



**BOARD OF COMMISSIONERS OF PUBLIC UTILITIES**  
**NEWFOUNDLAND AND LABRADOR**

**PETROLEUM PRODUCTS PRICING**

**Review of Petroleum Pricing Regulation**  
**Issues Discussion Document**

**JULY 25, 2005**

**Document released for stakeholder comment and feedback. Comments, feedback and/or expressions of interest in the review should be received from stakeholders by Friday, August 26, 2005. You may send your comments and/or submissions in writing, by fax, via e-mail or web feedback to the contact information below:**

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## **1.0 - Background**

On May 18, 2004 the Government of Newfoundland and Labrador announced the integration of the former Petroleum Products Pricing Commission (the “PPPC”) with the Public Utilities Board (the “Board”). With this integration the Board assumed responsibility and authority for the regulation of petroleum products pricing in the Province. On June 8, 2004, the *Petroleum Products Act* was amended to give effect to the change. The Board’s Petroleum Pricing Office (the “PPO”), located in Grand Falls-Windsor, now administers the functions of the former PPPC. The Board continues to use the same approach and methodology for adjusting fuel prices as did the PPPC.

Prior to its integration with the Board, the former PPPC commissioned a study of storage and distribution costs for petroleum products throughout Newfoundland and Labrador. The purpose of this study was to review all supply chains and distribution networks in the Province in order to estimate costs of moving regulated products from initial arrival by marine tanker through storage, handling and final delivery to the end consumer. In addition, the consultants examined the existing zone boundaries and zone pricing differentials used in the regulatory process and recommended changes to ensure a greater degree of fairness to respective stakeholders. This study has been completed and the full report “Study of Storage and Distribution Costs for Petroleum Products throughout Newfoundland and Labrador” including recommendations is now being released under separate cover for stakeholder input as part of this review process.

Government announced at the time that regulatory restructuring was aimed at improving efficiency and reducing costs. Government also requested that the Board conduct an operational review of petroleum pricing regulation to ensure the concerns of all stakeholders are being addressed. As a first step, the Board initiated a consolidation of the administrative and financial policies/practices of the former PPPC with those of the Board and to date has achieved substantial operating efficiencies and savings as this initiative continues. As a next step, the Board is now in a position to begin its operational review to address regulatory pricing and process issues that may be of concern to stakeholders.

As part of this operational review, in addition to the storage and distribution cost study referenced above, the Board has identified a number of other issues involving petroleum products regulation that may warrant further review. These issues are highlighted in this discussion paper and also form part of the considerations presented for stakeholder input during this review process.

## **2.0 - Petroleum Products Pricing and the Regulation Process**

The manner in which the Board regulates the pricing of petroleum products for the Province is set out in the *Petroleum Products Act* and the *Petroleum Products Regulations*. The following sections provide an overview of the pricing structure for petroleum products, including a description of the various component prices, as well as a discussion of the methodology used by the Board to set and adjust prices. Appendix A contains a glossary of many of the terms referenced in this section that the reader may also find helpful.

## 2.1 - Benchmark Prices and Base Prices

Pursuant to the *Petroleum Products Act*, the Board sets the maximum wholesale and retail price for all heating fuels and motor 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.

The initial 'base prices' were established for all regulated products in the fall of 2001 based on historical margins between the benchmark prices and the retail prices in St. John's, exclusive of all taxes. To recognize the differences in costs associated with the storage and transportation of the different petroleum products between various geographic areas, the province was divided into 14 primary pricing zones, and appropriate zone price differentials were established following a review of historical cost differences between zones.

## 2.2 - Product Taxes

Retail prices for motor (automotive) fuels and heating fuels include different levels of taxation. A federal Excise Tax of 10.0 cpl is applied to gasolines and 4.0 cpl is applied to diesel fuel. A provincial Gasoline Tax of 16.5 cpl is also applied to all automotive fuels, except for gasoline products sold in Zone 10 (which adjoins the Quebec border), where a provincial tax of 15.0 cpl is applicable. On top of this, a Harmonized Sales Tax (HST) of 15% is then applied to all automotive fuels. For heating fuels, the only applicable tax is the 15% HST, which is applied to the delivered price. The taxation pricing components are set by the federal and provincial governments and are not under the authority of the Board.

## 2.3 - Price Adjustments

In accordance with Section 7 of the *Petroleum Products Act* and Section 14(1) of the *Petroleum Products Regulations*, the Board makes scheduled adjustments to the maximum wholesale and retail base prices on the 15<sup>th</sup> of each month. Price changes for all products (except propane) are calculated by averaging Platts daily published pricing of refined products for the New York market over the previous period to arrive at revised base prices in accordance with changes in the benchmark prices. Propane prices are also changed based on the weekly average of Sarnia rack propane prices that are published by Bloomberg.

