NEW BRUNSWICK ENERGY AND UTILITIES BOARD

EVIDENCE OF
IRVING OIL MARKETING G.P. AND IRVING OIL COMMERCIAL G.P.

January 5, 2021

Written Direct Evidence of
Irving Oil Marketing G.P. and Irving Oil Commercial G.P.

Q1. Please state your name and position.

A1. My name is Darren Gillis. I am the President of Irving Oil Marketing G.P. ("IOM") and the President of Irving Oil Commercial G.P. ("IOC").

Q2. Please explain the nature of the business conducted by IOM and IOC in New Brunswick.

A2. IOM wholesales petroleum products to Irving branded independent retailers and third party locations, and IOC wholesales petroleum products to non-Irving branded third party retailers, wholesalers and wholesalers/retailers of petroleum products.

Q3. Please explain the purpose of this evidence.

A3. The purpose of this evidence is: (a) to explain the increases in the costs associated with the wholesaling of petroleum products ("wholesale costs") and critical challenges in the petroleum industry since the wholesale margins for motor fuels and furnace oil were last reviewed, and (b) to support an adjustment in the wholesale margins for motor fuels and furnace oil.

Q4. Please summarize your recommendations.

A4. The wholesale margins for motor fuels and furnace oil should be ultimately increased by \$0.0413/litre so that the current wholesale margin for motor fuels is increased from \$0.0651/litre to \$0.1064/litre and the current wholesale margin for furnace oil is increased from \$0.055/litre to \$0.0963/litre.

In the meantime, the wholesale margins for motor fuels and furnace oil should be increased immediately by $0.035/litre to adjust for increases in wholesale costs and critical challenges in the petroleum industry.

Q5. What is the "wholesale margin" and why is it an important component of the regulated price of petroleum products in New Brunswick?

A5. The "wholesale margin" was initially adopted to reflect both the wholesale costs and wholesale unit margin of wholesalers in the Province. It is an important component of the regulated price of petroleum products in New Brunswick because wholesalers supply petroleum products to retailers before petroleum products can then be resold to consumers across the Province. If the wholesale margin is not adequate to cover wholesale costs and a reasonable unit margin, wholesalers could choose not to supply or could not be in a position to supply retailers in the Province.

Q6. What are the current wholesale margins in New Brunswick and when were they put in place?

A6. The current wholesale margins for motor fuels is $0.0651/litre (or 6.51 cpl) and for furnace oil is $0.055/litre (or 5.5 cpl). The wholesale margins for motor fuels and furnace oil were determined by the New Brunswick Energy and Utilities Board ("Board"), effective on March 7, 2013.

Q7. Have there been any changes to the wholesale costs for petroleum products in New Brunswick since the last time that the wholesale margins were increased?

A7. Yes. Since the last time when the wholesale margins were increased, there have been substantial increases in wholesale costs.

Q8. Please describe the changes in the wholesale costs that have occurred over the past nine years.

A8. As shown in confidential Appendix A attached, there has been an increase in the wholesale costs between 2011 and 2019 associated with selling motor fuels and furnace oil. As indicated in confidential Appendix A, the wholesale costs which have increased include terminal fees, transportation and port fees, working capital management, overhead and compliance costs.

Q9. Why is it important that the wholesale margins provide for the recovery of the actual wholesale costs incurred by a wholesaler in wholesaling petroleum products in New Brunswick?

