making neither? You don't wish to make a presentation?

MR. M. EVERETT: No.

CHAIRMAN: Thank you. Gabriel Hache Ltee.? Anybody here from Gabriel Hache Ltee.? Global Fuels Inc.?

MR. MADDOCK: Gary Maddock, Vice-president, Global Fuels Inc. and Guy Gaudet, Territory Manager for Global Fuels Inc. will neither be making a presentation or cross examining.

CHAIRMAN: Thank you, Mr. Maddock. Greenwood Enterprises

Ltd.? Nobody here from Greenwood Enterprises Ltd. Hunter's One Stop? No one here?

MR. HUNTER: Eldon Hunter from Hunter's One Stop. I will making a brief presentation.

CHAIRMAN: Thank you, Mr. Hunter. Irving Oil Marketing Limited?

MR. HOYT: Len Hoyt for Irving Oil Marketing Limited. I'm joined by Matt Holland who is the Petroleum Manager for Irving Oil Marketing Limited.

CHAIRMAN: Mr. Hoyt, will you be both cross examining and making a presentation?

MR. HOYT: Yes, we will.

CHAIRMAN: Thank you. Magnetic Hill Esso? Nobody here from Magnetic Hill Esso? Michaud Petroleum Inc.?

MR. MICHAUD: Hermel Michaud, Michaud Petroleum. I will just appear for observation.

CHAIRMAN: Thank you, Mr. Michaud. Murray's Esso?

MR. GRANT: You can probably hear me.

CHAIRMAN: Well, I think for purposes of the court reporter we would ask you to speak into the microphone anyway.

MR. GRANT: Not a problem. Calvin Grant from Murray's Esso. We will be here for observation but would like to reserve the right to cross examine.

CHAIRMAN: Thank you, Mr. Grant. Notre-Dame Express? No one here from Notre-Dame Express? Richard Service Station and Richibucto Corner Store Ltd.?

MR. G. RICHARD: Gabriel Richard, Richard Service Station and Richibucto Corner Store. We will have a little presentation to be done.

CHAIRMAN: Thank you, Mr. Richard. Salisbury Road Gas and Convenience?

MR. NICHOLSON: My name is Ted Nicholson. I'm here representing some independent dealers from Moncton. I will be here as an observer. But I would reserve the right to cross examine.

CHAIRMAN: Thank you, Mr. Nicholson. Scholten's Group?

MR. C. SCHOLTEN: I'm Chris Scholten representing the Scholten's Group. And I'm here joined with Jerry Scholten as well. We will not be making a presentation. But we reserve the right to cross examine.

CHAIRMAN: Thank you, Mr. Scholten. Ultramar Ltd.?

MR. MAYNARD: I'm Warren Maynard from Ultramar Ltd. We will not be making a presentation. However, we would like to reserve the right to cross examine.

CHAIRMAN: Thank you, Mr. Maynard. Voice of Real Poverty Inc. I understand from Board Staff that Bethany Thorne-Dykstra has contacted Board Staff to indicate that she will be in attendance at a later time today or tomorrow.

Westmount Esso & Service Center 1992 Ltd.?

MR. ROY: My name is Ronald Roy. I'm representing Westmount Esso. And I'm just here to observe.

CHAIRMAN: Thank you, Mr. Roy. XTR Energy Company Limited?

MR. WOOTTON: Ken Wootton of XTR Energy Company Limited. Will not be making a presentation but would like to cross examine.

CHAIRMAN: Thank you, Mr. Wootton. New Brunswick Energy and Utilities Board?

MS. DESMOND: Ellen Desmond, Mr. Chair and from Board Staff, Douglas Goss, David Keenan and Dave Young.

CHAIRMAN: Thank you, Ms. Desmond.

I appreciate that many of the persons present today have never appeared before the EUB. And therefore before hearing from witnesses I'm going to take a moment to explain the purpose of today's hearing and the procedure that we are going to follow.

The New Brunswick Energy and Utilities Board is the body responsible for setting maximum wholesale and retail prices for heating and motor fuels within the province of New Brunswick.

The Board has initiated a review of the maximum margins, maximum delivery costs and maximum full service charges currently authorized under the PPPA to ensure that they are justified. The PPPA gives that jurisdiction to the Board under Section 14.

The Energy and Utilities Board Act specifically gives the Board the ability to engage the services of experts or other persons to advise it in any matter that the Board considers appropriate.

To assist with this review the Board engaged the services of Gardner Pinfold Consulting Economists Limited to provide the Board with an analysis of the New Brunswick petroleum market since the setting of the margins, delivery costs and full service charges in 2006.

In particular the review was to provide the Board with the basis for determining whether the current amounts for the margins and costs were justified, and if not if they should be adjusted.

The objectives of this engagement were to carry out an analysis of the heating and motor fuel wholesale and retail margins, maximum delivery costs and the full service charge for motor fuel, to produce a report drawing on industry data to document whether the amounts are justified or not with reasons and to provide guidance to the Board on the justification of various factors as set out in the Act.

Gardner Pinfold has filed its report to the Board.

And the report has been published in both official languages on the Board website. The report represents the recommendations of the consultant and not the opinions of the Board. It is subject to cross examination and argument by the parties and is not intended to establish the margins referred to under the Act. That is the function of this Board throughout the hearing process.

With respect to procedure the Board outlined the process to be used in connection with this review which provided an opportunity to registered participants to submit written questions, provide evidence and/or provide written submissions.

The only party to file evidence with the Board was the Department of Energy which filed a report prepared by M.J. Ervin & Associates. All parties were also given an opportunity to submit questions to the author of that report.

In addition to the above, Intervenors were given a choice to submit their remarks in writing prior to the hearing or to participate in the hearing occurring here in Fredericton over the next three days.

For those who have indicated that they wish to participate as full participants in the hearing, the following procedure is going to apply.

First, Michael Gardner of Gardner Pinfold will be made available for cross examination with respect to the report that he filed with the Board. The parties will proceed in alphabetical order with cross examination with the exception of Board Counsel who will proceed last in order to complete the record.

Michael Ervin of M.J. Ervin & Associates will be subject to direct examination by the party that filed the report, namely the Department of Energy. Following direct examination he will be made available for cross examination. And the same order of proceeding will apply.

Following the evidentiary portion of the hearing, each of the parties will be given an opportunity to make a closing argument to the Board whether or not they participated in the oral questioning of the witnesses. The same order of proceeding will be used with the exception of Board Counsel who will not make submissions as to what the outcome of these proceedings should be.

Does anybody have any questions or issues with respect to the process or procedure that we are going to follow today?

I think at this time then we can mark some exhibits. There are a number of documents that have been prefiled. And we are going to mark them as exhibits at this time.

The first document was the publication of the Notice and Hearing. And that is going to become exhibit number 1.

The next document was the report prepared by Gardner Pinfold entitled "Review of Regulated Fuel Margins, Costs and Full Service Charges in New Brunswick" dated August 22nd 2008. And that will become exhibit number 2.

Thirdly, we have questions posed to Gardner Pinfold dated September 3rd 2008 in connection with the August 22nd 2008 report from the following participants. Number 1) Co-op Atlantic; 2) New Brunswick Department of Energy; 3) Irving Oil Marketing Limited; 4) the New Brunswick Energy and Utilities Board and 5) Scholten's Convenience Stores. Those questions will become exhibit number 3.

The next exhibit are the responses of Gardner Pinfold dated September the 10th 2008 including the statement of W. Stephen Cannon to questions from Co-op Atlantic, the New Brunswick Department of Energy, Irving Oil Marketing Limited, the New Brunswick Energy and Utilities Board and Scholten's Convenience Stores. And that document will become exhibit number 4.

The next document is a report from Gardner Pinfold entitled "Review of Regulated Fuel Margins, Costs and Full Service Charges in New Brunswick, Addendum re Propane" dated September 10th 2008. And that will be marked as exhibit number 5.

The next document is M.J. Ervin & Associates Project Report dated September the 15th 2008 submitted under cover dated September 17th 2008 from Alain Bilodeau of N.B. Department of Energy. That will be exhibit number 6.

And the next document are the responses of M. J. Ervin & Associates to questions from the NBEUB submitted under cover of e-mail dated September 29th 2008 from Alain Bilodeau of the New Brunswick Department of Energy. And that will become exhibit number 7.

Those are all of the documents that the Board has to mark as exhibits at this time. Does anybody have any other documents that they believe should be marked?

Ms. Desmond, does that complete the record as far as you are concerned?

MS. DESMOND: Yes, Mr. Chair.

CHAIRMAN: Thank you. Does anybody have any preliminary matters or questions or issues to raise prior to us bringing Mr. Gardner forward for cross examination?

MR. P. ERVIN: Just one item, Mr. Chairman. Mr. Ervin is here for today and tomorrow. I discussed this with Board Staff previously. And he has a flight out on Wednesday morning from Saint John.

So I'm hopeful that we can get his portion completed by today or tomorrow and just wanted to make that clear at the outset.

CHAIRMAN: Okay. Well one way or another we will do our best to accommodate that request, Mr. Ervin.

All right. My understanding is that Mr. Gardner is not present yet but will be here shortly. So we are going to take a short adjournment. And I would expect that we should be able to reconvene about 10:30. Ms. Desmond, does that sound about right?

MS. DESMOND: Yes.

CHAIRMAN: Okay. So we will take an adjournment till 10:30.

(Recess - 10:00 a.m. - 10:30 a.m.)

CHAIRMAN: Good morning, Mr. Gardner.

MR. GARDNER: Good morning.

CHAIRMAN: We now have Mr. Gardner available for cross examination by the parties. But prior to cross examination we will ask Mr. Gardner to identify himself for the record. And if you wish to make any introductory comments, this would be the time to do that.

And Ms. Desmond, perhaps you might come forward and we will swear him in.

(Michael Gardner sworn)

CHAIRMAN: Mr. Gardner has been sworn. And so if you have an opening statement or anything of that nature, Mr. Gardner, this would be the time.

MR. GARDNER: Thank you. First I would like to apologize for arriving late. I had an opportunity to see some of the New Brunswick countryside. But it was inadvertent. So I apologize for the time that I have taken. And I will try to compensate by keeping my answers short.

Opening remarks, in brief the gasoline marketing end of the industry in Canada generally has faced rising costs, as has much of the rest of the economy over the past few years.

The effect in the case of the marketing branch of petroleums has been to reduce the net margins available through the industry with which to operate. And as a consequence this has tended to undermine the viability of this sector.

So the report examines a number of these cost factors and concludes that some adjustments to the margins and costs is justified. And these are summarized. I won't go into that detail at this point.

In reaching this conclusion or these conclusions we relied on a variety of sources of information. We had hoped to base our analysis and conclusions on industry data. We had engaged in extensive interviews with the major integrated refiner marketers, the wholesaling companies, with smaller wholesalers, resellers of both gasoline and heating oil, heating oil retailers. And as well we surveyed over 400 retail gasoline outlets in the province and conducted interviews with just under 30 of those to round out our information base.

Regrettably, the quality of the information that we obtained didn't allow us to generate results based exclusively on industry data. The results I think, and it is fair to say, would not I guess pass a test of statistical significance.

So we have relied or we tended to rely more heavily on published information and some of the data that was provided by the industry, which is admittedly in an anecdotal form.

The legislation asks I guess the Board to look at several factors, several relevant factors including transportation, capital costs, volumes, inventory turnover, levies and other factors.

And the other factors that the Board is invited to examine are not expressed in any detail. So it was left up to the consultant in this case to determine or try to determine what those other factors, those other relevant factors may have been.

And we did examine those and concluded that there were a couple of factors that were certainly key to the industry, again based largely on information provided by the industry. And these formed the basis for the adjustments that are laid out in the report.

I would conclude by observing that in the unregulated parts of Canada prices and the marketing margin has increased relative to those in New Brunswick and in the other regulated provinces in Atlantic Canada.

So the adjustments that are laid out in the report are not simply based on the information that has been provided to us by the industry and published information. But also looking at the industry elsewhere in Canada we see that prices have risen relative to New Brunswick and also that the marketing margin has risen relative to New Brunswick, which would support the argument that a combination of competitive factors and cost drivers have been at work elsewhere to the benefit of the industry elsewhere.

So with those opening remarks I would invite questions.

CHAIRMAN: Thank you, Mr. Gardner. And from my initial taking of appearances this morning I understood perhaps the first person that had an interest in asking questions or doing cross examination is Mr. Zed on behalf of Co-op

Atlantic.

Anybody who I guess appeared before Co-op Atlantic alphabetically, am I correct none of you wish to cross examine?

Okay. Mr. Zed, proceed.

MR. ZED: Thank you, Mr. Chairman.

CROSS EXAMINATION BY MR. ZED:

Q.1 - Welcome to Saint John North, Mr. Gardner. Mr. Gardner, if you would just please -- I'm going to refer for some time to your report. So if you could just turn to the first page.

The third paragraph from the bottom you talk about the challenge facing the regulator is to design a pricing model that balances the interests of consumers, retailers and wholesalers.

A. Yes.

Q.2 - Would you agree with me that the current regulation under which you undertook your report really balances the interest of the consumer moreso than the interests of business?

It is more directed to effect a favorable result for the consumer moreso than it is directed to a favorable result for business?

A. I'm not sure if I guess grasp the scope of the question. I think the legislation -- the mandate of the Board is it attempts to balance the interests of consumers, at least as I read the Act, by suggesting that the margins and costs should, well, balance the interests of consumers, that they not pay too much, but at the same time that supply of petroleum products to consumers not be constrained.

So there is an attempt to balance there. But the difficulty is that finding a test or a standard which balances those interests is the more difficult one.

Q.3 - The following paragraph you talk about -- the operative word here is "average". I mean, we could go through and will go through your report in more detail. But this concept of averaging keeps coming up.

And then you make a statement individual wholesalers and retailers could become either better or worse off depending on their starting position compared with the margins allowed under regulation.

Isn't this just a tacit admission that with respect to averaging there is somebody above and somebody below the line?

A. Yes.

Q.4 - And because you are doing averaging -- and I think it is fair to say we all agree that oil prices, petroleum prices have risen dramatically in the last few years --

A. Yes.

Q.5 - -- the time period of your report?

A. Yes.

Q.6 - And that if you are experiencing averaging you are always in a period of catch-up?

A. Given the way the regulation is structured in particular, yes, it is an attempt to catch up to the previous week, the previous two weeks as the case may be.

Q.7 - So the wholesalers and retailers are the ones bearing the burden of that catch-up?

A. That's correct.

Q.8 - And in a rising market the other factor that would come into play are costs? I think you have indicated that costs have been rising --

A. Yes.

Q.9 - -- in that same period?

A. Yes.

Q.10 - So it is fair to say that for the past two-year period the burden of the system has fallen on the business side as opposed to consumer side?

A. Yes. That would be true.

Q.11 - Okay. If we go to page 2 you talk about your four key price points. And the first of your price points is benchmark price. And you refer to the New York Harbour price as being a commodity price with the greatest direct influence on fuel prices in New Brunswick.

Now what about Saint John Rack? Where does that come into play? And how does it relate to New York Harbour in terms of its effect on what portion of the province and what type of business?

A. Well, the New York Harbour price essentially is what in a regulated regime is used as the benchmark. And it is used as the benchmark for a good reason. And that is because it is a substantial market in eastern Canada, the largest -- well, probably the largest market, petroleum market in North America. It is transparent. It is highly competitive. And so it serves as a good guide to what is going on in the petroleum market, not just in North America but globally.

The Saint John Rack price is a price that follows the New York Harbour movements very, very closely. I mean, it historically is in roughly the range of three cents over New York Harbour. And it serves as a guide for smaller wholesalers and resellers in New Brunswick who are buying from major refiner marketers.

It serves as a guide price. It is a posted price in the same way that a mortgage rate might be posted by a bank. You can come in and negotiate a better deal if you have the -- I guess the capacity or the ability to do that.

So the New York Harbour price serves as a reference price for major traders, the major marketer refiners. The Saint John Rack price serves as a guide for smaller wholesalers and retailers who are buying in the province and serving retail customers.

Q.12 - And to the extent that that price is higher, which you have indicated it is, in the range of about three cents --

A. Right.

Q.13 - -- then the cost of doing business for those people who are bound to buy by the Saint John Rack price is three cents higher?

A. That's correct.

Q.14 - Thank you. Now the next page 3. And first paragraph, prices are adjusted every week.

And my question really -- and I think you may have already answered it. But in a volatile market isn't it true that the average may never be the right number? It may never reflect the true price?

A. I'm sorry, the average?

Q.15 - The average cost?

A. You mean the average that the Board takes into consideration?

Q.16 - If we do an average on a weekly basis which is the process --

A. Yes.

Q.17 - -- and the price is changing on a daily basis --

A. Yes.

Q.18 - -- isn't it true that that average price may never be the same as the actual price?

A. It would be coincidence if it were. But in a steadily rising market the regulated price is always going to be trying to catch up because it is based on an average of the previous week, and conversely in a declining market.