In calculating the monthly price adjustments, the high and low daily prices for all products (except propane) are averaged and converted to Canadian cpl using the noonday exchange rates as published by the Bank of Canada, and the appropriate conversion factor. Propane prices, published by Bloomberg as weekly averages, are already converted to Canadian currency equivalents. Taking into consideration the requirement for notification of stakeholders, and the logistics of doing so in a timely manner, regularly scheduled price adjustments coming into effect on the 15<sup>th</sup> of each month are based on commodity pricing data for the previous period up to, and including, available data for the 11<sup>th</sup> of the month. The average of these benchmark fuel

prices for the period are used to establish the maximum regulated prices for the following period. Monthly scheduled price changes therefore reflect the movement in world market prices for refined products that have occurred since the last price adjustment.

## **2.4 - Interruption Formula**

In accordance with Section 14(2) of the *Petroleum Products Act* and Regulations, the Board regulates petroleum product prices based on prior period market conditions. However, if ongoing market prices become significantly and consistently out of line with the current regulated prices, the Board will make a price adjustment outside of the regularly scheduled adjustment using its Interruption Formula. For the Interruption Formula to be used to increase or decrease prices, the Board requires the average of the calculated daily benchmark prices to be +/- 3.5 cpl compared to current regulated prices, over a period of five business days (except for propane, which requires +/- 5.0 cpl). The Interruption Formula is not used for five days after new prices are set under regulation. Additionally, since at least five business days are deemed necessary to obtain an average for the following normal price adjustment, the five business days prior to the next normal price adjustment cut-off date are excluded from any calculations used to trigger the Interruption Formula.

## **2.5 - Example of the Price Adjustment Process**

Appendix B contains an example of the price adjustment process and illustrates how the benchmark price for regular unleaded gasoline is tracked each business day and how it was used to establish new maximum pump prices in the Avalon Peninsula base zone for the last regular monthly adjustment on July 15, 2005.

## **3.0 - Issues Identified for Review and Feedback**

### **3.1 – Pricing Adjustment Methodology**

The methodology used by the Board for the regular monthly adjustments is the same as that implemented by the former PPPC in October 2001 and used since that time. The Interruption Formula was implemented by the former PPPC in March 2003 following a review of the legislation and the model used for pricing regulation.<sup>1</sup> The Board is interested in receiving feedback on the model used for regulating petroleum products prices, including the process and timing of the regular monthly adjustment, as well as the use of the Interruption Formula.

Specifically, the Board would like to address the following questions:

- i) Is there a need for an adjustment mechanism, such as the Interruption Formula, outside monthly scheduled price adjustments?
- ii) What changes, if any, would be desirable to the Interruption Formula policy? (For example, should the calculated benchmark price difference be at least +/- 3.5 cpl each

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<sup>1</sup> See the report "[Petroleum Products Pricing Commission Review Petroleum Products Pricing Regulations in Newfoundland and Labrador](http://n225h099.pub.nf.ca/press/ppp/PPPC_030314_Review.pdf)", March 12, 2003. Report prepared by George Saunders, Commissioner and submitted to Honourable George Sweeney, Minister, Department of Government Services and Lands, ([http://n225h099.pub.nf.ca/press/ppp/PPPC\\_030314\\_Review.pdf](http://n225h099.pub.nf.ca/press/ppp/PPPC_030314_Review.pdf))

- day for the five business days to ensure the difference is significant and sustained as opposed to using the average difference, as is now the case.)
- iii) Should the Board consider adjusting prices on a specific day on a biweekly basis (for example, every second Thursday) and discontinue using the Interruption Formula altogether?
  - iv) Should there be any changes in the process and timing of notification of price changes? (For example, should the price changes be made public the day before the new regulated prices are to take effect?)
  - v) Should the Board publish periodic updates regarding current commodity pricing and the potential effect on petroleum products pricing in the Province?

### 3.2 - Base Prices and Total Allowed Mark-ups

As discussed in Section 2.1 petroleum product prices in each pricing zone in the Province were set initially and are adjusted by adding the appropriate zone differentials to the 'base prices' established in the base zone for each product. Base prices, which are in effect benchmark prices plus the total allowed mark-up, are therefore of prime importance to all stakeholders.