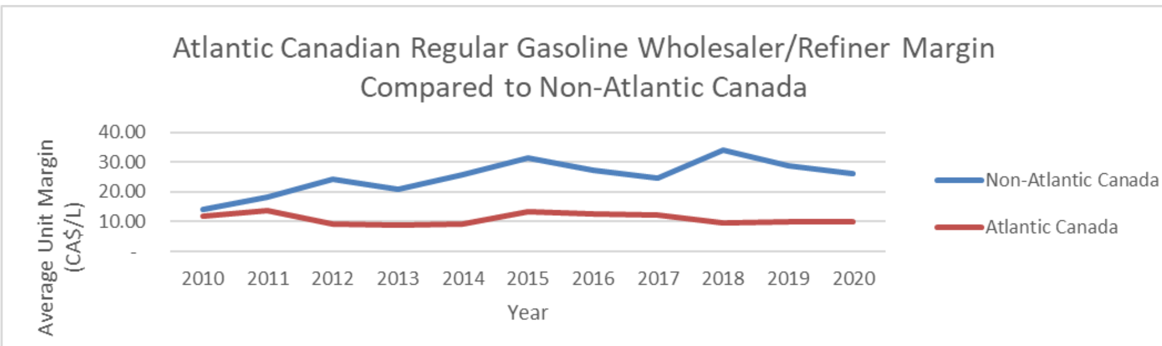
A9. The initial wholesale margins were set in order to cover a wholesaler's costs and to provide a reasonable return to the wholesaler. It is important for the actual wholesale costs to be recovered in the wholesale margins because without cost recovery it will not make economic sense to continue to supply retailers where the wholesale cost increases exceed what can be recovered from retailers. As the costs need to be ultimately recovered, it is necessary to provide for a reasonable opportunity of cost recovery to maintain a reliable supply chain.

Q10. Please describe factors that are contributing to those security of supply concerns.

A10. In this A10, all references to "Irving Oil" are more general than the earlier defined term.

Regulatory Markets (Comparison Regulated to Non-Regulated Markets)

As demonstrated in the graph below, on average there is a $0.15/litre difference in the gasoline wholesaler/refiner margin (the wholesaler/refiner margin is calculated by subtracting the relevant regional average crude price from the relevant wholesale price) between Atlantic Canada (regulated markets) and the rest of Canada (non-regulated markets) since 2012. Regulated markets have become disconnected from non-regulated markets over time and do not provide for adequate recovery of costs and have eroded industry's ability to continue to supply regulated markets and remain competitive across our regions.



Source: Kent Data Group

Major Industry Impacts

As a result of government policy, the petroleum industry is in transition. Industry costs are increasing as regulations for environmental and other compliance obligations are implemented. At the same time demand for refined products is decreasing over time. It is expected these factors will only continue at an accelerated pace. This alone has placed the industry under ongoing pressure and the current situation related to the pandemic has now evolved into a serious energy matter.

The COVID-19 pandemic is having a significant impact on the petroleum industry. [redacted] The reduction in demand for motor fuels, jet fuel and other refined products has been material and pronounced. As a result, the entire supply chain is under pressure and at risk. COVID-19 has exacerbated challenges for the industry and urgent action is required.

It is clear all industry participants are making changes to their business. In some cases, they are exiting markets, selling assets including refineries and terminals or significantly reducing inventory levels. For example, Royal Dutch Shell recently announced they will be reducing their number of refineries from 14 to 6 and closer to Atlantic Canada PBF made an announcement to shut down refined product production at their Paulsboro, NJ refinery. In all cases industry participants have cancelled projects, reduced spending and implemented permanent job losses industry wide. In 2020 alone, 20 refineries have announced closures or transitions. This number will likely increase.

Our Region is not isolated from these issues. At the start of the last decade, there were three refineries operating in Atlantic Canada. With the recent closure of the Come-by-Chance refinery in Newfoundland and Labrador, only the Irving Oil refinery in Saint John remains. With the closure of the Come-by-Chance refinery, it poses a risk to reliable supply of all energy products. It is unclear if the recent interim increases in wholesale pricing in that market will be enough to maintain the supply system.

Irving Oil has also made difficult decisions across its operations. These company-wide decisions have included, but are not limited to:

- the largest workforce reduction in Irving Oil's history, impacting over 250 employees and 600 contractors
- reductions in capital, operating and other costs across our operations by over $300M

- the cancellation of future capital projects and the imposition of other cost reduction initiatives

[redacted]

Q11. Are you aware of any wholesale margin increases that have been approved recently in other Atlantic Provinces?