Q.19 - And so that is just a catch-up that we are playing that you refer to in your opening --

A. That's right. Yes.

Q.20 - -- responding to the first question? Thank you.

I would like you to turn to page 5. And we are talking about then industry structure. And I may just have a couple of general questions.

In general would you categorize the New Brunswick market as competitive? And perhaps, you know, compare it to other jurisdictions. I mean, is it competitive compared to Nova Scotia? Is it competitive compared to Ontario?

A. Yes. It is competitive. It is competitive compared with markets generally across the country. If one considers the structure of the industry as an indicator of competitiveness, there are a number of competitors at the major wholesale integrated refiner level, five or six, 20, 30, 40 smaller wholesalers in both motor oil and motor gasoline and heating oil, and several hundred retailers.

So taken collectively there is a competitive structure at work there.

Q.21 - And basic economic theory is that if there is a competitive market then prices will not rise arbitrarily?

A. Prices wouldn't rise arbitrarily. They would presumably respond to supply and demand conditions in the market, yes.

Q.22 - And I guess really this is just kind of a very general question. But without regulation would prices necessarily be any different than they are today?

A. Well, prices may be lower than they are today. They could be higher than they are today. But if we look at what has happened in the rest of Canada in other -- in nonregulated markets, prices in western Canada for example are 2, 3, 4 cents on average higher than they were prior to -- well, prior to July 1st 2006. Prices in other parts of the country and margins in other parts of the country have risen relative to the Atlantic Provinces and New Brunswick in particular.

So the competitive circumstances are responsive to global conditions. But they are also responsive to cost factors as well. And we can see that I think in the way prices have moved elsewhere in the country.

Q.23 - So -- and barring any sort of weekly price wars and that kind of thing, over time businesses have to collect their costs before profit, and that if businesses don't collect enough to cover their costs, that businesses will no longer be, I mean, over time in the long run. Is that a fair statement?

A. Well, that is a fair statement. And we have -- I think we have seen that throughout Canada, throughout the Atlantic Provinces in the decline and the number of both wholesalers and retailers. It's a fact of life that costs are rising and margins have been declining and business is no longer viable.

Q.24 - I'm just going to ask you a question from page 8. And this -- you may not be able to answer this. But your third paragraph you talk about 20 percent of New Brunswick homes use oil for heating.

And I guess -- how does that compare to other jurisdictions, in the Maritimes in particular?

A. It is relatively low by comparison. So for example Nova Scotia would be in the order of 70 percent heating with oil. And Newfoundland somewhere between but closer to the 70 percent mark.

Q.25 - Do you know why that is?

A. Well, in large measure because alternative heating sources are relatively attractive in price compared with other jurisdictions.

So for example electricity in New Brunswick is competitive whereas in Nova Scotia it isn't. Natural gas is competitive and becoming increasingly so.

Q.26 - Do you see any problem in dealing with or administering a regulation that would recognize the Saint John Rack price for retailers or resellers as opposed to New York Harbour, in other words a split calculation? Isn't it just more paperwork?

A. Well, I'm not sure it's more paperwork. Ultimately the end point is going to be the consumer who is buying the petroleum product whether it is gasoline or heating oil. So in a sense it doesn't make a great deal of difference where you start.

Ultimately the market is going to determine what the consumer, the price consumer faces. So if you start with New York Harbour, a number of larger companies trade at that price point or that reference point. It is a more challenging environment for smaller wholesalers who are buying at the rack or near the rack price.

But whether you use one or the other, yes, it is a more complex calculation. At times -- even though there is an average of three cents, at times the spread goes to two cents or to four or five cents. And so the margin can be squeezed.

But presumably in setting the original margins the regulator would have been sensitive to those swings and set it at an average that recognized I guess the complexity of the market.

If that is not the case then trading at New York Harbour would tend to benefit those in the industry who buy and sell at that and to some extent compromise those who are buying at the rack, because they are all selling into the same market and realizing the same selling price.

So, yes, it is a more complex calculation. The end point would not be any different. You have got a single market price simply because you are selling with a lower margin or lower -- a higher buying point or acquisition point doesn't mean you would be able to sell at a higher price.

Q.27 - But it would afford those dealers an opportunity to raise the price if the market permitted in order to cover their increased costs?

A. Well, if the market permitted -- if by that you mean that currently they are trading below the maximum, then sure there would be room to move, if -- you know, again it is not so much dependent on where they start as where they end at the retail end.

Q.28 - Thank you. If you would turn to page 11 please, the last paragraph before figure 2.4. It talks about the average spread between New York Harbour spot price and the Saint John pump price excluding tax was fairly stable, in the 11 to 12 cent range between January -- now -- and then it says, the average spread presumably form the basis for the regulated margin of 11 cents plus transportation.

So 11 cents was chosen even though the range was 11 to 12 cents. Do you have any idea of what that extra one cent would represent the terms of profit or revenue for the average dealer?

A. Well, one cent on five cents is 20 percent. But again the reason why this is framed in fairly general terms is because it's not very clear to the industry on what basis the original margin was set.

The response to the question how was it set was well, it seems to have been set based on the experience during the two or so years prior to, and coupled with a look at what was going on in the other Maritime Provinces as a guide for what might be an acceptable margin.

Q.29 - But you would agree, according to your paragraph, that it was set at the low end of the range?

A. Well, it was set at low end of the range, yes.

Q.30 - Thank you. Next page, middle of the page 12, the paragraph beginning the point is that only looking at the margin or comparing margins and changes in margin without knowing more about the full extent of the financial arrangements is unlikely to provide a reliable basis for assessing the respective financial positions of wholesalers and retailers. What else should be looked at in a perfect world?

A. Well, in a perfect world I think the text describes the complexity of the arrangement between wholesalers and retailers. And it's unlikely that the same deal applies between any of the wholesalers and any of the retailers that that wholesaler supplies.

There are differences in volume, differences in location, differences in characteristics, in credit rating, a whole range of issues that make this a complex set of arrangements.

The point of this though is that if the regulatory framework had specified that five cents must be the retail margin and six cents must be the wholesale margin, then it would have made a mess I guess of the marketing arrangements between wholesalers and retailers.

But because there is the out provided that you can continue with your existing arrangements, that the five cents and the six cents don't mean very much. The 11 cents means something, the overall marketing margin in this case.

So I think your point would be well taken if there was some rigidity in how that overall margin were to be divided. But because of the flexibility provided it allows retailers and wholesalers to work out their arrangements in a way that presumably works to the benefit of both parties.

Q.31 - Thank you. Turn to page 17. Your very last paragraph on the page you make a statement regulation is generally a blunt instrument when used to address disparate economic objectives.

A. Right.

Q.32 - I just wanted to read that into the record to make sure everybody -- but my question really is wouldn't you agree that there are other ways to regulate the industry than the current system?

A. Well, there may be many other ways to regulate. This is the one that I was asked to look at.

Q.33 - I understand that.

A. So -- yes.

Q.34 - I understand that. But really what about a zero based cost, looking at zero based cost? Have you ever had any experience with looking at that kind of a system?

A. Well, I think the line you quoted is a blunt instrument. What I'm driving at there is that it essentially treats the industry as a collection of homogeneous entities or enterprises, which it manifestly isn't.

As a consequence, some better than others, moving back to your point about the average, the circumstances each of these enterprises faces is -- can differ substantially from the high end to the low end.

But regulation doesn't necessarily capture the nuance. Let's put it that way. It allows the parties to work out their arrangements but within that 11 cent range or whatever the particular fuel and the margin, you know, under consideration.

So it doesn't allow more flexibility than the nature of the arrangements. You are still restricted to when prices change. You are restricted to I guess the ups and downs and the vagaries of when you buy your fuel in relation to when the price was set and whether it is going up or down and so on. So I think it is a tough one to try to grapple with. But the -- and then again it depends on what your objectives are.

If the simple objective is to maintain price stability then this regime can do that. But if at the other end of it you are also trying to maintain a level of supply, the objective of the change in stability may compromise your ability to maintain levels of supply, particularly when they are operating through resellers with narrow margins or you are operating through retailers who are in remote or rural areas of the province where costs are higher and volumes are lower.

But the regulatory system, I guess ignores those nuances. It is a blunt instrument.

Q.35 - Thank you. I think you answered my first question of the day as to which way the balance was shifting under this regulation.

The next question I have for you is on page 20. And the lead-in to that is the bottom of page 19. But you are talking about the regulator in New Brunswick having no such discretion.

And that is with respect to "Weekly adjustments are made according to a strict application formula with no accommodation to ensure wholesalers and retailers are no worse off or better off than they would have been had market conditions prevailed."

Would such a discretion be a good thing?

A. Well, I think such a discretion could be a good thing simply because it allows the regulator a bit more flexibility, in times of -- let's say in times of rising prices to ensure that the wholesale sector is left whole. But at the same time, during times of declining prices that, you know, excessive margins aren't being earned.

So -- and that challenge is borne largely by the -- you know, by the smaller wholesalers and the smaller resellers because they are starting with a narrower margin. They are relying on -- in an unregulated market they rely on their nimbleness, their buying and selling ability, their ability to adjust rapidly to changing conditions in order to survive.

And by introducing the rigidity of a one-week change and not allowing the regulator to either compensate or to diminish the margin, as the case may be, it can leave the supplier, the wholesaler in particular, in a very difficult position, if you are looking at an extended period of rising prices.

Q.36 - And aren't the businesses that are in that position, and affected negatively in that position, the most vulnerable?

A. Well, they are the most vulnerable because they start out with lower margins, yes.

Q.37 - The next paragraph after figure 4.1 you are talking about rising prices. "During all but a few months since regulation was introduced wholesalers have been buying fairly consistently above the benchmark price."

I take it obvious that that means they absorb the cost of that?

A. That's right. In this type of regulatory environment it is the wholesaler that is the shock absorber.

Q.38 - And I think you in conclusion on page 22, that section, "To conclude, the marketing margin in New Brunswick has declined since regulation was introduced. This has occurred over a period when the average marketing margin in Canada has increased."

A. Yes.

Q.39 - That goes back to your earlier --

A. Yes.

Q.40 - -- statement?

A. That is right.

Q.41 - Thank you. Take you to page 26, Mr. Gardner, the second paragraph, the last sentence of that paragraph. "Anecdotal evidence suggests there has been some decrease in the number of retailers and also in the number of resellers over the past two years, though accurate data on the number, their capacity and the volume they account for are not available."

So on what basis did you -- you know, what is your anecdotal evidence that you are relying on to make that statement?

A. Well, I'm access to the list of wholesalers and retailers in the province that are licenced to sell. The difficulty with the files is they are not necessarily up to date. Some people may hold licences and not actually operate. Or since the licence was issued they have ceased operating, gone out of business.

Volumetric information tends to be collected perhaps on an annual basis. And it is not always up to date. So in other words it was difficult to do any fine analysis on volumes and on averages because the data weren't necessarily up to date.

But anecdote -- well, the best anecdote was the number of, not at this address, no longer in business and so on we received when we sent out the dealer survey. So I don't know how many of those we would have received, 30 --

perhaps in excess of 30. That was using the most up-to-date list that was provided by the Province.

Q.42 - So subject to all of those qualifications you really believe this statement to be true?

A. I'm sorry?

Q.43 - I mean, subject to all of those qualifications about the lack of solid information, you believe that statement to be true, notwithstanding that it is anecdotal?

A. That the numbers have declined?

Q.44 - Yes.

A. Yes.

Q.45 - I think that is about it for your report. If we could just turn to some of the IR's. Do you have the IR's --

A. Yes.

Q.46 - -- handy?

I'm going to take you first to the EUB IR's. Question 3 when you get there.

A. Yes.

Q.47 - And you may have already answered this in your opening remarks. But first of all do you view the responses that you received as being statistically significant?

A. To make sure I have the right question, these are the Department of Energy's questions?

Q.48 - No. EUB.

A. I'm sorry.

Q.49 - EUB, Question 3.

A. Okay.

Q.50 - The question re survey questionnaires.

A. Right. I see the question now. And so your question on that?

Q.51 - Your answer indicates that 12 percent of the survey questionnaires were returned, 27 gasoline retailers were interviewed, 12 wholesalers, 9 heating oil dealers. And you attach a list.

And my question to you is do you see the number of responses you received as being statistically significant?

A. No.

Q.52 - And what numbers would you have needed to make statistically significant findings?

A. Well, I guess it would have varied depending on the information we were looking for. But for example on cost data, which was one of the main objectives of our survey, we would have been looking for I think in the order of a 25, perhaps 30 percent response rate in order to obtain, you know, reliable information. Or even, if not statistically valid, at least representative information.

So it was -- on the cost side we had to look to other areas in order to -- other sources of information in order to come up with the impact of rising costs on the industry.

Q.53 - And when you say cost side, what costs in particular were you interested in looking at?

A. Well, we were looking -- interested in looking at for example the impact of credit card costs, the impact of labour costs, the impact of utilities, municipal taxes, cost of storage, the factors that the Board has laid out in the legislation.

Q.54 - I understand that. So you weren't looking for a rate of return or return on investment or any of those kinds of numbers because they are not -- they are not really relevant to the current regulation?

A. It's not a test, no.

Q.55 - Now are you satisfied that the information you received, because you also indicated that you went to outside sources, that the information you received is consistent with all other outside sources?

A. The admittedly anecdotal evidence that we did obtain from the industry, for example on credit card usage or on credit card rates charged by the companies, those values are consistent with ones that are available in the published literature. And that's certainly a key one.

On labour costs, again the proportion of costs that is accounted for by labour is consistent with statistical information from other sources that we were able to obtain.

Q.56 - Short of getting a bigger response from the business -- from the businesses that you surveyed, is there any other way that you could have verified the numbers other than what you did?

A. Well, for example, with the credit card -- the fees, it may have been possible to contact -- it would have been possible to contact the credit card companies. But whether we would have received information that would have been of any value is open to question.

It is clear that when it comes to credit card, the Visa and Mastercard in particular, the arrangements they make with individual companies are just that. And they will have a range of arrangements depending on volume, depending on revenue, depending on the number of transactions, a whole range of things.

So -- and we would have been told that it varies between 1.75 and 2.3 or 2.4 percent for the major cards. And that's -- there are published sources of information that provide just that. And that is what the dealer has told us as well. And that is what the major wholesalers told us.

So when you hear numbers like that often enough and in the same range you tend to accept them as having some validity.

Q.57 - So you are really comfortable with the methodology you employed. And in practical terms there was really not much else you could do?

A. No. In practical terms there was very little we could do. Because the industry, simply for a variety of reasons, wasn't forthcoming with the data that were needed.

Q.58 - Okay. Just give me a minute, Mr. Gardner. I may be very close to the end.

Okay. That does it for that. Now I just have a very general question for you.

You are familiar with utility pricing models like cost of service?

A. Yes.

Q.59 - In a perfect world and in a world other than the one we live in, is there any reason why a cost of service model could not be adopted as a regulatory -- part of a regulatory mechanism for petroleum pricing? Is there not a way you could do that?

A. Well, I'm sure there is a way. But whether it would be administratively straightforward or efficient is certainly open to question. Every single enterprise is different. So there is no utility in the purse sense.

Q.60 - Okay. No. I understand that. And there isn't a utility. But is there anything to prevent for example stakeholders getting together with proper supervision from the Board, in a stakeholders group, and developing in effect a proxy model for costs?

And there may be a formula for small retailers. There may be a second formula for wholesalers. There may be two or three formulae.

But is there any reason why a group could not get together to put together actual cost, a cost model that could be employed in these calculations?

A. Well, you could employ a cost model, sure. But your original question went to a rate of return and again in the regulated utility sense.

And the difficulty I think the Board would have or a regulator would have in those circumstances is the lack of homogeneity of the enterprises. They vary so much that a single rate of return or an acceptable rate of return for one may be, you know, substantially higher or much too low for another.

Q.61 - No. I understand that.

A. Yes.

Q.62 - But is there anything -- if a group could get together and agree to those figures, in other words, the industry would agree on a cost model for -- and maybe not across the board. There may be two or three little deviations here or there given size or market or whatever else.

But if the industry could agree on such a cost that would take into account actual cost from the business side, okay, is there any reason that could not be administered if the formula were agreed to and allowed under the regulation?

A. Sure. A cost model like that could work if its output were to measure I guess the change in costs over a period rather than a rate of return needed to support those costs. So if you just look at the cost side of things, sure, there are --

Q.63 - The rate of return might be built into the actual cost. But that wouldn't be what would be tried to capture by rate of return. You wouldn't try to capture a rate of return?

A. Right.

Q.64 - You would try to capture increased costs --

A. Sure.

Q.65 - -- in real time. And on the other side of the equation --

A. Yes. Of course you could do that.
Q.66 - Of course.
A. Yes.
Q.67 - And isn't there -- aren't there better models than the current model to increase -- or sorry, to capture actual pricing as opposed to average pricing?
A. Well, right now there is -- I don't think there is a model. I mean, that's part of the challenge here, is that the Act and the regulations don't provide a great deal of guidance. They list a number of factors. But those aren't, you know, necessarily the most important factors.
Q.68 - But we are reinventing that now. We are reinventing that.
A. Yes.
Q.69 - So isn't it possible that you could have such a regulation that will have closely captured price on one side, wholesale price on one side and, to go back to a couple of minutes ago, actual cost increases on the other?
A. Of course. I mean, if you were to simply take what might be a typical statement of expenses for a retail outlet, there may be 10 to 12 items on that cost sheet. And you could track those over time, sure.
MR. ZED: I have no further questions. Thank you, Mr. Gardner.