In March 2003, following the PPPC's review referenced earlier, an increase in the total allowed mark-up for gasoline automotive fuels was implemented, based on a number of factors. Included among the reasons to justify the increase were operating cost increases, more stringent environmental regulations, and higher insurance costs. As well the total allowed mark-up initially set was calculated over a two-and-a-half year period from April 1999 to September 2001 and was based on historic average margins between New York Harbour and St. John's retail prices for that period. As a result of the review, the PPPC increased the total allowed mark-up for gasolines by 1.5 cpl to 13.5 cpl from the New York Harbour benchmark price, effective March 15, 2003.

At that time no increase was granted in the total allowed mark-up of 16.5 cpl for home heating fuels, notwithstanding that a similar argument could be made for cost increases for those products. However, the PPPC did change its policy for the pricing of furnace oil from the previous practice of using only No. 2 fuel as a basis for the benchmark price to the policy of using a blend of 75% jet fuel and 25% No. 2 fuel as the basis for furnace oil pricing during the colder high volume home heating season from November through May. Given that jet fuel is more expensive than No. 2 fuel, the effect was an increase in the base prices and therefore in the maximum regulated prices of furnace oil during the heavy use period. This change mitigated the need to consider an increase in the standard base price for furnace oil at the time.

In early January 2005 the Board received an application from Harvey's Oil Limited under Section 8 of the *Petroleum Products Act* requesting an increase of 3.52 cpl in the base price of furnace oil to account for increases in costs of retailing home heat fuels to customers in the St. John's area since the base price was initially established in 2001. The Board reviewed the information provided by Harvey's in support of its application and, after further investigation, determined that an increase of 1.5 cpl in the total allowed mark-up for furnace oil sold by Harvey's was justified. Order No. P.P. 1(2005) was subsequently issued approving this increase to be effective March 1, 2005. Pursuant to Section 8 of the *Petroleum Products Act*, the Board issued a notice to retailers and wholesalers of home heat fuels in Newfoundland and Labrador advising that the Board may order the increase approved in Order No. P.P. 1(2005) to apply to

other wholesalers or retailers in addition to Harvey's Oil Limited. In response to this notice the Board received submissions from eight companies requesting that the same or a similar increase be granted in each case. In some instances the increase was requested for other products as well.

Based on these submissions the Board determined that it would not be appropriate to apply the same increase to other wholesalers and retailers in the province. Rather the Board decided that a review of the allowed mark-up for all products on an industry-wide basis should be undertaken. This review will revisit (i) whether the costs and other factors considered at the time of the setting of the initial total allowed mark-up in 2001 are still relevant, and (ii) whether an overall adjustment would be reasonable based on changes to these costs and other factors since that time. With respect to the base prices of home heat fuels (furnace and stove oils), the Board will request specific information from home heat wholesalers and retailers to permit a more immediate comprehensive review of this issue, with a view to making a decision in advance of the 2005-2006 home heat season.

Additional issues with respect to inventory carrying costs and the administration costs of both small and large home heat operations were also raised during the completion of the study of storage and distribution costs. These items remain outstanding and the Board is interested in receiving input from industry stakeholders in quantifying these cost items.

With respect to a review of the total allowed mark-up for all products on an industry-wide basis, the Board is also interested in considering the following questions:

- i) Is there any justification for further adjustment in the mark-ups and in base price differentials for different grades of automotive fuels?
- ii) Should an adjustment to the base price of propane be made at this time?
- iii) What is the cost impact on marketers of propane when there are unexpected disruptions in supply from the Come by Chance Refinery and should the maximum pricing model be revised to accommodate these incidents? If so, how should this be done?
- iv) Should the Board apply any price adjustment granted to one supplier as a result of an application under Section 8 to all suppliers in the same area?

### **3.3 – Retail and Wholesale Margins**

Under Section 4 of the *Petroleum Products Act* the Board has the authority to determine the minimum and maximum mark-up between the wholesale price to the retailer and the retail price to the consumer for both home heating and motor fuels.

Automotive fuels are provided through retail outlets – often referred to as service stations. Retail outlets in the current market take a variety of forms with many complementary products and services offered such as convenience stores, car washes, restaurants, service bays, etc. The PPPC established a margin of 5.0 cpl (before tax) between the maximum retail price of regular unleaded self-serve gasoline and the maximum wholesale price of the product for operators of retail outlets. This margin spread increased depending on the grade of gasoline offered and the type of service provided. Since a wholesaler could charge a retailer less than wholesale prices, these margin spreads are not fixed maximum margins. A minimum mark-up was not established by the PPPC. It has been suggested by certain independent petroleum dealers in the Province

that existing retail margins are not enough to meet the ever-increasing cost of operation and that they need to be adjusted immediately. The impact of local market conditions through “price wars” in certain regions can also have a significant impact on small independent dealers because of the absence of a minimum or guaranteed margin. On the other hand, an argument has been advanced by some major suppliers that the retail margins established by the PPPC were, and still are, too generous for retailers. Moreover, if guaranteed margins were established, retailers could lower their pump prices and wholesalers would be obligated to reduce their wholesale margins downwards accordingly.

