

# Board of Commissioners of Public Utilities

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## BACKGROUND

### Changes in fuel-price regulation to reflect updated storage and distribution costs

The Board assumed responsibility for fuel-price regulation in Newfoundland and Labrador (NL) through changes made to provincial government legislation in May 2004. The former Petroleum Products Pricing Commission (PPPC) was integrated with the Board and became known as the Petroleum Pricing Office (PPO) with its office remaining located in Grand Falls-Windsor, and has since existed as an office of the Board.

#### Pricing Methodology

Pursuant to the *Petroleum Products Act*, the Board sets the maximum wholesale and retail price for all heating fuels and automotive fuels in the Province. The pricing structure for each product is based on industry recognized 'benchmark' market prices. For gasoline, diesel fuels and heating fuels other than propane, benchmark prices are derived from the corresponding product classification published by Platts *U.S. Marketscan* for New York Harbour cargo pricing as set out in the Schedule to the *Regulations*. For propane used as a home heating fuel, the benchmark price used is the average price for propane sold from suppliers' racks at Sarnia, Ontario, as published weekly by Bloomberg's *Oil Buyer's Guide*. The maximum tax-excluded retail 'base price' in cents per litre (cpl) for each product is determined by adding a total allowed mark-up as set by the Board to these benchmark prices. To recognize the differences in costs associated with the storage and transportation of the different petroleum products between various geographic areas, the Province is divided into 14 primary pricing zones. Zone price differentials are then applied to the 'base price' set in the base zone for each product.

Maximum regulated fuel prices are adjusted on the 15<sup>th</sup> of each month using the average daily prices for most refined petroleum products as listed on NYMEX (New York Mercantile Exchange), plus the appropriate conversions using the daily noon-day exchange rate, total allowed mark-up, as well as taxation, when applicable.

In the event of volatile market behaviour between mid-month price adjustments, the Board uses an interruption formula that is based on specific criteria to make upward or downward interim price changes as warranted in the local marketplace. For the interruption formula to be used on gasoline, diesel or furnace/stove oil, price fluctuations on NYMEX must exceed an average of  $\pm 3.5$  cpl from the previously established base price under regulation over a five market business-day period. Adjustments are then made where price increases or decreases are warranted. The interruption formula criteria for propane require that Bloomberg's *Oil Buyer's Guide* weekly figures must exceed a  $\pm 5.0$  cpl change from the previously established base price under regulation.

**For illustration purposes only**, the breakdown of the pricing components for gasoline and furnace oil for the Avalon (base zone) effective on July 31, 2006 are shown as follows:

**MAXIMUM PRICES - JULY 31, 2006**

**Zone 1 Avalon (Base Zone)**

	<b>Regular Unleaded Gasoline Self Serve Cents per Litre</b>		<b>Furnace Oil Delivered to Households Cents per Litre</b>	
<b>Pump Price</b>	<b>122.5</b>			<b>Maximum Delivered Price</b>
<b>Total Tax</b>	<b>41.5</b>		<b>84.3</b>	<b>Tax Included</b>
HST @ 14%	15.0			
Provincial Gasoline Tax	16.5			
Federal Excise tax	10.0		10.4	<b>Total Tax HST @ 14%</b>
<b>Pump Price (Ex-Tax)</b>	<b>81.0</b>		<b>73.9</b>	<b>Regulated Maximum Price</b>
<b>Zone Differential *</b>	<b>0.0</b>		<b>0.0</b>	<b>Zone Differential *</b>
<b>Pump Price Ex-Taxes (Base Price)</b>	<b>81.0</b>			
<b>Total Allowed Mark-up **</b>	<b>13.5</b>		<b>18.1</b>	<b>Total Allowed Mark-up **</b>
<b>Average New York Harbour Benchmark Price for period</b>	<b>67.5</b>		<b>55.8</b>	<b>Average New York Harbour Benchmark Price for period</b>

\* Zone price differentials are appropriate price increments added to the base prices for products in the base zone (Zone 1) to reflect the additional costs for the transportation, storage and distribution of the product to the destination zone.

\*\* The total allowed mark-up is the amount set by the Board in cents per litre (cpl), which is added to the benchmark price of a product to establish the retail base price for that product in the base zone. This amount is meant to cover all costs in getting the product from its source to the end consumer plus provide a reasonable allowance for return on investment to participants in the supply chain. While the benchmark and base prices change monthly, the total allowed mark-up would only change if the Board initiated a change or approved a change on application by a retailer or wholesaler.

## **Storage and Distribution Study**

Prior to integration with the Board, the former PPPC issued a request for proposals for consultants to conduct a detailed review of pricing zone boundaries and the associated price differentials initially established in 2001 when regulation of petroleum products was introduced in the Province. David M. French & Associates was subsequently engaged by the PPPC to complete a study of the storage and distribution costs for all petroleum products throughout Newfoundland and Labrador. The consultant's report, entitled "*Study of Storage and Distribution Costs throughout Newfoundland and Labrador*" (the "S&D Study") was submitted to the Board in May 2005.

The S&D Study reviewed all supply chains and distribution networks in the Province in order to estimate the costs of moving regulated products from initial arrival by marine tanker through storage, handling and final delivery to the wholesale and retail points of sale. The study also looked at the existing pricing zone boundaries and differentials, as well as identified and reported on all storage facilities in NL. The recommendations of the final report recognized these costs and also depicted the unique supply and distribution network for some of these products in the Province.

The Board released this report to all stakeholders, including consumers and industry, in July 2005 for input and feedback in conjunction with a discussion paper that aimed to initiate a more finite review of fuel-price regulation in NL. Advertisements were placed in the major provincial publications/magazines, all relevant documentation was posted on the Board's website and several news stories were carried.

Submissions were received from a number of stakeholders on the S&D Study recommendations and subsequent meetings were held in May and June 2006 to gather additional feedback and information. As a result of these discussions, the consultant was asked to update the costing information for each product, and supplementary information was provided. The study recommendations for price differential changes for Bell Island (Zone 1a) and for Zone 10 (Labrador Straits to Red Bay) were also reviewed and updated to reflect additional information gathered as part of the follow-up consultation process.

Using the S&D Study, the Board has determined that adjustments to the existing allowed mark-up for gasoline and to the zone differentials for all products are required. As well some changes to the existing zone designations to reflect the fuel supply networks in those areas are also required. These changes will be incorporated with the scheduled mid-month price adjustment on August 15, 2006. The summary of these changes can be viewed on the Board's website [www.pub.nl.ca](http://www.pub.nl.ca).