CHAIRMAN: Thank you, Mr. Zed.

The Department of Energy. Mr. Ervin?

MR. ERVIN: Thank you, Mr. Chairman. Just a couple of quick questions.

CROSS EXAMINATION BY MR. ERVIN:

Q.70 - I think, Mr. Gardner, on page 22, and Mr. Zed referred to this, in unregulated areas of Canada prices and marketing margins have increased as of late.

Was there an actual study or data that you referred to in making that statement?

A. Yes. The figures 4.3 and 4.4. on page 21 and 22 of the report.

Q.71 - I guess my question is where does that come from, just briefly? Where does the data -- that conclusion come from?

A. Well, if you look at figure 4.3 for example, comparing the pre and current regulatory margin changes, the marketing margin, preregulation and disregulation at that time period, we see that the marketing margin in 4.3, figure 4.3 has declined in Saint John.

When we look at other centres in Canada over those periods, the relative changes have, with the exception of Toronto and Halifax, have increased.

Q.72 - Okay.

A. And similarly in the other part of the equation I suppose is the relative price changes. And if we look at figure 4.4 comparing major centres across Canada, there have been substantial increases relative to Saint John, New Brunswick and western Canada and even in central Canada. The differences between New Brunswick and Toronto, Sudbury, Montreal, what have you, have declined, had been larger prior to this.

So what these figures show is that relative to New Brunswick margins have expanded and prices have increased relatively more quickly.

Q.73 - You also made reference, Mr. Gardner, to the anecdotal evidence that there have been market exits from retailers in New Brunswick.

Are you aware of any new establishments that have established in the past two years? Or did you -- or was the length of service any part of your study to determine whether any of the respondents were in fact new entrants?

A. No. It wasn't a factor or an indicator that featured directly in the computations other than looking at changes in volume. And it's true there have been additions to the retail network in New Brunswick.

Again we have gone to each of the major wholesalers to -- individual refiner marketers to ask them about their site counts, how many additions, how many closures and so on.

We didn't get information from all of them. But the information we did receive indicated that there were a few new stations to offset some of those. But the exits exceeded the additions.

Q.74 - And in your survey I think you mentioned that you had surveyed the wholesalers, retailers in relation to what their costs were. And you got information back from that and I would imagine from your face-to-face interviews.

Were those just related to you? Or were you able to verify them or have them audited in any way?

A. No. This is the -- what we had asked for, particularly from retailers, what were their actual financial statements for four years. And most indicated they would not be prepared to share financial information.

We asked for it in two ways, one on the questionnaire itself itemizing the costs that we were looking for and would they, you know, fill in the numbers.

But there was another question asking whether they would agree to release their financial statements to us so that we could validate the information and have just a more accurate set of numbers.

And with very few exceptions the retailers and certainly the wholesalers and the integrated companies did not wish to share any of their financial information.

So what we ended up with were several returns with detailed information on a variety of costs, but not enough of those to be able to say anything about the statistical significance of what we were looking at.

Q.75 - And Mr. Zed examined or explored I guess the possibility of setting up some kind of a cost of service regulatory model.

And are you aware of any such model existing in North America at this time?

A. No.

MR. ERVIN: That is all I have. Thank you, Mr. Chairman.

CHAIRMAN: Thank you, Mr. Ervin.

I believe the next person that indicated they wanted to cross examine was Mr. Maddock on behalf of Global Fuels.

MR. MADDOCK: No. No questions right now. Thank you.

CHAIRMAN: Thank you, Mr. Maddock.

And I think the next person after that was Mr. Hoyt on behalf of Irving Oil Marketing Limited.

CROSS EXAMINATION BY MR. HOYT:

MR. HOYT: Mr. Zed has covered some of the ground. So it will save us some time. I will try just to deal with some new issues.

Q.76 - Can you describe, Mr. Gardner, how Gardner Pinfold came to be retained by the Energy and Utilities Board in this proceeding?

A. Yes. We received an invitation to submit a proposal on the terms of reference. We responded. And our firm was selected.

Q.77 - And do you know who else participated in that process?

A. I'm aware of only one other company who participated in the process. But I have that again anecdotally. There may have been more. But I'm only aware of one other.

Q.78 - Could you share that anecdote, who that other party is?

A. I believe it was M. J. Ervin.

Q.79 - Can you describe any other relevant experience you have in relation to petroleum products legislation?

A. Well, my firm conducted a review of the petroleum marketing industry in Nova Scotia two years -- three years ago. And then we were subsequently retained by the Province to review the regulatory -- well, the extent to which regulation was achieving its objectives in Nova Scotia a year and a half ago.

Prior to that I was an expert witness in the early 1990's during regulatory proceedings in Nova Scotia. That was I think the last year in 1991 that petroleum was regulated.

Otherwise I started my career as an economist with a utility, the hydro utility. And we have been retained in the past on regulatory matters related to natural gas as well in franchise applications. If that provides some background.

Q.80 - So it would be fair to say in the last couple of years you monitor what is going on with petroleum pricing regulation in the Atlantic Provinces?

A. Yes.

Q.81 - And I can assume that you have no vested interest in the motor fuel or heating fuel industries in New Brunswick?

A. None whatsoever.

Q.82 - Can you describe the process that you undertook in preparing your report please?

A. Yes. We drafted -- initially started by drafting questionnaires and survey instruments to circulate to the retail sector and to the wholesale sector both motor fuels and heating oil. We contacted the major integrated refiners and major wholesalers requesting interviews.

And these were face-to-face interviews. And all but one -- all agreed to those meetings. But we were unable to find a convenient time for one of them. So we did have meetings with all the major wholesalers. We met with several of the resellers of petroleum products.

We met with several of the heating oil companies, two of the major propane distributors. As well we met with I think just under 30 of the retail gasoline dealers in the province.

So this formed the basis of our attempt to gather the information that we needed in order to meet the objectives of the analysis.

Q.83 - And over what period of time did those consultations take place?

A. Those consultations took place between mid June and mid July roughly. Sorry, it would have been mid June toward the end of July.

Q.84 - And Mr. Zed referred to the EUB Question 3. I will just -- I will cite the relevant portion of it, where you had indicated that Gardner Pinfold interviewed 27 gasoline retailers, 12 wholesalers and 9 heating oil dealers. And then, as you pointed out, you attached a table 2 which sets out the names of the parties that you consulted.

Would you describe the gasoline retailers, wholesalers and heating oil dealers interviewed as a good sample of the industry in New Brunswick?

A. Yes.

Q.85 - And did you receive a good level of cooperation from those that you interviewed?

A. With the exception of providing us with the detailed costs we were looking for, the cooperation was excellent.

Q.86 - And you had an opportunity to speak with a representative of my client Irving Oil as part of that process?

A. Yes, I did.

Q.87 - I would like to refer to page 11 of your report. And Mr. Zed referred you to this statement. I want to refer to it in a bit different way.

And it states that "The average spread between the New York Harbour spot price and the Saint John pump price excluding tax was fairly stable, in the 11 to 12 cent per litre range between January 2003 and July 2006. This average spread presumably formed the basis for the regulated margin of 11 cents per litre plus transportation currently in place in New Brunswick."

Do you see that statement?

A. Yes.

Q.88 - And so am I right that you believe that is likely how the original total maximum margin of 11 cents was originally established?

A. Yes.

Q.89 - And do you believe that the Province of New Brunswick gave any consideration to non-petroleum revenues in setting the initial motor fuel margins under petroleum products pricing legislation?

A. I'm not aware of any consideration.

Q.90 - Can you refer to page 30 of your report? And I would just ask you to read the conclusion at the bottom of the page.

A. Conclusion, the maximum margin should increase by two-tenths of a cent per litre to compensate wholesalers and retailers for general price inflation since regulation was introduced.

Q.91 - So could you confirm that your calculation of that .2 cent per litre increase was in recognition of a general price inflation that has affected both wholesalers and retailers since July 2006?

A. Right. Yes.

Q.92 - Could you refer to the summary page which I believe is at the beginning of your report?

And I note, just looking at the chart, that there is a recommendation that there be a one cent per litre increase in delivery cost for wholesale heating fuels.

Do you see that?

A. Yes.

Q.93 - And could you confirm what you are proposing is that the one cent per litre increase be available to be shared between the wholesaler and retailer of heating fuel?

A. That is correct.

Q.94 - So it is not just to be on the wholesale side. The idea is that that would be shared?

A. The idea is that the current two cents, as it is laid out in the price schedule, be increased to three cents. However, that is shared between wholesalers and retailers.

Q.95 - All right. In your view, Mr. Gardner, how often should the maximum margin and delivery costs under the petroleum products pricing legislation be reviewed?

A. I would think at least once a year.

Q.96 - And is there a better way to do it than the process that we are in the midst of?

A. I think the process that we are in the midst of should result in, at the very least, identification of the most significant heads of cost that underpin the structure of the industry, both the wholesale and retail level.

It should identify the data sources that might be available to support an analysis of those costs. And ideally it would provide a methodology that allows the Board and the industry to make the adjustments in a more expeditious way.

In other words, when I look at the sources of information that ultimately we are left to rely on, they are all in the public domain with some minor exceptions. And I think those areas of exception could easily be addressed in a more I guess mechanical way.

Let's take credit cards, for example. The major swing factor there is price and usage. Both those values would be well known to the industry and could be verified by the Board by collecting information, by extending the collection of information for example that the Board now compiles from industry.

Transportation costs, again the main swing factor is the price of fuel, the fuel adjustment charge. Again it is a factor that could I think easily be rendered through a formula. I mean, the industry uses a formula to arrive at the fuel adjustment charge. It results in a price.

Again the Board could obtain that information I believe under the current legislation in order to effect the changes in a more automated way.

Q.97 - So then to kind of summarize that then, it would be possible to develop a fairly transparent formula that would track and recognize wholesalers' and retailers' increasing costs?

A. I believe so, yes.

MR. HOYT: That is all the questions that I have.

CHAIRMAN: Thank you, Mr. Hoyt.

I believe the next person indicated they would have questions or might have questions was Mr. Grant with Murray's Esso.

MR. GRANT: No questions at this time.

CHAIRMAN: Thank you, Mr. Grant.

The next individual was Mr. Nicholson with Salisbury Road Gas and Convenience. Okay. We will come back to him.

Mr. Chris Scholten of Scholten's.

MR. SCHOLTEN: No questions at this time.

CHAIRMAN: Thank you, Mr. Scholten. Mr. Maynard of Ultramar Ltd.

CROSS EXAMINATION BY MR. MAYNARD:

Q.98 - I just have a question regarding your opinion on how the distribution costs are addressed in the New Brunswick regulations.

They differ quite a bit from other jurisdictions in that there is a provincial price set. And then market participants are asked to justify their distribution cost.

The industry has a need for infrastructure. If we all pull from one product source of course there is not a whole lot of flexibility in the system.

Do you feel that the method in which the New Brunswick regulations govern that threaten the level of infrastructure in the industry?

A. Well, at this point, as I understand the industry, there are let's say two, three major supply points for product, petroleum product in New Brunswick.

Let's take gasoline diesel, the Irving refinery, the Ultramar refinery through its Chatham storage facility and from the Imperial refinery in Dartmouth. Product is supplied from each of those sources depending on relative costs and logistical considerations.

Under current regulation the wholesaler is permitted to charge the retailer the actual costs of delivering to the point of distribution or the retail outlet whether it is a gas station, a bulk plant, what have you.

What this has done is to change the competitive dynamic in the province. So that at this point the retailer in a market area that is supplied through the least cost method essentially determines the market price in that area. Because they are not permitted to charge any more than the actual transportation cost.

So what has happened is that -- in the past the price in a given market would have been determined by a number of factors including price leadership in a particular market, a different set of dynamics.

But now the distribution costs, the transportation cost is the primary force and the most efficient, either -- the most efficient retailer in terms of its transportation costs is going to set the lowest price.

Now what does that mean? Well, it means that if you are operating a large storage facility, as Ultramar does in Chatham, that your ability to supply the market and to meet the costs of that distribution facility are now driven by a province-wide set of distribution costs that may be different than those that are applied before regulation was introduced.

Whether or not a dealer wishing to purchase from Ultramar can get product to the outlet, the retail outlet or to its own bulk plant in the case of heating oil, in a way that it could prior to regulation, at least in a way -- you could get it in a way, but whether you can get it at a least cost point I guess is open to question.

Because running that plant up in Chatham is costing the operator and it is costing each of the purchasers from that plant. Whether that price is now competitive with the actual distribution cost that is allowed to be passed through is I guess the factor that is going to determine in the long run whether or not you are able to sustain that facility.

So without knowing more about the details, I don't think that you can say in the abstract that this is a good thing or a bad thing. But it changes the competitive environment. I think that is the key.

And given the cost structure and given that regulatory environment governing transportation costs, it could well undermine the viability of that plant.

Q.99 - Moreso than the manner in which other jurisdictions handle distribution costs?

A. Well, yes. The two other jurisdictions, Newfoundland and Nova Scotia divide the province into essentially subjurisdictions where allowed costs are permitted to be passed forward.

So it's not a single market from a distribution standpoint. That creates its own set of challenges for operators within each of those areas, those market areas.

But the average cost in that area is one that is known and permitted to be passed through, subject to the minimum price in each of those -- in each of those areas. So it is not necessarily the least cost supplier that is running or driving the market, unlike the case in New Brunswick.

One of the factors that would be affected of course is the volume of sales. Because if you suddenly shifted to a least cost supplier or a retailer in an area, that retailer sets the price.

If that price, you know, is set at a level where another retailer or other retailers in that market area cannot match it in the long term, they go out of business.

And so the volume that another, for example Ultramar would have had in that region would be adversely affected. The same could be said for supplies from Imperial in Dartmouth into southeast New Brunswick.

Q.100 - I guess as a consultant for the Province in this process can you comment about the amount of infrastructure that has been removed from the industry over the last 10, 20 years?

A. In this province or generally?

Q.101 - Well, generally, yes.

A. Well, generally, I mean, the number of retailers in Canada generally and in the Atlantic Provinces has probably dropped by 50 percent in the last 15 to 20 years. The number of wholesalers has declined. The number of bulk plants has declined. And the number of refineries in Canada has dropped significantly. The storage capacity has declined.

A lot of this has been facilitated by product exchange agreements between the refiners, that they will supply from different points. And not everybody has to maintain storage facilities or even have a refinery in a market area.

But all of which has also served to -- I guess to shorten the supply capacity in the event of a shortage. And it contributes, as we have seen in North America generally to, you know, quite sharp price spikes, if there is a problem with one of these facilities, whether it is a refinery or a storage centre.

Q.102 - So I guess in summation you would agree that the methodology that is being used by the Province really creates a market condition where there is the lowest common denominator.

The participant that has the lowest distribution cost will basically set the price in a particular area of the province?

A. Yes. That is what is happening. That is right.

MR. MAYNARD: No further questions.

CHAIRMAN: Thank you, Mr. Maynard.

We are going to take a break. I guess it is 12:00 o'clock. So I think we will break for lunch at this point in time. When we come back I think Mr. Wootton of XTR Energy may have some questions, he indicated earlier.

As well Mr. Nicholson I think was out of the room when we called upon him. And then Board Counsel will have an opportunity to ask questions.

So we will break until 1:15.

(Recess - 12:00 p.m.- 1:15 p.m.)

CHAIRMAN: Good afternoon. I understand there may be a couple of people here this afternoon that may not have been in attendance this morning when I did the appearances.

So is there anybody that is currently a registered Intervenor is now in attendance and we should take note of their attendance?

MR. MCDOWELL: My name is Jim McDowell from Notre-Dame Express in Moncton. I just checked in.

CHAIRMAN: I guess you missed that part of it this morning. We asked everybody to speak into the microphone.

MR. MCDOWELL: So I talked with Lorraine (Mrs. Légère) just moments ago. I do not really have any questions at the moment. Thank you.

CHAIRMAN: Thank you, Mr. McDowell.

Is there anybody else in attendance that we would not have taken note of this morning?

All right. Well, in continuing with cross examination, I think we had indicated we had missed Mr. Nicholson. Is he in the room?

All right. Mr. Wootton?

MR. WOOTTON: Thank you. Just a couple of questions for Mr. Gardner.

CROSS EXAMINATION BY MR. WOOTTON:

Q.103 - One of the factors that significantly impacts the New Brunswick marketplace are the privately-owned retail petroleum workers. They represent the lion's share of the rural fabric that really holds the province together and provides petroleum services to the community at large.