Some independently owned automotive and home heating fuel suppliers have also proposed that the current regulatory pricing regime leaves them vulnerable to financial hardship. This is primarily due to variations between rack<sup>2</sup> prices they are charged, which change daily or weekly, versus the maximum prices they are permitted to charge consumers under regulation, which only change monthly unless an intervention occurs using the Interruption Formula. Historically, rack prices generally rise regularly during the heating season and once-a-month adjustments by the Board may not fully recognize what has transpired with acquisition costs incurred by the independently owned home heating suppliers. As well, while the normal cycle sees rack prices recede in the non-heating season months, the volumes sold during this period are relatively small and not sufficient to compensate for the margins lost during periods of rising prices in the peak heating season.

Rack buyers in the Province, commonly referred to as ‘resellers’, are locally owned businesses involved in delivering fuel as both wholesalers and retailers and subject to regulated retail prices for fuel delivered, except for commercial and contract deliveries that are exempt from price regulation. That is, they buy at the rack and resell product to retail outlets, to home heat customers or to commercial or other type of accounts. It is not predetermined at the time of loading at the supplier’s rack to whom, or to which type of customer, the product will be delivered.

Section 2(2) of the *Petroleum Products Act* states:

*“(2) This Act does not apply to a wholesaler in relation to the sale by the wholesaler of a petroleum product to a person other than a retailer or the keeping of a petroleum product by the wholesaler for sale to a person other than a retailer.”*

Because some of the products can be, and are, sold as non-regulated sales, the PPPC could not treat all rack purchases as sales applicable under the *Petroleum Products Act*.

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<sup>2</sup> Rack prices are nominal prices charged by refiners or major suppliers at their truck loading racks. These prices are published weekly by the Bloomberg [Oil Buyer’s Guide](#) (OBG) for most major centres throughout the country where there are refineries or primary marine terminals. In Atlantic Canada, rack prices generally change in line with changes in Platts New York Harbour prices. The actual price charged to a ‘rack buyer’ by the supplier for specific products are not necessarily those posted. Depending on the supply contract or terms negotiated between the parties, the actual price charged could be different than the published rack price at any time. A number of factors affect these transactions including, for example, the volumes involved, the credit worthiness of the buyer, and the history of the relationship between the two parties. However, quite often contract prices are referenced to the published rack prices.

This issue has been a matter of contention ever since the *Petroleum Products Act* was proclaimed. Some have argued that ‘resellers’ should have wholesale prices regulated with maximum values set for fuel delivered directly as a retailer, since if a ‘reseller’ delivers and sells home heat fuel directly to a consumer, this is a retail transaction, with a wholesale transaction occurring to secure that same fuel previously. The question then becomes why wouldn’t the rack purchase of that same fuel not then be a wholesale purchase, with a regulated price in effect?

This conundrum remains a matter of debate since resellers are limited as to the price they can charge a retailer (or a home owner in the case of home heat deliveries) by the maximum prices set by the Board; whereas, there is no clearly enforceable maximum price set for the rack prices that suppliers can charge them for product at any point in time. More than anything else, it was this situation that precipitated the development of the Interruption Formula to provide the resellers with some degree of protection when New York Harbour and, consequently, rack prices were suddenly increased over a short period of time. Similarly, when falling New York Harbour and, hence, rack prices result in triggering the Interruption Formula, the consumer gains the immediate advantage of a decrease in price.

The Board is interested in evaluating the following questions:

- i) Should the Board continue to set the maximum wholesale price for gasoline and diesel retailers as well as the maximum retail prices? If so, are the current margin levels too high, too low or just about right?
- ii) Should the Board set minimum mark-ups for gasolines and diesel sold through retail outlets?
- iii) Should the Board set maximum wholesale prices for wholesalers or retailers who pick up product at the supplier’s truck loading rack? If so, how can this be accomplished to be fair to all stakeholders?
- iv) Should the Board set the minimum and maximum retail mark-ups for home heat fuels?
- v) Are existing margins fair to consumers, retail operators and oil companies when volumes and revenues from various services are compared with operating and financing costs?