A11. By an Order dated October 27, 2020, the Newfoundland and Labrador Board of Commissioners of Public Utilities approved, on an interim basis, an increase in wholesale markups of 5.0 cpl for gasoline (up to a total wholesale margin of 15.65 cpl) and 4.0 cpl for diesel, furnace oil and stove oil (up to a total wholesale margin of 14.52 cpl), effective October 29, 2020. The Order is attached as Appendix B.

By an Interim Order dated December 30, 2020, the Nova Scotia Utility and Review Board approved, on an interim basis, an increase in the wholesale margin for self-service and full-service gasoline and diesel of 2.5 cpl (up to a total wholesale margin of 9.15 cpl), effective January 8, 2021. The Interim Order is attached as Appendix C.

Q12. Is this the end of your evidence?

A12. Yes.

Appendix A

New Brunswick Wholesale Cost Analysis

Wholesale Cost Build-Up (CPL Based on Saint John Rack Volumes)				
Cost Categories	**2011**	**2019**	**2020 (prorated)**	**Difference btw 2011 vs 2019**
	values in Canadian dollars per litre			
Terminal Fee	$ [redacted]	$ [redacted]	$ [redacted]	[redacted]
Transportation & Port Fees	$ [redacted]	$ [redacted]	$ [redacted]	[redacted]
Federal Compliance Costs	$ [redacted]	$ [redacted]	$ [redacted]	[redacted]
Working Capital Management & Overhead	$ [redacted]	$ [redacted]	$ [redacted]	[redacted]
Total Cost per Litre (CPL)	**$** [redacted]	**$** [redacted]	**$** [redacted]	[redacted]

New Brunswick Wholesale Cost Analysis

Detailed Description & Values

Terminal Fees		**2011**	**2019**	**2020**	**Diff. 2011 vs 2019**
Terminal Operating Expenses (OpEx) and Capital Spend. (CAPEX)	This includes costs to operate the East Saint John terminal. 1) Operating expenses; maintenance, salaries, additives, utilities and general operating expense (IT, Admin etc.…), 2) Current year capital and prior years investment depreciation	[redacted]	[redacted]	[redacted]	[redacted]
Transportation and Port Fees					
Marine Freight	Poten & Partners average freight rates for 2011, 2019, 2020 from New York Harbour to Saint John, NB	[redacted]	[redacted]	[redacted]	[redacted]
Ethanol Freight	Includes only detention / demurrage charges	[redacted]	[redacted]	[redacted]	[redacted]
Port costs	Includes pilot costs, dredging, wharfage, harbour dues to bring product into port.	[redacted]	[redacted]	[redacted]	[redacted]
Working Capital Management and Overhead					
Working Capital	Annual Volume (barrels per day) x # day sales x market price #/bbl x #% WACC / 365 days. Based on Saint John terminal volumes	[redacted]	[redacted]	[redacted]	[redacted]
Accounts Receivable	Based on average Days Sales Outstanding	[redacted]	[redacted]	[redacted]	[redacted]
Quality, Compliance and Oversight	Costs for product quality control costs are included and have been allocated over Saint John rack volumes (total Quality Control Team costs x #% SJ rack domestic volumes divided by SJ rack volumes).	[redacted]	[redacted]	[redacted]	[redacted]
Overhead Costs	Admin costs (Customer Service; Pricing; Credit; Billing; Inventory; P&T (EHS L&D TVC CVC)). Allocated corporate overhead costs (buildings, admin, HR costs, insurance, people) over Saint John rack volumes.	[redacted]	[redacted]	[redacted]	[redacted]
Compliance					
Federal Compliance	Federal Renewable Fuels Regulation 5% Ethanol in gasoline/ 2% renewable fuel in diesel	[redacted]	[redacted]	[redacted]	[redacted]
	Total Wholesale Cost Build-up	[redacted]	[redacted]	[redacted]	[redacted]

Appendix B

NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

AN ORDER OF THE BOARD

NO. P.P. 52(2020)

IN THE MATTER OF the *Petroleum Products Act*, SNL 2001, Chapter P-10.1 and regulations thereunder; and

IN THE MATTER OF a request from NARL Marketing Limited Partnership that the Board implement increases in allowed wholesale mark-ups for gasoline, diesel, furnace oil and stove oil.