It is really critical that the legislation, as everybody has talked about, continues with equitable solutions for all the stakeholders. And oftentimes they are not as vocal as some of the rest of us.

So I wanted to ask you a few questions from their perspective in how this legislation affects them.

These folks privately invest in their facilities and all are the entrepreneurs out there in the marketplace. They provide the essential services to the rural markets. and under the legislation today there is only established a maximum selling price, no minimum selling price.

Did you investigate, as part of establishing and looking at this legislation, did you investigate the opportunity to establish a minimum selling price to provide these independent owners and operators some protection from aggressive pricing strategies of integrated natures or the large big box stores?

A. The legislation doesn't provide for a minimum price. And we didn't direct our attention to determining whether or not there was a case for a minimum price. It is not one of the listed relevant factors.

But in the course of meeting with the dealers in the province and in selecting the dealers we have been able to speak with, we identified what I think was a good representative sample across the spectrum of suppliers as well as geographically, but focusing on the independence rather than the integrated, which we have dealt with indirectly through the meetings with the wholesalers.

And I think there was little question that the independents in rural and remote areas feel particularly vulnerable under regulation, in part because their costs tend to be higher, in part because their volumes tend to be lower and in part because their opportunities to generate revenues from activities or services other than petroleum are more limited.

And many of them did come out and ask, you know, why can't we have a minimum price like they do in Nova Scotia, like they do in Prince Edward Island. And I mean, the response is simple, that it is just not provided for in the Act.

And it does affect the smaller dealers, the regulatory structure, because of the change that occurred, and we discussed this earlier, in the way transportation affects the competitive environment, driving price to the lowest cost supplier within a market area.

So that is one factor in some of the smaller stations that have either taken delivery from a tandem rather than, you know, a B-train or one of the larger trucks.

They also face a competitive dilemma of trying to price and retain some margin against the -- particularly the integrated refiner outlets, and particularly if they operate in close proximity to one of the integrated refiner outlets. Because the bigger companies have got deeper pockets and can drive down price to a level where it is very difficult for some of these smaller dealers to compete.

That is the reality in the rural and remote areas. They face competition. They face pricing strategies that are, if not intended to, you know, make it a nonviable operation. That is unfortunately from their perspective the result they see. So it is a tough business.

Q.104 - You had mentioned some of the other regulated markets. Some of those regulated markets, in fact most of the ones we operate in, do provide that downside protection for this very important group of stakeholders, and therefore establish a minimum price in the marketplace to provide them at least a level from which they can go to their bankers and to other investors into their business and provide at least a level of comfort that the risk isn't zero margin.

Is there any downside protection for this important group within the current legislation?

A. No. There is no minimum margin.

Q.105 - And could a minimum price structure be easily implemented and established within the context of this legislation?

A. I think the legislation would probably have to be amended in order to provide for it. But I mean, there is nothing to stop that.

Q.106 - Okay. In your experience would you suggest or agree that this particular group would be served well with the introduction of minimum pricing?

A. Well, in some markets they would be. I think one would have to go and look at the actual pricing behavior. And again it can be deceiving.

Because if you look at where in major locations, the major urban centres where pricing information tends to be available, you will see that in most areas the price is fairly close to the maximum, on average, week to week.

There are some exceptions. But those areas are not the areas that are necessarily influenced by -- or where the rural and remote dealers would be influenced by those pricing strategies.

So coupled with the higher costs they face and coupled with the specific pricing activity that occurs in those areas -- and you know, I will give you a concrete example of one, when we were going around.

And I spoke with a -- in fact it was an XTR station in one of the smaller communities in the center of the province. The owner, who happened to be, you know, a couple of doors down from a larger station run by one of the integrated refiners, or at least owned by, said that she is facing, you know, the closure of her station because she is finding it impossible to compete.

And the pricing strategy that is going on in that market, which will never appear in the official statistics, she is a full serve and the station is a self-serve. And as soon as she tries to move her price within a cent of the self-serve, they drop their price.

So that there is a two cent spread. Knowing that people in the community, even though they may be supportive of her, are not going to stand for, you know, a two cent difference. They will go to the lower price. So she has been forced to keep her two cent spread in order to sell any gas at all.

So it is that kind of environment that people are trying to survive in. And in that case and in many of the other cases you ask the owner and say, well -- and she has got, you know, a small store as well. But she will close when she retires. Because she can't imagine being able to sell the business.

But I asked her how much she earned. Because this business is open, you know, 16 hours a day and so on, five, six days a week, seven days a week. She takes home about $25,000 after all things are said and done. And there is no -- there is nothing else left over. There is no contribution to anything else. 25,000 bucks.

And this is the state of things in rural parts, not just in New Brunswick but in Nova Scotia, P.E.I. and Newfoundland as well. People in rural areas running stations, marketing a service don't take a whole lot home. And they work very long hours.

Q.107 - So in the example you use, they are being allowed today to enjoy a two cent -- or they are being allowed to price two cents above that competitor in that particular market?

A. That's right. Where the preference would be to price one cent above in order to maintain volumes.

Q.108 - And today it is two cents. And tomorrow they may decide that they want it to be 3 or 4. Under the current legislation there is nothing that would prevent them?

A. Well, as long as the -- as long as the price doesn't exceed the maximum.

Q.109 - Yes, correct. Under the current legislation and the application of it as it relates to this important group, would you expect that you would see an increase in the number of people entering the petroleum marketplace as private rural retail petroleum facilities? Or do you think that their numbers will decline?

A. Well, I think the history is one of declining numbers again in this province and elsewhere. New highways are terrific. And I just drove down through New Brunswick, you know, from Montreal. And I think at one time or another I visited, you know, each one of these stations.

And it's great to have the on and off-ramps. But for every one on the off-ramp there is probably one just a few kilometers down the road that is -- or two or three that are going out of business.

So the size of the margin is ultimately going to determine the level, the location and the quality of service. I mean, that is the decision. That is the tradeoff.

And to the extent that the margin is reduced to benefit consumers, and we all want lower gasoline prices, you are effectively saying this is the level of service or the location of service that we are trying to achieve, that we are happy to have. And there is a tradeoff there. There is no question.

Q.110 - Thank you. On to haulage for just a minute. Under the current legislation the maximum haulage recovery rate is two cents per litre.

Would you agree that the haulage costs that are in excess of two cents a litre to deliver to some of the rural facilities reduces the overall margin -- as you refer to it, as 11 cents.

So if it is -- if the haulage into a site is say three cents, then the net available margin for the wholesaler and the retailer to share is then reduced from 11 down to 10?

A. Depending on which market you are in, 11 would be the outside limit. But in some of these remote rural areas the outer limit may be let's say 12 cents. Where you are up against the least cost competitor your costs are going to be higher, your transportation costs to a small station.

That money has to come from somewhere. And it is going to come from the margin that the market will tolerate in that area, as driven by the most efficient supplier into that area.

Q.111 - Sure.

A. I mean, the notion that -- and we hear this a lot, the notion that somehow transportation is outside the margin. I mean, it isn't. It forms part of the difference between the purchase price and the selling price.

And it could be utilities. It could be labour. It could be a number of other things. All of that has to come out of the marketing margin.

Q.112 - Throughout this year we saw huge increases in diesel costs which directly resulted in higher than traditional haulage costs and in some cases for deliveries to the smaller sites taking split loads, for example. Their haulage rates have gone far in excess of the two cent maximum provided for under the legislation.

We have seen a slight decline in that, thank goodness, over the last couple of months. But we still have a variety of sites which have excessive haulage rates over and above the maximum.

As part of the review process that you did for haulage rates specifically, did you look at creating a haulage rate structure that would be variable driven by the movement of diesel?

A. Well, it would be I think a straightforward matter to design one and build it into the weekly margin setting. The industry uses a formula in a nutshell. For every cent increase you are looking at a .5 percent increase in the fuel adjustment charge.

So it is just a matter of applying that to the starting point, whether it is -- I can't remember -- let's say 90 cents on the diesel, something like that. And there you get your formula.

So it could be formula based in the same way that dealing with credit cards could be formula based. Because both are sensitive to the price of fuel which is a fairly transparent -- it is a known quantity.

MR. WOOTTON: Thank you. Those are my questions.

CHAIRMAN: Thank you, Mr. Wootton.

Before I ask Ms. Desmond whether or not she has any questions, is there any party present that I didn't call upon for cross examination that wishes to cross examine Mr. Gardner?

Well, it doesn't appear that there is anybody then that has any further questions other than Ms. Desmond. So Ms. Desmond?

MS. DESMOND: Thank you, Mr. Chair.

CROSS EXAMINATION BY MS. DESMOND:

Q.113 - Mr. Gardner, could you turn to page 7 of your report and specifically to paragraph above the chart. There is a reference to stations selling approximately as an average 200,000 litres of gasoline annually.

Are your recommendations that are included in your report based on that average volume?

A. No. You are referring to the smallest size stations of 200,000 litre? Or the 2,000,000?

Q.114 - Sorry. I mean to say 2,000,000. Is that the average on which your recommendations are based?

A. Well, that is the average in the province. And I think the recommendations are based on the average values for the key recommendations based on average values for the stations as we see them. And that 2,000,000 is just about where the arithmetic average is. So yes.

Q.115 - And given that some retailers sell a lot less than that 2,000,000 litres, are your recommendations appropriate then for those smaller vendors?

A. They are appropriate in the sense that they apply equally on a -- given the way the legislation is framed.

It is not going to -- you know, it is going to make a difference to a smaller retailer who has low volumes. But the actual amount of income that is generated is still relatively small.

So for a station selling 200,000 litres annually, a cent increase, you know, amounts to what, to a thousand dollars? I mean, it is not that great. But it does make a difference. So it is appropriate in that sense.

The difficulty -- and I guess we get back to the blunt instrument that that regulation is, that when you allow a cent that one of those smaller low volume dealers desperately needs, we are also providing the market and the multimillion litre station with that same margin, whereas that station may not be as desperately in need as the smaller one.

Q.116 - Recognizing though that certain costs don't vary with volume, how should those factors be taken into consideration?

A. The cost or the factors that we have looked at, I'm trying to think of one that doesn't vary with volume. Labour costs tend to.

Although there is, you know, there is -- again the average of about 50 percent of the costs of running a station are accounted for by labour. And there is some variation although it is not much from the smallest to the largest. Credit card, that is simply a function of price.

Transportation is largely a function of price although the nature of the station is also going to be a factor there, whether it can take deliveries from, you know, an efficient tanker or it is going to take deliveries from a smaller tandem with the attendant higher costs that that entails.

And if you could give me an example of a cost that is insensitive to volume and how that might apply, that might make it a little bit easier to respond.

Q.117 - I think just one that comes to mind is municipal taxes. They wouldn't -- that wouldn't necessarily be sensitive to volume.

A. No. Except that higher volume stations are going to, you know, have a higher assessment. Now whether that is proportionate to volume or not, I guess it would vary from station to station.

In the course of looking at that as an issue, we did obtain from Service New Brunswick a listing of all the stations and the levy and the assessment. And they tended to vary, rural and urban as far as the levy was concerned.

It was impossible to determine, particularly without volume information, whether the assessment or whether the levy was then sensitive to volume. There was just no way of knowing that.

Q.118 - Okay. I have a question with reference to page 11 of your report. And at the bottom of that page there is a reference to marketing margins?

A. Yes.

Q.119 - Now as I understand it, Mr. Gardner, a lot of resellers or secondary wholesalers are paying less than the rack price, is that correct?

A. The ones we have talked to would be paying at rack and some slightly below. We are talking a tenth or so or slight above. But the rack tended to be a good guide to what the resellers are paying except in the case of -- well, I'm just saying the very large ones.

But the very large ones in a sense aren't resellers, they are wholesalers. But even in that case, if they are as much as a cent below rack they would be doing well.

Q.120 - And can you identify the type of reseller that would purchase motor fuel at or above the rack price?

A. The type? Well, these are resellers who supply almost exclusively retailers in rural and remote areas.

Q.121 - And for those retailers then the rack prices were only a guideline, is that correct?

A. Well, it's a starting point. And the actual price they pay would depend on the volume they draw and ultimately the kind of deal they can strike with the supplier. That's usually a function of volume, credit rating, you know, factors like that.

Q.122 - So the actual margin then flows to the wholesaler, retailer. And it depends whether or not they pay, not necessarily on the rack price?

A. Well, that is right. It is the acquisition cost that is going to determine their margin, yes, at the buying end.

Q.123 - And for heating fuel retailers what would be the differential there from the posted rack price and what would normally be paid?

A. Well, again it is going to vary. The best -- the best deal what we heard was I think a tenth or so below rack. And then you could be up to two, three cents above rack depending.

Like some of the smaller heating oil retailers are buying from regional resellers. So it is going through two hands and a bulk plant before it gets onto their truck. So they are down the chain of it.

Q.124 - Mr. Gardner, on page 12. And you indicate a number of factors that should be considered when you are assessing the accuracy of the retail margins. And some of those factors include whether there is fuel sold on consignment, which party is responsible for the investment in the physical assets.

But isn't it the total concept matter, not the financial arrangements between the wholesaler and the retailer?

A. I think the discussion you refer to on page 12 is I think a kind of a reminder to somebody looking at this industry that the margin does not always reflect the sum of the relationship between the buyer and the seller.

So that someone receiving -- let's say a retailer is given a five cent margin, it may not be comparable to a retailer who is getting a 3.5 cent margin. Because a 3.5 cent margin retailer is perhaps selling on consignment, so doesn't bear the carrying cost, doesn't bear the risks of, you know, the ups and downs depending on when it is purchased.

So I think your point is accurate. At the end of the year what that dealer is looking at is how much revenue did I earn, what were my costs, did I make a profit this year? And if you wanted to, you could divide that by your volume and say, here is my actual margin.

But this discussion is not directed toward trying to design a system or trying to specify a margin. It is simply to point out that the relationship between wholesalers and retailers is complex, not just because everybody gets a different deal on the margin but because of the different costs that each bears in the relationship or can bear in the relationship.

Q.125 - And if I understand that, there is risk that both parties are able to share that risk to some extent. But really who pays is not an issue. It is whether the total margin should be adjusted.

Do you agree with that?

A. Well, who pays is certainly an issue from, you know, a retailer's standpoint who is trying to stay in business. And presumably if the wholesaler wants that dealer to stay in business they will make an adjustment in the relationship that ends up with that retailer getting more margin.

But yes, I mean, at the end of the day it is the overall margin that has to cover the cost of marketing. And that is what is important, sure.

Q.126 - Okay. And the lack of knowledge as to the specific financial arrangements between the different wholesalers and the different retailers, that doesn't in any way inhibit the Board from setting an appropriate margin during the course of this hearing?

A. No. Because given the latitude that the Act provides for wholesalers and retailers to work out their own arrangements, unless, you know, you happened to, you know, strike a retailer who has got -- that was living by the letter of the regulation as far as margin is concerned -- that may occur.

But broadly, I mean, virtually all arrangements are carried over from the preregulation days. And very, very, very few dealers or wholesalers that we talked to are living according to, you know, the 6 and 5. They are carrying through their original arrangements.

Q.127 - Next on page 27 of your report. Table 4.1 And I'm looking at the line where you have got price and then there is gasoline, diesel and heating fuel. And then price -- should those numbers -- are they wholesale or retail prices that you have indicated there?

A. These are retail prices.

Q.128 - Why is it you list a retail price there? And how did you come to that?

A. Well, the retail prices are -- let's call it indicative prices looking -- based on recent months on the assumption that the recent past is going to be a better guide to the future than the distant past.

And by distant I mean prior to, you know, 2000' and early 2008. So retail prices were used because they approximate what the retailer is paying the wholesaler.

I mean, it's subject to the margin, yes, and HST. But as an indicative guide to what the carrying charges would be, in my view it reflects a basis for making this computation.

Q.129 - Wouldn't it be fair to suggest that the retailer is paying the wholesaler maximum price but that would be sort of the maximum cost to the retailer, the wholesaler maximum?

A. That price includes road tax. It includes provincial -- sorry, the federal excise tax. So the only thing that is excluded is the retail margin plus the HST on the margin. That is right.

Q.130 - What would be the normal terms of payment between a heating fuel retailer and your wholesaler?

A. Again, normal. We have heard everything from three days, 10 days. It does vary. We view seven days as a guide for motor fuel.

And 40 days -- the 30 days for heating oil refers not to the payment terms to the wholesaler but the payment terms from the customer to the heating oil company. So it is that carrying charge that is reflected here.

And again it varies. It varies. Some of the dealers, particularly the dealers in the more remote and rural areas, pointed to, you know, 45 and 60 day terms, that this was how long it was taking to get their money. But we use 30 days as a guide.

Q.131 - Recognizing that that is going to depend on the circumstances and recognizing a 30 day carrying charge from the retailer to the customer and a seven day carrying charge from the wholesaler to the retailer --

A. Right.

Q.132 - -- should there not be sort of an adjustment for those carrying charges, say a net carrying cost of 23 days?