### **3.4 - Regulatory Reporting**

Section 4 of the *Petroleum Products Regulations* includes the provision that the Board may require periodic reports to be submitted on a quarterly basis by wholesalers and by retailers of home heat and motor fuels. The Board is considering instituting the provision of this Section and putting in place a reporting format that would require submission of certain information to the Board on a quarterly basis. This is consistent with the Board’s approach to its regulatory oversight of the utilities as required by the *Public Utilities Act*. In the Board’s view regular reporting will dramatically improve the body of knowledge with respect to such information as the volumes of regulated products sold in each zone and sub-zone, differences in prices charged for such products by zone, etc. The Board is interested in receiving views from wholesalers and retailers on this proposed requirement for regular reporting and any associated issues.

### 3.5 - Price Differential Between Stove Oil and Furnace Oil

Historically and up until January 2004, the Oil Buyers Guide rack pricing schedules for the refineries in Halifax, Nova Scotia and Saint John, New Brunswick have maintained a differential of 1.8 cpl between the price of furnace oil and stove oil. This differential was referenced to initially establish base prices for stove oil in all zones of the province and for No. 1 (stove oil) based diesel fuel in Labrador. Since February 2004 the rack price differentials between these two products has ranged from 2.8 cpl up to 6.0 cpl. This instability, along with the generally increasing price differential, raises the issue of whether the existing differential should be adjusted to reflect the production and cost of stove oil relative to furnace oil and what is known as “Arctic Diesel”. This issue is particularly relevant in the case of distillate product supply in all areas of Labrador.

As described in Section 3.2 Base Prices and Total Allowed Mark-ups, the current policy for establishing base prices for furnace oil on the island portion of the Province during the colder months is to use a blend of 75% jet fuel and 25% No. 2 fuel. Both these products use Platts New York Harbour postings as benchmark prices.

Given the apparent change in the level of production and market pricing for stove oil and current pricing for No.1 diesel, the Board is interested in industry input on the following questions:

- i) Is the 75% jet - 25% No. 2 fuel blend appropriate for the island portion of the Province during the colder months, or is a blend of 50% of each sufficient to achieve an acceptable quality product?
- ii) What are the differences in the specifications for jet fuel, No.1 fuel/stove oil, and No. 1 or Arctic diesel?
- iii) Can one be substituted for the other without problems?
- iv) Is the Platts jet fuel price a reasonable benchmark for No. 1 fuel oil or stove oil?
- v) Is the Platts jet fuel price a reasonable benchmark from which to price No. 1 Arctic diesel in Labrador?
- vi) The Board has learned that some companies are now producing, or intend to introduce, a ‘furnace oil light’ product to the market. What are the complete specifications and intended use for this product?

### 3.6 - Diesel Fuel Surcharge (DFS) for Tractor Trailer and Tank Wagon Transportation

The Diesel Fuel Surcharge (DFS) was introduced several years ago as a means for truckers to add a premium to their contracted cartage rates because of the sharp and often sustained increases that occurred in diesel fuel prices. It is understood that the floor price for diesel fuel on which the DFS is based is often cited as 40.0 cpl, excluding taxes. As the price of petroleum products has risen over the past 12-18 months, the DFS has also increased substantially with a resultant impact on the cost of transporting petroleum products. This raises the question of whether a formula should be incorporated into the Board’s pricing structures for base price adjustments when the DFS increases or decreases by a certain percentage. This would only impact prices in zones where distance trucking is a significant component of the wholesale or retail cost prices in that zone.

The Board would like to address the following questions:

- i) How is the DFS calculated and applied in this Province?
- ii) Are adjustments in the DFS automatically passed on to suppliers by distance haulers through some formula on the haulage rate, or are such adjustments applied when contracts are renegotiated or in some other manner?
- iii) Are the adjustments in the DFS significant enough to be considered in adjustments to the zonal pricing at certain times in some areas, and if so, by what methodology?

## APPENDIX A

### Glossary

#### **Base Price**

The Base Price is the ex-tax retail price as set at any time by the Board in the reference Base Zone for a particular product. The base price is the sum of the Benchmark Price and the Total Allowed Mark-up for that particular product.

#### **Base Zone**

The Base Zone is the geographical area defined as the reference zone for a particular product. For all regulated products except propane, the base or reference zone is the Avalon Peninsula. For propane, the base or reference zone is the Burin-Bonavista Peninsula Zone because the majority of propane used in the Province comes from the Come by Chance refinery.

#### **Benchmark Price**

The Benchmark Price is the commodity market price for a particular product at any point in time. Benchmark prices are published daily or weekly by independent market assessors and are recognized and accepted by all industry participants as standard market reference prices.

#### **Bloomberg**

Bloomberg is a leading global provider of data, news and analytics. The Bloomberg's media services provide real-time and archived financial and market data, pricing, trading, and news to corporations, news organizations, financial and legal professionals and individuals around the world. The Bloomberg Oil Buyer's Guide is a standard source in Canada for Rack Prices of petroleum products and provides the Board with weekly rack prices used as benchmark prices for propane.

#### **Consumer**

A person who acquires a petroleum product for that person's use and not for the purpose of selling, exchanging or otherwise disposing of it to another person, but does not include a person who acquires a petroleum product under a contract between the person and a retailer or wholesaler at a price that the person and the retailer or wholesaler have previously agreed on.

#### **Grades of Gasoline**

Gasolines are refined to different octane number specification levels. Octane number is a measure of the detonative quality of gasoline. Higher compression engines require higher octane rated gasoline for optimum performance. Each vehicle manufacturer's manual will indicate which grade of gasoline or octane quality is recommended for use in a particular vehicle. Premium gasoline has the highest octane number rating while mid-grade gasoline is generally a 50% blend of Regular and Premium gasolines. The vast majority of today's automobiles require only regular gasoline for satisfactory performance.

#### **Heating fuels**

Heating fuels generally mean furnace oil, stove oil or other fuels, such as propane, that can be burned in a household furnace or space heater or other approved heating device. Heating fuels are more specifically defined as follows:

**No. 2 fuel oil** – (furnace oil) - A light distillate fuel refined from crude oil having a distillation range suitable for use in atomizing burners in furnaces for domestic heating.

**No. 1 fuel oil** - (stove oil) - A very light distillate fuel refined from crude oil having a distillation range suitable for use in household space heaters or outdoor vented heaters.

**Heating fuel blend** of 75% jet fuel and 25% No. 2 fuel – This is No. 2 fuel mixed with 300% jet fuel (essentially a variation of No. 1 fuel oil) in order to enable the resultant blended fuel to flow at low winter temperatures to prevent the waxing up and blocking of the fuel flow lines.

### **Propane**

A pure carbon / hydrogen  $C_3H_8$  gas derived from the production of natural gas or via the crude oil refining process. Propane is commonly used for household cooking, for space heaters, for barbeques and for household fireplaces. Propane burns smokeless and completely to water and carbon dioxide.

### **Margins**

Retail margin – The difference between the cost to acquire a product at the wholesale price and the selling price of the product to retail consumers, exclusive of taxes.

Wholesale margin - The difference that results when the retail margin is deducted from the total allowed mark-up.

### **Maximum retail prices**

Prices set by the Board, by product, by zone as the maximum prices that a retailer can charge a consumer.

### **Maximum wholesale prices**

Prices set by the Board, by product, by zone as the maximum prices that a wholesaler can charge a retailer.

### **Motor fuels**

Any fuel that can be used to power an internal combustion engine. These fuels would include all grades of gasoline, diesel fuel and propane.

### **New York market**

The NYMEX (New York Mercantile Exchange) where a number of commodities, including West Texas Intermediate (WTI) Crude Oil, unleaded gasolines, jet fuel and heating oils are traded daily on a futures basis.

### **Platts**

Platts is the world leader in providing energy information. For nearly a century, Platts has offered independent industry news and price benchmarks to global energy markets. Platts U.S. Market Scan is a daily market overview of the major refined products in the United States. It carries daily high and low prices for all key products traded on the NYMEX.

### **Primary pricing zones**

The Province of Newfoundland and Labrador is divided into 14 primary pricing zones for the setting of maximum prices for petroleum products. Each of these primary zones is separated from the next by unique geographic boundaries, and each has established product-pricing differentials from the base zone. Within some primary pricing zones, which contain special

geographic features such as islands, pricing sub-zones have been established to reflect the additional cost differentials of providing products to these more remote locations.

**Outlet**

A service station or other physical establishment which provides storage and pumping facilities suitable for the holding and dispensing of gasolines and/ or other motor fuels to retail consumers.

**Rack price**

Rack price specifically means the price of petroleum products at a refinery loading rack. In general use, it has come to mean the published price of a supplier to buyers who purchase product under supply agreements at the supplier's racks, be they at a refinery or at any of the supplier's petroleum product storage locations.

**Refined products**

Petroleum products derived from the distillation and other refining processes of crude oil at refineries.

**Regular unleaded self-serve gasoline**

Gasoline containing no lead additives, which is dispensed from an outlet pump by the consumer into their own vehicles. Regular unleaded gasoline (RUL) has a minimum octane rating of 87.

**Retailer**

A person who sells a petroleum product or keeps a petroleum product for sale directly to consumers.