A. Well, we are talking about heating oil versus diesel and gasoline, the motor fuels. The carrying charge for gasoline and diesel that is included in the analysis here is from the retailer paying the wholesaler. The retailer gets the money. It is a cash transaction.

In the case of heating oil we are looking at the carrying costs to the retailer rather than the retailer to the wholesaler, okay. And that is what I'm reflecting here.

So there wouldn't -- there wouldn't necessarily be a net 23. It is a question of what the industry is carrying. And the carrying costs are different in the case of motor fuel compared with heating oil.

Q.133 - So if there are -- with the heating oil customers, if cash is paid by the customer, is the 30-day carrying cost appropriate? Is that what you are suggesting?

A. Well, what I'm suggesting is that what the heating oil companies, the retailers we spoke with, were telling us that their customers are taking up to 60 days to pay their costs, okay, the cost of fuel, that 30 days is the norm, 45 to 60 is not unusual.

Some pay by credit card. And it is simply taken on or averaged over the year. It varies widely. We use 30 days as an indicative term based on what we are told.

Q.134 - Just looking to July of 2006. And you have got a price of 1.05 for gasoline?

A. Right.

Q.135 - How did you calculate that figure?

A. I can give you the data sheets for all of those values if you wish. I mean, if you are asking -- are you going to go through each of these prices?

Q.136 - Actually I have a sheet that maybe we could circulate and have a look at and see how that compares with your data, if I have the permission of the Chairman to do that.

CHAIRMAN: Certainly. Before we proceed, the Board didn't receive a copy of those.

MS. DESMOND: I believe Mr. Young went to make a few extra copies of the price sheet. I could come back to this.

CHAIRMAN: Look, as long as we had one more we can probably share.

Okay. Any time you are ready, Ms. Desmond.

MS. DESMOND: Sorry about that.

Q.137 - If I could just -- Mr. Gardner, the information we just circulated, for the benefit of other participants, is the maximum posted prices by the Energy and Utilities Board.

And I just wanted to provide that to you so we had that as a source of reference and wondered how you came to your prices for July '06 and July 2008?

A. Okay. The -- I have to apologize right off the top here. Because the '06 price is an average for the year rather than the month. And it is for diesel as well as gasoline.

Q.138 - Recognizing that the first six months of 2006 would not have been regulated prices --

A. That is right.

Q.139 - -- would you need to make an adjustment now to this table to reflect that?

A. If you were going to used this method I would make an adjustment, basing it on the average for those last six months.

The reason I framed that as a conditional is because the net effect, when you run the calculations, is so small that the conclusion was that this could be rolled into the, you know, inflationary value rather than computed on this basis.

Q.140 - I think that is the case for motor fuel. But what about heating fuel for July 2006?

A. Heating fuel, I think it is substantial enough that it would warrant -- yes, again it is the annual average that is used there which is roughly 85 cents. So if you want to use it you would use six months.

Q.141 - Are you prepared, Mr. Gardner, to perhaps redo that table?

A. Sure. Yes.

Q.142 - For July of 2008, in those three columns, can you confirm to the Board how that number was calculated?

A. Sure. Again it is not specifically July. My apologies again. The -- I think for this type of calculation, because it is intended to be forward-looking -- in other words, we are not simply trying to compensate dealers for what happened six months ago or over the past two years, but rather to look ahead to ensure that the base of the margin reflects what is likely to occur, I used the -- used prices from April to

September of this past year as a guide to what is more likely to occur than an annual average or even a two-year average.

So in other words, it is looking at crude prices as they were and fuel prices as they were during the April to September period rather than in a specific -- a specific month or a longer term average as a guide to what is likely to occur in the future.

Q.143 - Did you say April to --

A. April to September.

Q.144 - -- September? Or would that have been perhaps August? Because I believe the report was submitted in September.

A. Well, sorry. The price sheet I'm looking at includes September. So you are right. It would have been August.

Q.145 - So just for clarity purposes, I guess, you have got it labeled July. But it is really not representative of that month?

A. No. That is an error in that. That shouldn't have read July.

Q.146 - It is representative of April to August?

A. In 2008.

Q.147 - And is that the same in each of those three columns, gasoline, diesel and heating oil?

A. Yes.

Q.148 - Okay. And just on that point, if I could reference you as well to table 4.2. This is on page 28. It is just the next page. And in the table there you have a reference to 2006 and then May of 2008.

So I'm wondering if you could explain what those entries represent and if they are consistent with the entries that you used in table 4.1?

A. Right. The 2006 value is an average. And I -- if you look at the response to the Co-op IR it essentially takes the two-year period from 2004 to 2006 as the basis for that computation. And I can -- I can give you the detailed data sheet that supports that table.

So it is essentially taking not just 2006 but the period from July '04 to June '06, the two years prior to the introduction of regulation that gets you to that 98 cent average price. And that is a volume weighted average.

The price in 2008 is for the month of June. Again I think one of the IR's had questioned that. And it was an error on my part. It should be June, not May.

Q.149 - Yes. And I think that was an IR from the Department of Energy?

A. Right.

Q.150 - But if you could just back up to the 2006 entry, I think you said that was an average of --

A. That is average of 2004 to 2006, from July '04 to end of June '06.

Q.151 - And is that January 1, 2004 to the end of --

A. July '04 to --

Q.152 - July '04?

A. -- June '06. Yes. Two years.

Q.153 - Is there some rationale for why you took those -- that particular time frame as opposed to the period of time just prior to regulation or maybe May of 2006?

What was the rationale for picking those months?

A. Well, the rationale for pricing the period leading up to regulation was that it, as I understand it, formed the basis for the margin that was applied in July of 2006. In other words, these values would have been consistent with the cost base over that same period, okay, that this price applied to credit cards.

The use of June '08 rather than a long-term average in my view would make more sense, since it is the more likely price going forward than a long-term average. In other words, it is more likely you will see prices in the $1.25, $1.35, $1.40 range looking ahead than you will see prices in the -- you know, in the 90, 95 cent range.

So again, the computation I believe for the contribution to the margin should reflect as closely as possible current circumstances.

Now the difficulty of course this presents is that if this is done on an annual or a biannual basis, given the way prices fluctuate, it could rapidly become dated, either too high or too low.

So I guess it is another example, going back to some earlier questions, of a variable that has a substantial effect on the net margin over which the dealer has really no control, that could I think easily be computed to form part of, you know, the week to week margin setting, since it is a function of price.

Q.154 - But this though -- this is an important factor for the Board. Because it has a significant impact on the total recommended change.

A. Right.

Q.155 - So that entry for 2006, I think wants to be as reflective as possible of the differential in the two years since regulation.

So is it still your view that the two-year average is appropriate? Or would a figure from June of 2006 perhaps be more appropriate?

A. Well, my view is that the margin, the 11 cent margin that was selected, as I understand it, was based on conditions in the two years leading up to the introduction of regulation. And so this is the cost base that would be consistent with that period, 98 plus cents.

If you used a month -- I mean, take your pick. They range from 96 cents to $1.12 in the six months leading up to the introduction of regulation. So there is considerable variation there.

But I think the key point is to try to make the base upon which, you know, the comparison is made as consistent as possible with the base that determined the margin to begin with, which is the two years, as I understand it.

Q.156 - You indicated that in table 4.1 it was an April to August entry for July of 2006?

A. On table 4.1, yes.

Q.157 - 4.1?

A. Yes.

Q.158 - Why did you not use that same rationale then for table 4.2?

A. In the case of -- in the case of credit cards, this is a factor that -- to which the margin is highly sensitive. I mean, it varies literally from day to day.

So I think the ideal from my perspective would not be to tie the future setting for a year at a time or two years at a time, but rather to have it fluctuate with prices.

So the more flexible or the more -- yes, the more flexible that that setting can be, I think the better off it is for, you know, for retailers who are facing these costs.

In the case of carrying charges, the carrying charges are not going to fluctuate. They are not driven by a variable that is as sensitive to market conditions as is the price of fuel. And so it seems to me entirely consistent to use a price which is indicative of future levels rather than a longer term price.

CHAIRMAN: Ms. Desmond, before you leave that line of questioning, one of the questions I think that you put to Mr. Gardner with respect to table 4.1 I believe was "Can you redo that?" And I believe he said yes.

Was that intended to be an undertaking?

MS. DESMOND: Yes, it was, Mr. Chair. And perhaps if Mr. Gardner might indicate how quickly --

CHAIRMAN: That was my question, if that was intended as an undertaking.

Mr. Gardner, could you perhaps let us know how long that would take to do that calculation and to provide us with the amended table 4.1?

I don't expect that you will do it sitting there, but --

WITNESS: I mean, I do have my -- I don't have a printer here. But the computation itself could be done fairly readily.

CHAIRMAN: Is that something that if for example your testimony were completed today that you could work on and provide potentially by tonight or tomorrow?

WITNESS: Yes.

CHAIRMAN: And that was, as I understand it, Ms. Desmond, the single undertaking, was to redo table 4.1, is that correct?

MS. DESMOND: Yes. That is correct, Mr. Chair.

CHAIRMAN: Thank you.

Q.159 - And with respect to credit card costs -- and I know there has been some reference to anecdotal information. And I believe that is the case with credit card usage. You reference an increase in credit card usage. And I have got, you know, sort of a collection of information that was provided to you.

How comfortable are you, Mr. Gardner, that that is a reliable estimate?

A. I'm comfortable that the current level of usage is in the 40 to 45 percent range. Whether it started from 30 percent or 35 percent or 25 percent, I'm less confident.

Because we asked the question of -- in the questionnaire we asked the dealers we were dealing with. We asked the wholesalers, the major wholesalers, the integrated refiner marketers the same questions. How much has this changed? What was it four years ago or an average of two to three years ago? What is it now?

This represents I guess our best assessment of what those numbers look like. And it is anecdotal. It is important. But you know, I'm afraid that is the best we could do with the information we had available.

In the course of discussing this with the major wholesalers who would have I think a better -- would have better systems to track this kind of information, I did ask them specifically if it would be possible for them to document this.

Because putting 30 and 45 percent in, even though it is based on a number of -- or input from a number of people, doesn't carry the evidentiary weight that something that is generated based on actual information -- you know, it wouldn't carry the same evidentiary weight. But we didn't get that information.

Q.160 - I do see that you referenced testimony from the States. I think it is the Cannon testimony?

A. That is right. Yes.

Q.161 - And I believe that at page 4 of that document he talks about a percentage increase to 40 percent, that that was the increased usage of credit cards?

A. Yes.

Q.162 - And I'm just wondering why, if that is a document you have relied upon, why you have suggested 45 as opposed to 40 percent?

A. Well, again Mr. Cannon actually said over 40 percent. If I can read the -- just for the benefit -- I don't know if everybody has read this.

But the document we are referring to is a statement by counsel for an organization called the Merchants Payments Coalition pursuant to an antitrust inquiry in the U.S. Congress specifically dealing with credit card companies, Mastercard and Visa.

And the testimony walks through how the business is conducted and indicates the -- well, in their view that the practice of Visa and Mastercard in particular in establishing these interchange fees is noncompetitive because they collude with the banks in setting these rates.

In the course of his testimony he indicates the amounts of money that are -- that are in question. And they are in the billions of dollars, tied up in just the interchange fees.

On page 4 that counsel just referred to the heading is Merchants Must Accept Visa and Mastercard Brands of Credit and Debit Cards. In 2006 the dollar value of all U.S. general purpose payment card transactions exceeded $2.7 trillion. This represents more than 38,000,000,000 credit card and debit card transactions in the United States alone which account for more than 40 percent of all transactions between merchants and consumers.

So the support for the statement in looking for some support for this statement at 45 percent, I came across this document. And it seemed, because it was on point with respect to credit cards, seemed to provide at least, you know, a ball park for the value that retailers and wholesalers in this province have provided us with for the proportion of transactions.

On the question of -- which you may be going to, the percentages, we were given a range of percentages by -- this is a percentage, the interchange fee, the transactions fee. The lowest was 1.75 in current transaction fees all the way up to 2.3 percent. And this is just for Mastercard and Visa.

And those fees vary depending on the number of transactions, the value. And it depends again on the deal that that particular station negotiates with the credit card companies. And from there the fees go up. So that if anybody is accepting American Express that might be the 3 to 3.5 percent range.

So what that means is that on -- you know, if gasoline is one dollar, 2 percent of that price goes to the company, comes off the top of the retailer's 5 cent margin or whatever the margin is.

As price goes up, the percentage -- I mean, if it goes up to say $1.50, the price of gasoline, then it is 3 cents off the top. So the margin goes from 5 to 2 cents.

A question had arisen in one of the IR's about where is the support for the fee, the size of the fee. And again everyone to whom that question was put, the wholesalers and retailers, the lower bound of the fee was 1.75 and the upper bound was 2.3 for the generally accepted cards, Mastercard and Visa. So just to provide in this case a conservative estimate, we used the 1.75 percent.

The discussion on the size of the fee, if you read on in that document, is on page 13, 14 and 15.

Q.163 - I take from your testimony, Mr. Gardner, then that you have used a conservative number for the credit card fee, that perhaps the 45 would not be as conservative a figure?

A. Yes. It's more difficult to say whether that's conservative or liberal. It represents what many of the people who spoke to that issue used, that the number is -- and some of them are up in the 50, 60 and 70 percent range. So it's probably at the middle.

But as I say, it is anecdotal. And it is unfortunate that the companies in whose interest this number operates weren't more forthcoming in the -- with the details.

Q.164 - I just have one further question on credit card cost. And you might have suggested that in table 4.1 the better approach was to use an April to August average for the July 2008 entry.

Could I ask you to take that same methodology, and using April to August 2008, apply that average to table 4.2?

A. Okay.

Q.165 - Are you able to do that calculation, sir?

A. Yes.

CHAIRMAN: That would be undertaking number 2.

Q.166 - Mr. Gardner, have you ever made changes to the maximum margins that have been made in other regulated jurisdictions since July 2006?

A. Yes.

Q.167 - Can you just provide a brief summary of what those changes were and why the changes were made?

A. I just hope I have my dates right. But in Prince Edward Island the Gasoline Dealers Association formally applied for an increase in the margin. And I have a copy of the application document.

The Board there agreed to an increase of one cent that was phased in January 1st. I'm trying to recall whether that was -- I believe it was 2008, in June of 2008, two 5 cent increments.

Newfoundland more recently has introduced a 1.5 cent increase which seemed to be preemptive in the sense that there was no -- at least to my understanding no formal application or no process that heard an application, but rather the Board recognizing that costs had increased and informally, hearing pressure from the retail sector, had directed an interim increase of 1.5 cents.

Q.168 - If you could turn to page 29 please of your report. In table 4.3 you reference the wage share of margins. Is that a statistical term used by Statistics Canada? Or is that your own term? And what would that incorporate?

A. The wage share -- I guess using it that way it is my term. The basis for that 50 percent share is an analysis, a financial analysis of gasoline stations in New Brunswick compiled by Statistics Canada based on Revenue Canada information. I have a copy of the financial statement which I would be happy to submit.

And essentially what Statistics Canada has done is introduce a service, and it is online, it is web-based, where it provides almost as a guide I suppose to small business, an ability to determine what the financial position of other businesses in your industry is and divides it into, you know, quartiles and so on. And you can go and you can see how well you are doing. You can essentially benchmark.

So this analysis for New Brunswick focuses on gasoline stations both incorporated and unincorporated. There are just over 300 in the sample. And it is based on the financial returns to Revenue Canada. So it lays out in some detail the cost structure of the industry.

The wage share of operating costs is 49.98 I think percent which we rounded up to 50 percent. We have used the term wage share of margin because the industry essentially operates at something very close to zero profit in the aggregate.

So in other words, the entire margin is needed to cover the operating costs, okay. Just to extend that, that analysis shows that 50 percent -- sorry, 51.6 percent of the gasoline stations incorporated -- 306 I think there are in the sample. 51.6 percent are profitable. So 48.4 per cent are unprofitable. And the amount of profit is literally about $2,000.

And this is based on 2004 data. And that analysis will be available for 2006 I think in another month or two.

Q.169 - So when you talk about 50 percent of the operating costs and then 50 percent of the wage share of the margin, it is just coincidental that they are both 50 percent. Is that what I'm hearing you say?

That the operating cost, 50 percent of that goes to wages and salaries, but that there is a margin and that half of that margin is used just for those operating costs?

A. Okay. Because we don't have actual data from the gasoline stations in New Brunswick to form the basis for the analysis, we were I think fortunate to find this source of data. Because for the industry it provides a rich database.

It shows and it breaks out several different elements of cost, operating cost. And wages and salaries is one of them. Wages and salaries account for 50 percent of total operating costs.

Then the question is how do you apply that or relate that to the margin?

And in our approach to this we reasoned that since the industry is only just breaking even, it means that the entire margin is used to cover operating costs, with a negligible amount for profit. So it is reasonable to assign 50 percent of the margin, the 5 cents, to cover operating costs.

Q.170 - Okay. And that has been very helpful.

We do have -- I think what you are referring to is your source document. And perhaps with the permission of the panel we could circulate that.