**Retail prices**

The prices at which a retailer sells product directly to a consumer.

**Sarnia rack propane prices**

The average weekly propane prices charged to contract buyers as posted by Bloomberg Oil Buyer's Guide each week at Sarnia, Ontario. The average price is normally calculated from the postings of four suppliers - Amoco, Kinetic, Conoco Canada and Shell.

**Total allowed mark-up**

The amount set by the Board in cents per litre, which is added to the benchmark price of a product to establish the retail base price for that product in the base zone. The benchmark and base prices change monthly, or more frequently as determined by the Board in accordance with average market price changes in the benchmark prices. However, the total allowed mark-up (the difference between them) would only change if the Board initiated a change or approved a change on application by a retailer or wholesaler.

The total allowed mark-up 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. The initially established total allowed mark-ups for each product were based on historical mark-ups in place at the time regulation was effected.

**Wholesaler**

A person, other than a retailer, who sells a petroleum product or keeps a petroleum product for sale.

**Zone price differentials**

Appropriate price increments added to the base prices for products in the base zone to reflect the additional costs for the transportation, storage and distribution of the product in the destination zone.

## APPENDIX B

### Example of the Price Adjustment Process for Gasoline

Schedule 1, shown below, illustrates how the benchmark price for regular unleaded gasoline was tracked each business day for the last pricing period of June 13-July 11, 2005, and how it was used to establish the maximum pump prices for both the Interruption Formula used to set maximum prices on June 24, 2005 and the normal monthly price adjustment for July 15, 2005.

#### SCHEDULE 1

#### Example of Price Adjustment Calculations to July 15-2005

<b>Daily Tracking of Unl 87 (Platts Oilgram)</b>					Bank of Canada Noon Rate \$Cdn / \$US	NY Hr Daily Price Converted to Cdn Cents per litre	Difference In NY Hr Price since last Set Max Price	Average Change Over Last 5 Business Days	Platts Price Average Since Last Adjustm't	Add <b>13.5</b> CPL <b>Total</b> <b>Allowable</b> <b>Markup</b>	Add All Taxes CPL	Maximum St. John's Pump Price Regular Self Serve CPL	
Day of Week	Date	Day Low	Day High	Day Avg									
Column 1	2	3	4	5	6	7	8	9	10	11	12	13	
<b>Average New York Harbour Benchmark Prices from May 12 to June 11-2005</b> →									<b>46.3</b>	<b>59.8</b>	<b>39.4</b>	<b>99.3</b>	
Monday	13-Jun-05	147.90	148.40	148.15	1.2577	49.22	2.89	Normal Monthly Price Effective June 15th				<b>Decrease</b>	
Tuesday	14-Jun-05	146.00	146.20	146.10	1.2554	48.45	2.12	Price Change Effective June 15-2005				<b>-0.6</b>	
Wednesday	15-Jun-05	148.40	148.90	148.65	1.2400	48.69	2.36						
Thursday	16-Jun-05	152.05	152.25	152.15	1.2376	49.74	3.41						
Friday	17-Jun-05	156.60	156.90	156.75	1.2345	51.12	4.79	3.11	<b>Average Prices June 12-June 20-2005</b>				
Monday	20-Jun-05	157.20	157.40	157.30	1.2320	51.19	4.86	<b>3.57</b>	<b>49.7</b>	<b>63.2</b>	<b>40.0</b>	<b>103.2</b>	
Tuesday	21-Jun-05	155.40	155.65	155.53	1.2308	50.57	0.83	<b>Interruption Formula Triggered</b>				<b>Increase</b>	
Wednesday	22-Jun-05	153.80	154.00	153.90	1.2355	50.23	0.49	Interrupt Price Change- Effective June 24th				<b>3.9</b>	
Thursday	23-Jun-05	157.65	157.90	157.78	1.2311	51.31	1.57						
Friday	24-Jun-05	157.30	157.55	157.43	1.2326	51.26	1.52						
Monday	27-Jun-05	158.00	159.00	158.50	1.2308	51.54	1.80	1.24					
Tuesday	28-Jun-05	152.50	153.25	152.88	1.2312	49.72	-0.02	1.07					
Wednesday	29-Jun-05	149.45	149.95	149.70	1.2263	48.50	-1.24	0.73					
Thursday	30-Jun-05	147.70	148.45	148.08	1.2256	47.94	-1.80	0.05					
Friday	01-Jul-05	154.85	155.10	154.98	1.2256	50.18	0.44	-0.16	Cdn Holiday-Use exchange rate from previous day.				
Monday	04-Jul-05	N/A	N/A	N/A	1.2401	N/A	N/A	N/A	US Holiday - Merchantile Exchange Closed for day.				
Tuesday	05-Jul-05	157.85	158.10	157.98	1.2432	51.88	2.14	-0.09					
Wednesday	06-Jul-05	168.00	168.50	168.25	1.2362	54.95	5.21	0.95					
Thursday	07-Jul-05	169.05	169.30	169.18	1.2287	54.91	5.17	2.23					
Friday	08-Jul-05	162.85	163.10	162.98	1.2208	52.56	2.82	3.16	<b>Average prices June 21 to July-11-2005</b>				
Monday	11-Jul-05	158.70	158.95	158.83	1.2114	50.83	1.09	3.29	<b>51.1</b>	<b>64.6</b>	<b>40.2</b>	<b>104.8</b>	
Normal Monthly Price Change Effective July 15th												<b>Increase</b>	
Price Change Effective July 15-2005												<b>1.6</b>	