And you could just maybe walk the panel through those numbers to demonstrate how you got that 50 percent?

A. Certainly.

CHAIRMAN: You have our permission to circulate that provided you give us copies this time.

MS. DESMOND: We also have by way of information the source document that supports the 40 percent in table 4.4. So we will circulate that now as well.

CHAIRMAN: Thank you. Okay. Everybody appears to have both of those documents.

Q.171 - So Mr. Gardner, is this the same document you referenced? I think we tried to find your number 1, Statistics Canada?

A. Yes.

Q.172 - Okay. And can you explain how you got to that 50 percent based on the source data?

A. Sure. If you go to the line Operating Expenses, it shows 177,000 as the average.

Q.173 - Just for the benefit of other people in the room, we are talking about the gas stations 2004?

A. That's right.

Q.174 - Thank you.

A. So looking at line 1, 2, 3, 4, 5, 6, 7, Operating Expenses, it is the third line in bold, it shows an average of $177,000 for the industry as a whole. That is per station.

And directly under that, labour and commissions is $88.4 thousand. That is where the 50 percent came from.

Q.175 - I think when we were looking at this source document there is an entry for wages and benefits, right under "Cost of Sales".

I'm wondering how you account for that now based on -- I guess how does that fit into your 50 percent?

A. Well, I think that relates to the acquisition of fuel which is the primary product, and possibly other items that the gasoline station may sell. But that's related to purchasing the inputs rather than selling the outputs.

Q.176 - And on the next page and your reference to 40 percent of the wage share of margin for heating oil -- could you perhaps -- it is the document entitled "Petroleum Product Wholesaler Distributors, 2004."

A. Right.

Q.177 - Are you able to maybe just walk us through how you got to that 40 percent?

A. Sorry. I'm just going to -- yes. This one I used the same -- the same basis, the 116/261, but adjusted it downward. Again to -- in this case to reflect -- so that computation works to 44 percent. I got it down to 40 percent based on the input from the industry, and also in part because this was as close as we could get, you know, to heating oil.

It is not exactly the same business. It is wholesalers and distributors. And even though we are only talking four percentage points, just based on the information we got from people in the business, it seemed that 40 percent might be a more accurate picture of the labour cost.

Q.178 - Just a minute ago you referenced the profitability of different retail service stations and the difficulty that businesses were having in their operations.

When you talk about profitability does that refer just to motor fuel sales? Or are you including the profitability of all business loans including all petroleum operations?

A. I'm referring to the profitability of the gasoline stations as they are configured in the province. Now clearly some are more profitable than others. But the reference includes all lines of business.

Q.179 - And that is the 2004 Statistics Canada study?

A. That's right. The --

Q.180 - I was just going to ask if you might make a copy of that available as an undertaking?

A. Sorry. When you say that --

Q.181 - It was a reference to the 2004 StatsCanada study?

A. Well, so we are talking about the same thing, I mean, we retrieved this from the StatsCan website, okay. So it is the same document, yes.

The version I have breaks it down by size of firm into quartiles. So there is I guess a richer analysis available there.

But your question I think goes to whether or not in this case non-petroleum revenues are included. And they are. This represents all gas stations, independent gas stations in the province.

Q.182 - Given that statistic of the level of businesses that are struggling, why is it that we have so many retail operations still continuing to operate in New Brunswick?

A. I think until the capital completely runs out, in many cases it is less expensive to stay in business than it is to get out. There are substantial costs associated with exiting the industry, associated with environmental cleanup, pulling out tanks and so on.

Why people do it -- if you look at this statistic where 51.6 are profitable -- 51.6 percent are profitable and 48.4 percent are unprofitable, that is not a snapshot. I mean, if you go back and look at this in 2002, 2000 the same proportions are there. So people are just getting by.

But when you look at what is critical for a company, particularly an independent retailer in a rural or remote area, there is no capital to reinvest. There is no capital to expend.

In Michael Ervin's report he talks about non-petroleum revenues. And believe me, I mean, there are many, many stations in New Brunswick in rural and remote areas who would love to have a C-store or a car wash. But there are two impediments. (1) they don't have the capital and (2) they are not in the right location.

And so the notion that non-petroleum revenues are somehow going to rescue the industry I think is misguided. It cannot happen. It happens in certain locations for certain well-capitalized companies. But generally it is problematic.

Now just before I leave that point, unfortunately in the case of New Brunswick this StatsCan or Industry Canada small business profile breaks down the gasoline industry into two parts, incorporated and unincorporated.

If we look at Nova Scotia, whether the question was asked a little differently or whether the results were submitted a little differently, the report breaks down the industry into two parts as well, gasoline stations with convenience stores and those without, another category.

The number of businesses with convenience stores number 100. 52 percent are profitable. 48 percent are unprofitable. In the gasoline stations without convenience stores, the data show -- and there are 248 of those -- the data show that 77.5 percent are profitable.

Now it is difficult to know what kind of inferences to draw from that. But I guess if I were getting into the business, I'm not convinced that unless the location were ideal, I would put in a convenience store.

Because it is not axiomatic that this makes a business more profitable, judging from the data from Nova Scotia.

And I think those stations are broadly similar to the ones we would find in New Brunswick.

Q.183 - But should not at least some of the costs that would be related to non-petroleum sales be -- shouldn't those costs be attributed to those other parts of the business?

Is there some fashion or mechanism by which you can make that analysis?

A. Well, again we asked that question on the survey. And we didn't get enough response to make a difference. But ideally, sure, you would want to have a breakdown of both where the revenues come from and where the costs go.

But in the absence of that detailed breakdown, if you make the assumption that 50 percent of those costs would be attributable to the back store and 50 percent to the pumps, you are still looking at 50/50.

And I think 50 percent is not unreasonable, again given the limited information we have from the industry, coupled with what we see for, you know, the business or the gasoline stations without convenience stores. It is still in that range.

Q.184 - I wanted to just reference then -- there was an IR from the Department of Energy. I'm sorry. It was a report from the Department of Energy in the report of M.

J. Ervin.

And he has a table, table 3, if you could just maybe turn to that.

Now I stand corrected. I'm told it is in an IR response that was posed by the Board to M. J. Ervin. I'm sorry about that. But it is table 3, if you are able to find that reference. It is in the IR's to Mr. Ervin.

A. Yes. If you have a copy of that somewhere, but -- thank you. Yes.

Q.185 - And I'm just actually comparing your report, page 29, right under "Minimum Wage", where you suggest that the minimum wage in New Brunswick has risen by 19 percent. And then his response to an IR, table 3. And he has significantly different percentages of wage increases.

And I'm wondering if you might want to comment on the data that has been provided in table 3?

A. Our survey of the retail gasoline dealers indicated that virtually all the pump attendants and workers, other than skilled mechanics, worked essentially for minimum wage.

Since July 1st of 2006 the minimum wage in New Brunswick has gone up by 19 percent. And those statistics are available from -- I think it was $6.30 to 7.75 over that period.

Q.186 - Yes. I think that you have in your report at page 29?

A. Right.

Q.187 - 6.50 to 7.75?

A. Yes. And so applying that to the wage bill, you know, suggests that the industry is facing a major cost crunch. I don't know how you would compare an industry-specific statistic, the sector specific in the case of gasoline, with one that covers the entire retail trade industry.

And to suggest that weekly earnings in the retail trade rose by only 3.6 percent from '06 to '08, you know, if that is what the stats show, that is what the stats show. I don't know.

But many people in the retail trades also work, broadly speaking, in convenience stores, in grocery stores, in department stores, in shopping malls, you name at, work at minimum wage.

How they either escape the law or misreporting is not clear. But for wage earners only in that industry it is surprising that we have only seen a 3.6 percent increase. I can't explain the difference.

Q.188 - My next question is with respect to full service charge. And I believe in an IR response you did provide information about the full service charges in other Atlantic markets.

Based on the information that you have provided to the Board in your report in the IR responses, do you have a recommendation for the Board as to what an appropriate charge would be for full service?

A. Well, I understand that the Board can't simply by regulation lift the cap. But based on what we have observed in Nova Scotia, where again there was a recommendation or a report a year or so ago that said lift the cap, and they were similarly constrained, they didn't lift the cap. They set it at $999 I think or something like that. So there is an abstract cap which is never achieved.

But the analysis that the regulator in the province has conducted weekly surveys by zone in the province of many of the full-serve and split-serve dealers that would have been affected by the removal of the cap, and they found that on average the dealers increased their prices by a cent or so. And it varied between rural and urban.

But at the outer limit, the more remote stations, in most zones -- now I can find the actual table here -- in most zones the maximum went to one to two cents over the full-serve.

Q.189 - Mr. Gardner, perhaps I could have panel members turn to that document. Because I believe you did provide it as a response to an IR. And it was a response to an EUB IR.

A. IR number 1 I believe.

Q.190 - Number 1? Thank you.

A. And there is a table at the back of the IR's that summarizes the month-by-month changes in six zones in the province.

So essentially what the dealers are subject to is the competitive environment. So they are free to raise their full-serve charge to what the market will bear. And what the market bears depends on how far the next station is away, whether it is full-serve or split-serve, a number of those kinds of competitive factors.

And in only one zone had dealers in the rural part raised their prices into the 4 to 5 cent range above the full-serve price.

In most zones the shift falls in the 1 to 2 cent range, 2 cent per litre range. And that is above regulated full-serve.

So lifting the cap hasn't meant that most dealers are able to raise prices indiscriminately. They are still governed by the competitive environment.

If there were a number you had to pick -- and this is based on the outside limit in Nova Scotia in rural areas -- it is somewhere in the 4 to 5 cent range.

But as I say, in most cases, in rural areas there is very limited latitude to price above the -- significantly above the self-serve limit.

Q.191 - I appreciate that you are looking at Nova Scotia information. But would you make that same type of recommendation here in New Brunswick?

A. Well, the recommendation in the report was to lift the cap and let the market settle where it may. And I understand that there is a regulatory problem with doing that.

So you know, limiting the increase, you know, to 10 cents over self-serve would probably see in some areas as much as 3, 4 or 5 cents over. But at least it would give the retailer the opportunity to -- or a greater opportunity to realize a margin that worked.

But again, the dealers in New Brunswick who provided specific comment on the margin suggested that a margin in the 4 to 5 cent range, these were rural dealers, would be more appropriate in their circumstances. And they felt that they could charge those kinds of prices.

Q.192 - Okay. Our next line of questioning is to delivery costs.

CHAIRMAN: I'm just wondering how much longer your cross examination might be. Because it was our intention to have an afternoon break.

MS. DESMOND: Perhaps we should have a break now. I'm going to be probably another 20 minutes or so.

CHAIRMAN: Okay. We will take a 15-minute break then.

(Recess - 3:00 p.m. - 3:15 p.m.)

CHAIRMAN: Ms. Desmond, before you proceed it has been brought to my attention -- and perhaps it is partly because of the fact that Mr. Gardner is unrepresented, but is here as a result of having been retained by the Board.

But the Board didn't actually qualify him as an expert. And I suspect that maybe Mr. Ervin might ask -- or his counsel may ask to have him qualified as an expert.

Does anybody here have any objection to the Board qualifying Mr. Gardner as an expert?

Mr. Zed, I see you with your hand on the microphone.

MR. ZED: I have probably known Mr. Gardner for about 40 years. And I certainly would have no objection of him being qualified as an expert.

CHAIRMAN: And Mr. Hoyt quite frankly asked the type of questions that one might ask leading up to it. But if there is any objections -- does anybody wishes to ask any questions on that?

MR. HOYT: I certainly have no objection.

CHAIRMAN: Okay.

MS. DESMOND: Mr. Chair, can I suggest that Mr. Gardner be declared an expert, I guess as an energy economist with an expertise in petroleum products, if that is an appropriate area of expertise.

CHAIRMAN: I think that would do it. And again is everybody okay with that?

All right. He is so declared as an expert. So you can proceed, Ms. Desmond.

Q.193 - Mr. Gardner, our next -- a few questions related to delivery costs.

And with respect to motor fuel could you please explain how you arrived at a 3 cents per litre as an appropriate maximum delivery cost?

A. We asked the wholesale companies for delivery costs to each of their stations. We reviewed data that the companies had supplied to the Board on delivery charges.

We -- I met with one of the transportation companies to review their method of charging for fuel delivery. We asked retailers throughout the province what they were paying to wholesalers for delivery costs.

On the basis of that, the number that sort of popped out of the analysis was something between 2 and 3 cents at the outer limits in areas in northeast, northwest of New Brunswick.

So recognizing that this isn't a specific value but rather an up to amount, that 3 cents in the current and anticipated price environment, seemed to capture the outer range of what was likely to occur within the next year or so.

Q.194 - Perhaps without identifying any particular community, could you indicate what the highest delivery cost is that you found in the course of your review?

A. I think I have a table here somewhere that sets out that information. If I can just remember who asked the question.

Q.195 - I believe it was IOL number 14.

A. Yes. Table 2 in the IOL response. This is I guess a sample of charges we included in table 2. And I see Caraquet, Edmundston.

There are two areas, two locations where we withheld the name because it would have been so specific I think to identify the retailer and the supplier and Pointe-Sapin as well. So there are five listed here that are 3 cents or more. And all the rest are in the 2 plus cent range.

So even at 3 cents there are two here that exceed that amount or at least did exceed that amount during I guess what we would call the peak that was realized in the July period.

Q.196 - Are there any communities in New Brunswick where there is only one petroleum retailer?

A. Well, I'm sure there are many. But we haven't visited them all. So I'm not sure how to answer the question. But I'm sure there are.

Q.197 - Moving then to heating fuel at the bottom of page 33, you have got a recommendation I believe, increasing the maximum delivery cost by one cent per litre?

A. Yes.

Q.198 - But if I read the bullet point just at the bottom of that page, there is a reference to what that one cent per litre includes. And it includes the 0.75 cents per litre for the actual increase in fuel cost.

And I believe the 0.25 cents is for anticipated or future cost, is that correct?

A. Well, it is -- it is one cent. It is not adding anything to it. It is one cent based on the 15 percent increase in costs. But the allowance -- it would provide an allowance for future price increases.

Q.199 - And I guess that is the distinction I'm trying to make. You have got a piece there for actual costs plus a percentage for future cost increases, is that correct?

A. Well, I'm suggesting that the one cent per litre would cover the increase in cost and at the same time provide an allowance for future increases, in other words, that going to 3 cents would provide for costs in the -- let's say 2.2, 2.3, 2.4 and in anticipation of future increases up to the 3 cents.

So it is not adding anything to the one cent. It is simply anticipating it.

Q.200 - I believe the delivery on heating fuel though is 5 cents?

A. Well, but the -- I guess the point I'm making is that this one cent, following the same logic as the gasoline and diesel, it is the same trucks, it is the same range of destinations, that one cent would increase, would provide enough ground for the delivery at least to the bulk plants.

I have made a distinction in the analysis that heating oil companies are essentially transportation companies. They are storage and transportation companies. And as such their operating costs capture. And in some cases that 13 cent per litre margin is made up largely of transportation costs.

So it is kind of -- the way the margin is broken down is artificial, let's put it that way, in the regulations, that it doesn't reflect accurately how the businesses or the diversity in the businesses and their cost structures.

As I think the note -- there are a couple of heating oil dealers I spoke with. Their distribution costs, that is before the fuel gets to them -- sorry, after the fuel gets to them, their distribution from their bulk plants to their customers is in the 10 cent per litre range, out of the margin of 13 cents.

Q.201 - How did you arrive at that 15 percent increase in cost for delivery on heating fuel?

A. Using the same approach as for gasoline and diesel fuel. When I looked at the change, you know, in the pre and post regulatory period, the increase at the start, I think the fuel adjustment -- or the delivery cost plus fuel adjustment was something in the order of 1.2 and it had risen to 1.45 cents per litre on average.

So it worked out to about a 15 percent change. But it was the same -- the same figure as for gasoline and heating oil.

Q.202 - If you could still look at that table 2 which we just referred to. Can you perhaps just explain the indicative freight rates including fuel surcharge that you reference at the bottom of that page?

A. Sure. These rates were provided by -- it is an amalgam of two or three wholesale companies who provided these rates. And for specific locations the actual rate had increased.

Because what I had asked each of the wholesalers to provide us with was a buildup over a period of months from the start of regulation to -- at the time we did the survey it was in June, July of 2008 -- was to ask them for specific rates in those months. And they had provided that or at least some of them provided that before I met with the transportation company.

And what the transportation company provided was the formula to actually compute the fuel adjustment charge, which at this point I wasn't aware of yet.

So what this reflects is for specific locations the actual transportation cost including the fuel adjustment charge. So you can see the buildup of how that occurred. And this kind of buildup would have occurred for a variety of stations around the province.

Q.203 - I don't see any reference to what the first line of data is versus the second line of data?

A. These are two locations, okay. And I had left them off deliberately. Because the source wanted this to remain confidential.

Q.204 - You have created that chart I guess with the data from two companies. Is that representative of --

A. Yes. The rates -- the rates that the companies charge vary very slightly to -- you know, there can be a slight difference in the fuel adjustment charge. There may be a slight difference in the fixed component of the charge.

But at the end of the day, at current levels, you could probably reliably say that for extended hauls you are looking at 6/10 of a cent per hundred or 7/10 of a cent per hundred kilometers.

I mean, there are different rules of thumb, $75 an hour depending on the type of truck to $85 an hour of delivery time is another way of looking at it.

And you can look at the total litres, 50,000 litres and work out over a three or four-hour haul what the per unit is. But I think using 6/10 to 7/10 of a cent would capture the range.

Q.205 - In the recommendations you have differentiated between the increase for wholesalers and the recommended increase for retailers. I think it is one cent per litre for wholesalers and 0.2 cents for retailers.

Can you explain why you have presented it in that way?

A. Well, I presented it that way because there are a couple of components there. One is the delivery from the refinery or the storage to the heating oil bulk plant which is captured by the 5 -- notionally captured at least by the 5 cents.

The .2 cents per litre is meant to reflect the fuel -- just the fuel cost share of total operating costs, which based again on information provided came to about 10 percent of the operating costs of the retail heating oil dealer.

And so applying the increase in operating cost, the 15 percent against the 10 percent share against the 13 cent per litre margin gets you to 2/10 of a cent.

Q.206 - It just would appear to me that that 0.2 cent is really not an operating cost --

A. It is --

Q.207 - -- it is a delivery cost?

A. It is an operating cost. But it is the estimate of the delivery component of operating costs. It is a way of getting at what these companies really do. They are transportation companies.

And as I said in the introductory remarks, it is just a bit artificial to have this 5 cents out there when the 13 cents is really capturing what the companies do. And that is to deliver fuel.

Q.208 - Mr. Gardner, I just want to look at your addendum, the propane addendum that was filed separately from your original report. And I'm looking at page 2 of that report.

And you have got two sort of tables on page 2. And I'm wondering if you might explain how you arrived at the 18 percent and 82 percent that you have got documented on those two tables?

A. Well, this is -- propane is about the most opaque segment of the energy industry in the province. There are no published prices other than for transportation. So heating fuel, unless you are a buyer yourself, going to the company and asking for price data, is going to not be very rewarding.

Because I did ask that of two of the major companies. And that was too sensitive. So I didn't get that information. The propane rack price I obtained from Shell, who were quite happy to provide it on request.

But in order to get some kind of history of the margin, the 50 cents that is allowed in the legislation, it is difficult to find, impossible to find a series that would go back a period of years to be able to determine where that 50 cent per litre came from.

So without having a clear sense of where the 50 cents came from, I understand -- I presume that when the original margin was set that the regulator had input from industry.

Although neither of the companies that I met with, you know, was prepared to allow, you know, where that number might have come from. But both agreed that it seemed a reasonable guide to the margin prior to regulation.

Now when it comes to the delivery costs, I asked the companies what does it cost to move product from Sarnia to Moncton. And again I did get information on a cents per litre basis, that to make sense of producing a table that was consistent with the approach used in the rest of the report, I rendered as a percentage of the overall margin, since that is what has to cover that transportation cost. There is no wholesale segment in this industry to speak of. It is primarily retail.

So the retailers essentially occupy that 50 cent marketing margin. And the amount of the cost, or the cost two years ago, was approximately 18 percent of the 50 cents, okay, 9 cents.

And I was given the end point. Taking the 15 percent used as a guide to the increase in transportation costs, it implies an impact on a gross margin of 1.35 cents per litre.

So it was industry information on the cost of delivery from Sarnia to Moncton that provided the basis for this 18 percent, okay.

Q.209 - I note that you have a note "Subject to verification."

What does that mean?

A. Well, it means that I didn't receive a document that laid out prices the way I did for gasoline and for heating fuel in discussions with retailers.

The industry is -- propane industry is very, very sensitive about its information. There are limited numbers involved. And giving one source effectively gives the other the competitive information it needs.

So it was very difficult to extract useful information, let's put it that way, in this industry. And this is about the best I could do.

Q.210 - Could you also explain, when you look at the increase in freight cost -- first there is the increase in operating cost -- how did you arrive at that breakdown of 15 percent and 6 percent?

A. Again the 15 percent reflects the same percentage used for gasoline and diesel fuels and heating oil in the province. So it is as simple as that. I just used that as a guide.

And the basis for that is essentially in the increase in diesel fuel costs, since that reflects the fuel adjustment charge and it reflects what a large user like CN would be using, okay.

Q.211 - And perhaps you could just identify, where you have a delivery allowance on page 3 of your report, what is the distinction then between that delivery allowance on page 3 and your transportation information on page 2?

A. The delivery allowance is from the bulk plant to the customer, okay. So it reflects the delivery allowance in the last column on the price sheet that the Board circulates, okay, that 10 cents.

And again it reflects the cost or the increased cost of fuel, diesel fuel over the period, 15 percent.

Q.212 - I don't think you addressed the 6 percent at the bottom of page 2. I'm not sure that I heard that explanation.

A. That is based on the GDP deflator, for lack of a better term. You have a 6 percent annual -- sorry, 3 percent annual increase over two years. It is a 6 percent increase. That is a StatsCan inflation figure.

Q.213 - Mr. Gardner, I see in your report that you also have allowed an increase for the levy fee based on the regulated levy fee --

A. Right.

Q.214 - -- that must be paid?

Now the levy fee arguably was understood to be part of the legislative regulatory scheme. The legislation was put in place in 2006.

Would you agree that perhaps when the government introduced this legislation in the regulations that that was anticipated, that that levy fee would be a necessary piece of what would have to be paid, and as such set the margins accordingly?

A. Well, I have no specific information about what the regulator might have incorporated into the original margin when it was set.

Q.215 - Or when the government introduced the legislation?

A. Right. Yes. I don't know. If that is the case then perhaps it shouldn't be there.

Q.216 - And Mr. Gardner, you are aware that there was changes to the legislation in 2007. And I don't believe there were changes to the levy or how changes -- how the level was to be recouped at that particular point in time?

A. Right.

Q.217 - So is it fair to say that the intent of the legislation is that perhaps the wholesalers are responsible for that levy and not the consumers?

A. Well, if it was intended to be part of the margin then consumers are responsible. If it's not intended to be part of the margin then wholesalers would be responsible, recouping it out of costs somewhere. But I don't think you can have it both ways.

MS. DESMOND: Thank you, Mr. Gardner. Those are all my questions.

CHAIRMAN: Thank you, Ms. Desmond.

Any questions from members of the panel? Mr. Radford?

MR. RADFORD: No, Mr. Chairman. That is fine.

CHAIRMAN: Mr. McLean?

MR. MCLEAN: No.

CHAIRMAN: Mr. Toner?

BY MR. TONER:

Q.218 - I have a few questions now that you are deemed an expert I guess.

My question relates to volume of litres. Because you make reference to the retailers in the province. There are different types of volume, as small as 200,000 litres.

A. Mmmm.

Q.219 - Can you give me a breakdown of the number, of the 470 dealers? Like are they broken up into three categories and what those categories are for? Or is a breakdown -- is there such a breakdown?

A. There may be such a breakdown, but -- and I had hoped to use Board data to try to determine what categories dealers might fall in.

But it is incomplete, let's put it that way. The information that has been provided to the Board doesn't allow for that kind of calculation.

Q.220 - So when you talk about a rural dealer and an Irving dealer -- I'm going to give you an example, like the Irving Big Stop in Salisbury is a high volume?

A. It is a big Big Stop.

Q.221 - Is it a rural dealer? Or is that an urban dealer?

A. That is a rural dealer in an urban environment. That's a -- you know, that's a multimillion litre a year operation.

But it is -- in my view it is an urban dealer that happens to be in a rural area. But it is on the main highway. I stop there frequently.

Q.222 - So I take it that it is an urban dealer?

A. Well, I mean, it is an urban capacity, let's put it that way. I mean, the volumes are such that it would conform to what you would expect to see in a major urban centre.

Q.223 - Yes. In the report in relation to the credit card fees, because I'm going back down that road, you talk about -- in the report that you gathered here, you are talking about 40 percent. But credit card fees and debit card fees aren't the same?

A. No, they are not.

Q.224 - And they are quite a bit different?

A. Yes.

Q.225 - So when you have reflected in this report that you took your data from, which is from the U. S., when it states -- it states that this represents more than 38,000,000,000 credit card and debit card transactions, represents more than 40 percent of the transactions.

I find that this conflicts with your 45 percent that you are using. I'm having difficulty with your 45 percent average --

A. Mmmm.

Q.226 - -- to be honest with you. And because it makes such a big impact on the 58 cents that you are suggesting.

And I find that a lot of the data that is gathered to get there is very difficult for me to accept. So I would like you to run down that again. Because if we are going to use this 45 -- I believe there is a cost, let's put it that way, I just don't understand how the real impact is.

Because there is no math. It seems to me it is a very easy mathematical calculation for the retailer to give that data. So I guess --

A. Yes. Sure. None of the dealers we asked pulled out a record of transactions and said, here it is. None of the companies we asked pulled out a record and said, here is the percentage.

The dealers we spoke with vary in terms of the level of sophistication and running a business. Some of them are -- you know, they could run, you know, substantial enterprises in a number of different disciplines. Others, they are just not that sophisticated.

This is more anecdote. But one dealer we met with who was very small, maybe a couple of hundred thousand litres, maybe less, she had no idea of why she wasn't making any money, no idea.

And she offered some invoices. And they happened to be records where credit card transactions were kept, all right. They showed up because of the transactions with her supplier. Virtually all her margin was gobbled up by the transaction fee, by the credit card fee. And I pointed this out to her. It was pretty obvious. She wasn't sophisticated enough to pick up the nuance.

She was surprised. And she wondered why her accountant had never brought this to her attention. But she in the final analysis was thinking that she was going to get out of the gasoline business altogether because it just didn't pay.

So when we go to see people to ask them for information, there are one or two people, usually the owner. And he is trying to run the station. And he is doing this, he is doing that and he is distracted. Ask him to fill out forms, it takes time.

So the long and short of it is that trying to gather this kind of information in the space of a month or two that we had to do the analysis proved to be very, very difficult. So we accepted at face value the information that people provided us with.

And many, many, many of the dealers said, I'm using -- I'm getting, you know, 40, 50 percent of my transactions are with credit cards. Because it is costing 70 to $100 to fill the tank.

Most people don't have that kind of cash or they don't keep that kind of cash in their pockets. They are now using credit cards whereas before they would have used cash. Yes. No question. Debit cards are in there.

But that 40 percent in that report is not what we relied on. What we relied on was the information we obtained from the dealers. And they indicated that it had gone up from 30 percent, 40, 45 percent.

And what I had tried to find was some evidence that would corroborate that in a published form. And this was as close as we could get to something that was specific to retail transactions, including gasoline.

So I think you are right. And I'm, you know, I guess a victim of the inability or the unwillingness of people to provide or do the work that it requires to provide that kind of information.

But I -- you know, a number of the major companies said that that is not -- you know, it is not a trivial exercise to go back and recreate those files and to document that stuff, so --

Q.227 - That it is not trivial?

A. It is not trivial.

Q.228 - Yes.

A. And it is not -- it is certainly not trivial for the individual dealers to go back and do that. It is time-consuming.

And they, with all due respect, believe that they have, you know, other things, and some of them would even think better things to do with their time than talk to consultants who are prying about their financial information.

Q.229 - Now -- and if you took it now from a number of stations -- because I think like there is 470 stations, but there is a billion dollars of volume -- a billion litres of volume. What -- if we were to get a true -- if we were to go and say, let's get a true number, like let's take the time, let's say take a year and figure that out, how many -- what percentage of litres would be required in your opinion to give us an accurate figure of this number, to give us an idea of what real percentages of people that use credit card versus --

A. Well, I guess if I were, you know, empowered to get that information, I wouldn't -- I don't think I would go to the individual dealers. But I would deal directly with the major wholesalers who end up processing a lot of this information.

And if you look at the proportion of gasoline that flows through the integrated refiner outlets, I think you would get a very good idea of the proportion overall in the province.

But to ask -- you know, if you have got between 450 and 500 dealers or 550 dealers in the province, I think you would want to get at least, you know, 25 percent. And in order to get a good weighted average you would want to have rural and urban and so on and make sure those volumes captured, you know, the industry as a whole.

So it is -- I mean, with some thought I think you could probably work out something that is statistically reliable, given the kind of information you are looking at.

But off the top I would think you would be -- you would probably be in the 25, 30 percent of volume that you would want to be looking for.

MR. TONER: Okay. Thank you.

CHAIRMAN: Thank you, Mr. Toner. Mr. Johnston?

VICE CHAIRMAN: Thank you.

BY VICE-CHAIRMAN:

Q.230 - Mr. Gardner, could you turn to page 21 of your report. This page contains data relating to the marketing margin in Saint John and across the country.

What is the source of this data? Did you compile this yourself or your firm?

A. No.

Q.231 - How did this come about?

A. No. The data -- and maybe the print is small, but -- my apologies to Mike Ervin there. This information is available on public -- publicly accessible websites. And in this case I relied on M. J. Ervin's website for this information.

Q.232 - Okay. On the charts it makes reference to Gardner Pinfold. Is that --

A. Just prepared by, just pulling in the data and creating the chart. The data itself comes from M. J. Ervin.

Q.233 - All right. Now my next question is with respect to the margins in cities outside New Brunswick, and particularly western cities, I understand that what we refer to as the marketing margin with respect to Saint John and the upper graph is the pump price as compared to New York Harbour, is that correct?

A. That's right.

Q.234 - With respect to other cities, let's pick Vancouver, is it -- are we using another base line apart from New York Harbour?

A. Yes. In strict terms the marketing margin is defined as, you know, the rack to retail price. So all of these prices are from the local rack price in that city to the retail price in that city.

Q.235 - Okay. So these two charts are showing separate things then. Because the upper chart, which is figure 4.2, that is showing rack to retail and New York Harbour to retail?

A. That's right.

Q.236 - And the bottom chart is showing rack to retail only?

A. That's right.

Q.237 - Okay. So this is showing in the western cities the growth in the margin between rack and retail and then the reduction. Okay.

So these are showing slightly different things?

A. Well, yes, they are. Though because -- the lower chart is a comparison of relatives. The upper chart is taking Saint John only and showing, you know, how the effective margin, New York Harbour to retail, as well as the marketing margin rack to retail have moved over the last eight years.

It is showing the distinction between an integrated refiner, what the acquisition cost to the pump price would be versus let's say a reseller purchasing at the rack price.

Q.238 - Okay. Now in the last bullet point above the lower graph it says "The average margin in Canada has increased by just over .6 cents per litre."

Can you tell me anything about what that means, "average margin"? Are we dealing with that on a volume basis? Or how is that being handled?

A. Yes. That is done on a volume basis. So that is taking the average across all the points where data is collected across Canada.

And I can't remember the total number of stations or the total number of cities. It is in the order of 12 or so. And I think they may all be here, where there is a rack price quoted and reflected in a marketing margin.

Q.239 - So just so that I'm clear on this, we have in the southern Ontario market where the margins have in fact declined?

A. Right.

Q.240 - Because that would be a very large volume area, that is going to pull the Canadian average down?

A. Yes.

Q.241 - Okay. Now there was a conversation that -- well, there was a question and answer this morning with the gentleman from Ultramar regarding delivery charges and the bulk plant situation.

And I'm just wondering if you could elaborate a little bit on that and how the structure of delivery charges under our legislation affects wholesalers who are operating bulk plants.

I'm not sure if I fully understood the difficulties that that was posing.

A. That is probably a question that is best directed to the operator of the bulk plant in question. But in this case Ultramar. But if Mr. Maynard is not going to appear on the stand I will try to take a crack at it.

They charge a fee for deliveries taken from that bulk plant. And I don't know if it is a public number. But in any event there is a fee associated with that. And I have been given a number. Although I have been given a number by a number of different people. So perhaps I can say what it is.

But in any event let's say it is in the range of, I don't know, a cent or so, okay. So from Chatham to the market they serve they are trying to recover their one cent or so per litre.

Now their ability to realize that amount depends on the relative cost, delivered cost of fuel from the refinery in Saint John and to some extent the refinery in Halifax or Dartmouth.

And the transportation costs of course are going to vary with distance. But in the area served by the Chatham facility, it starts off charging a cent or so for deliveries taken from that plant.

So in effect it is competing with deliveries that are taken from the refinery let's say in Saint John. At some point there is -- before regulation there was a break-even point. However the company sorted out their cost or their delivered costs.

In this environment, in the regulated environment, the delivered cost becomes an explicit part of the final product price in the sense that the wholesaler has to or is supposed to show it as a distinct segment of the price, so that the retailer knows how much he or she is allowed to add to get at the maximum or the total rather retail selling price.

So exchange the competitive dynamic. Because now, depending on where you -- from whom you are buying your fuel and how far it goes, and depending on competitive conditions in that market, you are either able to or not able to pass along the full cost of delivery.