In the Schedule, Columns 1 through 5 show how the Platts average daily benchmark prices are tabulated. Then, using the currency exchange rate in Column 6, the equivalent daily product price in Canadian cents per litre (cpl) is calculated in Column 7. Column 8 records the difference in the daily average product price and the benchmark price used for the previous price adjustment. Column 9 calculates the average differences in Column 8 for the previous five-day period.

The maximum self-serve pump price for regular unleaded gasoline effective June 15, 2005 was established at 99.3 cpl, based on the average of the daily benchmark New York Platts prices for the period May 12-June 11, 2005 of 46.3 cpl (Column 10). In the following days, the difference between the daily average benchmark price and this 46.3 cpl was tracked (Column 8). On the sixth day following the last established price, the average difference had reached 3.51 cpl, which triggered the Interruption Formula since the average difference over the previous five days was greater than 3.5 cpl. The average benchmark price since the last adjustment was calculated at 49.7 cpl, an increase of 3.4 cpl. The maximum pump price effective June 24, 2005 was then set at 103.2 cpl for regular self-serve gasoline in the Avalon Zone, an increase of 3.9 cpl including taxes.

As can be seen, the average change in the benchmark price did not increase or decrease sufficiently from June 20-July 11, 2005 to trigger another interruption. Therefore, effective July 15, 2005 with calculations based on the average benchmark prices since the June 20, 2005 interruption, the average benchmark was calculated at 51.1 cpl, an increase of 1.4 cpl. The maximum pump price for regular unleaded self-serve gasoline effective July 15, 2005 was then set at 104.8 cpl, an increase of 1.6 cpl including taxes.

Continuing to use the above example for regular unleaded gasoline, Figure 1 below shows graphically how the self-serve pump prices for both self-serve and full-serve grades are built up from the 51.1 cpl benchmark price as calculated in Schedule 1 for the July 15, 2005 price adjustment. First the 13.5 cpl total allowed mark-up (including both the wholesale 8.5 cpl and the retail 5.0 cpl margins) is added to arrive at the 'base price' of 64.6 cpl for the base Avalon zone. The federal Excise Tax of 10.0 cpl and the provincial Gasoline tax of 16.5 cpl are then added. Finally the 15% HST is added bringing the maximum self-serve pump price to 104.8 cpl. An additional retail margin of 3.0 cpl (HST included) is provided to compensate the retail outlet operator for providing full service. The additional 3.0 cpl results from the 2.6 cpl increase to 7.6 cpl in the allowed retail mark-up (ex-tax) for full-serve versus 5.0 cpl in the case of self-serve.

## SCHEDULE 2

### Maximum Gasoline Prices - Avalon Zone - Effective July 15-2005

<b>Regular Unleaded Gasoline Self Serve Cents per Litre</b>			<b>Regular Unleaded Gasoline Full Serve Cents per Litre</b>	
<b>Pump Price</b>	<b>104.8</b>		<b>107.8</b>	
<b>Taxes</b>		Add 3.0 cpl for Full Serve		
HST	13.7		14.1	
Provincial Gasoline Tax	16.5		16.5	
Federal Excise Tax	10.0		10.0	
<b>Total Taxes</b>	<b>40.2</b>		<b>40.6</b>	
<b>Pump Price Ex-Taxes (Base Price)</b>	<b>64.6</b>		<b>67.2</b>	
Retail Dealer Margin	<b>5.0</b>	Total Allowable Markup 13.5 cpl	<b>7.6</b>	
Wholesaler Margin	<b>8.5</b>		<b>8.5</b>	
<b>Average New York Harbour Benchmark Price for period</b>	<b>51.1</b>		<b>51.1</b>	