So if the wholesaler purchasing from the refinery in Saint John is saying right, that has cost you 2 cents, so here is -- your all-up cost is now 13 cents -- say it is in a northern community -- if you want to buy from Ultramar or, you know, you may have a better price from Ultramar for your fuel, but the cost of operating that facility plus the delivery cost may leave you in a disadvantageous position.

So you either have to, you know, roll back your selling price, including the distribution -- or the storage charge, or lose the customer.

And I think what has been happening in some of these markets is that because the market price is now driven by the lowest cost supply into that market, it has become more difficult for companies with storage to compete.

Before, the price was not necessarily driven by that least cost distribution. It was driven by market forces. Transportation was in there somewhere. But there wasn't an explicit limit that said you may only charge this much. Now -- at least that is my sense of it.

One of the difficulties -- and we went to a number of retailers and asked them what is your transportation cost to get the fuel here? They couldn't tell. Because it was rolled up into the price. Or how are you determining what your maximum price is? They said well, we priced it off the station down the road.

So I think we have got a sense of how regulation is supposed to work. But how it is actually working, not just in the rural areas but out there, I think retailers, many of them don't have a very clear sense of how it is supposed to work.

They are behaving the way they used to behave. Maybe they have got an explicit transportation cost that they can show to the Board and maybe they don't. But many of them said, we don't know, okay.

So the dynamic -- in a nutshell the dynamic has changed because the price in any given market is now set by the station that has got the lowest cost delivery. And before, that wasn't necessarily the case.

And so you had -- competition was, you know, the final selling price, where this variable transportation formed part of that. And now it is explicit. It is taken out.

It is shown or it should be shown.

And it is more difficult I think for some companies to realize the costs or to recover the costs that they had prior to regulation been able to recover.

Q.242 - So in a nutshell, prior to regulation you had a series of variables that you could compete on. And now the only variable is transportation?

A. Well, it is not the only variable. But it has become an explicit variable. And as a consequence, and because regulation says you may not charge any more than your maximum retail price plus transportation, it has driven the market to the lowest cost -- well, the retailer that has the lowest cost delivery.

Q.243 - Just one final point. Do you have -- have you formed any opinion as to what would be the effect on the continuity of supply if the margins were not increased?

A. Well, I think that -- I think that retailers, some retailers -- you know, the high cost, so the less competitive retailers out there, particularly in rural and remote areas, that we will see further attrition from the industry. Some of that is going to occur anyway.

But I think that not increasing margins could accelerate that. It is a difficult argument in those markets where prices are not now at the maximum, you know.

Why should they increase?

And I think the purpose of the legislation is to provide a framework for competition to occur in that allows the industry to move up to a maximum margin as competitive conditions warrant.

So I know in some markets, the more competitive markets, particularly in the southern part of the province, the pricing below, you know, the maximum. But those are competitive conditions in that market.

We know that circumstances have changed between say Saint John and Moncton because of transportation, that Moncton used to be a lower cost environment but now it is higher cost. Those kind of relative changes have occurred across the province. And you can see that by looking and tracing price changes before and after regulation was introduced.

But to go back to your general point, I think that establishing -- or failing to increase the margin is going to compromise the ability of a number of retailers to stay in business, not just retail gasoline but heating oil as well.

The sense I get from talking to retailers is a number of them, the first question they ask when you come into the room is, do you want to buy a business? Because a number of them are in pretty rough shape.

But not necessarily because markets -- but margins are limited, that is a factor -- but because of competitive pressures in that industry. There are lots of things at work.

VICE CHAIRMAN: Thank you very much. Those are my questions.

BY THE CHAIRMAN:

Q.244 - Mr. Gardner, it has been a long day. So I won't ask you very many questions many questions.

But I am going to take you to the end of page 21. And that would be figure 4.3 which is the change in the average marketing margins. And I think Saint John in that chart is probably -- and I assume that is representative of New Brunswick -- is essentially the only market that shows any significant decline in the margins.

And I think from listening to you today, that would be an advantage to the consumer, I think is what you would say and in a situation like that, is that correct?

A. Yes. That is correct.

Q.245 - Okay. And the converse would be true then. So if the margins had increased that would be an advantage to industry?

A. Yes.

Q.246 - And the note on the side of figure 4.3 says that the decline in Saint John is due mainly to the adjustment lag in a rising market.

Well, we currently seem to be in a declining market. So would the converse be true? Would that in fact then drive the margins in the other direction?

A. Yes. That tends to be the case.

Q.247 - This morning in a response to -- I think it was a question from Mr. Zed, you said something to the effect that industry is not very forthcoming with data. I find that somewhat intriguing given that industry has not filed any evidence with us here today.

Do you have any explanation? Did anybody explain to you why they were not forthcoming with data?

I'm not suggesting names. But what was the rationale is really what I'm wondering about. Particularly whereas I say we don't really have evidence from industry at all. What we have is your evidence and Mr. Ervin's evidence and of course the cross examination and what we will get in argument.

Did you get -- were there reasons put forth for that position?

A. Well, the main reason I think is that the industry, particularly the refiner marketers, do not want to reveal commercially sensitive information.

And I would be very surprised -- and this is not just New Brunswick. This is -- you know, Nova Scotia as well there was a hearing a couple of years ago. None of the participants in the industry put forward evidence to support a position or another position.

I think that they are simply unwilling to risk revealing the kind of commercially sensitive information or subject that information to cross examination.

Q.248 - Is that your supposition or was that -- is that the kind of explanation that you got? Or is that what you just imagined must be a good reason --

A. Well, that is partly what I have been told. Another reason is that, for some of the larger companies, depending on where they are, the information that is necessary to address some of these issues is consolidated over wide areas. And it would not be again a trivial matter to try to isolate New Brunswick from those operations.

So that there is a -- I guess there is a data issue. And there is also -- I think as well there is a cost issue of actually doing the work.

Q.249 - Did anybody explore with you the possibility of providing information on a confidential basis such as is allowed under the EUB Act?

A. No.

CHAIRMAN: Well, thank you, Mr. Gardner. As I say, it has been a long day for you for sure. And we thank you for your attendance here today.

WITNESS: Thank you.

CHAIRMAN: I guess normally that would take us to our second witness. But it is 4:30.

My understanding, Mr. Ervin, is that you would prefer that the cross examination of your witness occur essentially all at the same time. You don't want to really split it between today and tomorrow.

Is that a fair --

MR. ERVIN: That is correct, Mr. Chairman.

CHAIRMAN: Okay. All right then. Did I understand that there may be one party that has indicated that they would like to make a submission today, if it were relatively short?

Ms. Desmond, is that correct? There was -- for somebody that couldn't be here tomorrow that wanted to make a submission today that had approached you?

MS. DESMOND: I believe there may be more than one. But that is the case, yes.

CHAIRMAN: Okay. Because what I was going to say is if we had one person and everybody was in agreement to have it sort of done out of order and it was relatively short, we might consider doing that.

But I don't really want to get into hearing submissions before we have heard all of the evidence.

MS. DESMOND: I believe it was Ms. Savage. She had expressed an interest if it was possible to do her and her submission this afternoon.

CHAIRMAN: Okay. I understand Ms. Savage has filed the submission with us?

MS. DESMOND: Yes.

CHAIRMAN: I'm just wondering. How long would it take you to make that submission? It is not possible for you to be here tomorrow I take it is your problem?

MS. SAVAGE: I apologize. That is right. It would probably take me about 10 minutes I'm expecting to make the submission.

CHAIRMAN: Well, the only qualification I'm going to put on that is that I really don't really want to start taking submissions today.

And I don't want to take them out of order, if the parties have any problem with that, in the sense that normally we would hear the evidence first of course and we still have evidence yet to come.

Who knows? Maybe your submission would change after you heard the other witness. I don't know.

But if you say it would take about 10 minutes, does anybody here have a problem with Ms. Savage presenting her argument today out of order?

MR. ERVIN: Speaking for the Department, Mr. Chairman, we would have no objection to that.

CHAIRMAN: If anybody has a problem just put your hand up and I will hear you. All right.

Well, even though it is fairly late in the day we will -- if you want to come forward, Ms. Savage, we will hear your submission now.

MS. DESMOND: Mr. Chair, I'm sorry, I wasn't clear on the undertakings Mr. Gardner had provided to the Board, what his claim was for.

CHAIRMAN: I understood when I questioned about it that he was going to prepare the responses to them and would have it done today or tonight. I guess he has been here all day. So I'm assuming he didn't get much chance to work on them.

So my understanding is that they would be done this evening. He is nodding his head affirmatively, so tonight. And once we have those they can be circulated by way of e-mail to all of the parties who have registered.

MS. DESMOND: I just wonder, Mr. Chair -- and I haven't seen of course his new material. But if there were questions arising from the new data.

CHAIRMAN: Mr. Gardner, you plan to be here tomorrow anyway, I think in the original scheme of things. So you can be available tomorrow for additional questions if necessary?

MR. GARDNER: Yes.

CHAIRMAN: Thank you.

VICE-CHAIRMAN: Just before you begin, Ms. Savage. Monsieur est-ce que vous avez quelque chose que vous voulez dire?

MR. BOSSE: « inaudible »

VICE-CHAIRMAN: Vous voulez parler au micro?

MR. BOSSE : J'ai préparé un document pour eh, une entrevue que j'ai eu avec Radio-Canada. Eh, il y en a des copies pour tout le monde, si on peut les distribuer puis « inaudible ».

VICE-CHAIRMAN: Alors c'est, essentiellement une soumission par écrit?

MR. BOSSE: Une soumission par écrit.

VICE-CHAIRMAN: Pour la Commission?

MR. BOSSE: Pour la Commission.

VICE-CHAIRMAN: O.K. À la fin d'la journée, madame la secrétaire va prendre votre soumission, va donner des copies à tous les membres de la Commission ainsi que eh tout le monde dans la salle.

MR. BOSSE: Merci.

CHAIRMAN: Okay, Ms. Savage.

MS. SAVAGE: Thank you very much for the opportunity to do this early and out of order. It is very much appreciated.

In general, we would like to thank the New Brunswick Energy and Utilities Board for the opportunity to present our views.

My name is Jane Savage and I am the President of the Canadian Independent Petroleum Marketers Associate, acronym is (CIPMA). CIPMA is a national not-for-profit trade association, based in Toronto, representing the independent sector of the Canadian Fuel marketing Industry. "Independent" in our industry just to clarify means non-refiner and non-integrated oil companies. Independents in this context, are industry participants who buy rather than refine their fuel for distribution and sale to Canadian consumers. Our members market fuel products in all provinces of the country. CIPMA members represent about 15 percent of the retail gasolines sites in Canada, while about 30 percent are owned and operated by refiners or fully integrated oil companies. The balance are independently owned or dealer-owned sites. In New Brunswick, our members are Co-op Atlantic, Wilson Fuel

Co. Ltd., Bluewave Energy and Canadian Tire Petroleum. These companies comprise a significant share of both the retail heating oil and retail gasoline markets.

My background is in the refining and marketing segment of the Canadian oil industry where I have been for almost 30 years. I am a professional engineer registered in Ontario and a graduate of Queen's University with a Masters of Business Administration from McGill University. My background includes refinery design and operation, commodity futures trading in crude oil and petroleum products, international petroleum products, cargo trading, supply economics and marketing in all petroleum products. I feel I bring a knowledge of the workings of global and Canadian petroleum markets to CIPMA and to government and I am a regular commentator on gasoline prices.

As a general statement on price regulation, CIPMA recommends against the regulation of petroleum products prices in all circumstances except where there has been a failure in the federal competition laws (or application of these laws) to prevent anticompetitive activities. Consumers will enjoy the lowest possible price for fuel products if there is strong competition.

The New Brunswick government opted to regulate gasoline prices in July '06 for another purpose to stabilize prices for New Brunswick consumers and not because in our view of a failure of competition laws or their application. In CIPMA's opinion, compared to other parts of the country at the time, New Brunswickers were not only enjoying competitive markets, but relatively stable pricing. Nonetheless we fully accept the will of the people of New Brunswick and are honoured to be part of this process.

At this juncture, CIPMA advocates that the Board recommend that the government engage in the development of broad objectives of the regulation.

To regulate an industry, in our view, means to marry the needs of consumers with the needs of the industry to deliver against certain expectations. It is only when these inputs have been established transparently can a regime function effectively into the future with a minimum of unexpected consequences including interrupted supply, lack of capital input, closure of sites or companies and possibly disenfranchised consumers, as examples of unexpected consequences.

Since this Board has taken this approach with other regulated utilities, and since the New Brunswick government decided two years ago to make petroleum retailing a utility, these inputs along with robust models that normally accompanies regulated entities we feel is required.

So, we recommend first that the service level expected from the industry to ensure consumers are well served by the regulated industry be established. Then a rate of return must be established using zero-based costing, from which flows margins and pricing. This should all be done in a consultative approach with the key stakeholders in the process with the end result being a model we can all live with.

Because this essential analysis has been omitted, in our view, thus far from the regulatory process, it renders it difficult at best to objectively assess the adequacy of the prices and margins. By choosing the wrong margins or pricing in the absence of robust agreed to models with zero-based costing, could result in adverse consequences.

At this point, our members are concerned that costs have increased without a commensurated increase in margin. Costs such as credit card fees, minimum wage costs, working capital costs and electricity rates are all contributing to a reduction in return, in particular, smaller, lower volume retail operations are becoming more marginal.

As with other regulated utilities, once objectives are defined, a rigorous and transparent application and review process must ensue. It is well documented that capital investment will not occur in a jurisdiction where economic outcome is subject to political whim. So CIPMA advocates that the Board recommend a rigorous zero-based approach or model and if the regime's objectives need to be altered, updated or changed according to changing conditions -- political or economic, it is recommended that this be undertaken with input from all stakeholders.

As a final point, an important change has been taking place in New Brunswick and other jurisdictions in North America which CIPMA would like to emphasize for this Board so that this can be emphasized in the Board's final report.

This change is the devolution of integrated oil companies from the marketing segment of the industry and their replacement by independent fuel marketers. This is happening because these regional, often family-owned or cooperatively owned businesses have intimate knowledge of their markets and can serve them more efficiently, that is more cost effectively. They are in the business of distributing and marketing fuel products directly to consumers in rural and urban markets. It is important to note that unlike the major integrated oil companies who profit from rising crude oil prices or rising refining margins -- both of which are demonstrably the key drivers behind consumer price, independents' profits do not increase with rising prices. Instead, they are seeking ways to decrease consumer prices by fighting against rising credit card fees and calling for higher levels of oversight in the crude oil futures markets to reduce speculation. Both of these latter two initiatives, CIPMA is actively involved in.

In other words, the folks from whom most New Brunswickers buy their heating oil and gasoline are on their side and are not profiting from consumer price increases.

With this in mind, we invite this Board and indeed all New Brunswickers to avoid strategies with regard to price regulation which is underpinned by the belief that windfall profits are being made by the companies selling petroleum -- sorry, the companies selling petroleum to the consumer. This is not the case.

In summary, I would like to thank you for your attention and opportunity to present our views.

Petroleum retailing companies in New Brunswick expect to be treated as any other business that is regulated by the province. We believe it is in the public interest to do so.

We encourage the Board, with full consultation with stakeholders, to take the same zero-based approach to establishing the desired service levels and appropriate rates of return for the regulated petroleum retailing industry in New Brunswick as they have with other utilities. Only then will defensible margins and prices, which should be reviewed regularly in an open and transparent process.

Thank you again for your time. And thank you again for letting me intervene earlier.

CHAIRMAN: Thank you, Ms. Savage. Does anybody on the Board have any questions? Mr. Radford?

MR. RADFORD: Mr. Chair, I am sorry, Ms. Savage is rushing off, because she has raised a couple of points that I would like to think about further. But you did mention just so I can clarify it, you did mention that you represent, for example, Canadian Tire?

MS. SAVAGE: That's right. Yes.

MR. RADFORD: But Canadian Tire does cross merchandising?

MS. SAVAGE: Yes.

MR. RADFORD: They have their own, and they have their own credit card, right?

MS. SAVAGE: Yes.

MR. RADFORD: And when I listened to Mr. Gardner, he says about 1.75 goes towards credit card. Your client has also got not only the 5 -- got it at 1.75 for themselves, don't they?

MS. SAVAGE: Right. And I will just clarify Canadian Tire Petroleum is a unique member of our association because they have their own credit cards, and so take a -- call it an agnostic position on the subject of credit card fees.

MR. RADFORD: Thank you.

CHAIRMAN: Mr. McLean, anything? Mr. Toner?

MR. TONER: No.

CHAIRMAN: Mr. Johnston? And I don't have any questions. Thank you very much for taking the time to make that presentation today.

MS. SAVAGE; Thank you very much.

CHAIRMAN: We appreciate the effort that you put into it. And I guess we just -- we are going to hear as well from Mr. Bosse?

(Off the record)

CHAIRMAN: We will adjourn until tomorrow at 9:30 a.m.

(Adjourned)

Certified to be a true transcript of the proceedings of this hearing as recorded by me, to the best of my ability.

Reporter

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