WHEREAS on October 5, 2020 NARL Marketing Limited Partnership ("North Atlantic") wrote the Board requesting amendments to the existing pricing structure to expeditiously increase the wholesale mark-up for gasoline, diesel and furnace oil as an interim step and, after completion of the Board's review, further adjust the wholesale prices to reflect the incremental costs of importing all fuels to the island portion of the Province (the "Application"); and

WHEREAS the Application advocated that the price increases be implemented for all fuel suppliers to provide a level playing field, ensuring the viability of terminals and a long term reliable supply for the Province and that this uniform pricing structure would ensure that multiple suppliers can operate economically on the island; and

WHEREAS the Application stated that the North Atlantic Refinery was transitioned into standby mode on March 30, 2020 and that North Atlantic has been importing refined products from New York Harbour and Europe for the past six months; and

WHEREAS the Application stated that the current wholesale mark-ups established by the Board are based on an operating refinery on the island and that it urgently requests the review of the wholesale mark-ups for gasoline, diesel and furnace oil to reflect the current circumstances with no operating refinery and a 100% import market; and

WHEREAS the Application provided information related to the five main factors which North Atlantic believes need to be taken into consideration to determine the cost of importing fuel: i) shipping costs from New York Harbour, ii) inventory financing and hedging costs, iii) the use of 3rd party terminals or the Come By Chance terminal, iv) the loss of butane blending, and v) subsidized pricing in the Newfoundland market due to local production; and

WHEREAS North Atlantic subsequently clarified that the requested wholesale mark-up increase was to also apply to stove oil and that the proposed increases are requested to be implemented for the island only; and

WHEREAS in response to requests from the Board, North Atlantic provided additional information to support the Application; and

WHEREAS on October 19, 2020 and October 22, 2020, in response to requests from the Board, information was received from Imperial Oil Limited and Irving Oil, also suppliers of petroleum products on the island, in relation to the impacts of the Application and the standby operation of the North Atlantic Refinery; and

WHEREAS based on its review of the information provided the Board is satisfied that there are incremental costs associated with changes in the method of supply on the island made necessary by the transition of the North Atlantic Refinery into standby mode and that these costs are not reflected in the current wholesale mark-ups for gasoline, diesel, furnace oil and stove oil; and

WHEREAS the Board is satisfied that interim adjustments to the allowed wholesale mark-ups for gasoline, diesel, furnace oil and stove oil in all zones on the island are required to ensure the viability of terminals and long term supply and to ensure that multiple suppliers can operate economically on the island and that the uniform treatment of suppliers is appropriate and reasonable in the circumstances; and

WHEREAS the Board is satisfied, based on the cost and supply information provided, that there should be an interim increase in the wholesale mark-ups for all wholesalers in all zones on the island of 5.0 cents per litre for gasoline and 4.0 cents per litre for diesel, furnace oil and stove oil, with corresponding increases in the total allowed mark-ups for these products in these zones.

<u>IT IS THEREFORE ORDERED THAT:</u>

1. The wholesale mark-ups in all zones on the island shall increase, on an interim basis, by 5.0 cents per litre for gasoline and by 4.0 cents per litre for diesel, furnace oil, and stove oil, with corresponding increases in the total allowed mark-ups included in maximum prices, effective 12:01 a.m. October 29, 2020, until further order of the Board.

DATED at St. John's, Newfoundland and Labrador, this 27th day of October, 2020.

Darlene Whalen, P. Eng., FEC
Chair and Chief Executive Officer

Dwanda Newman, LL.B.
Vice-Chair

John O'Brien, FCPA, FCA, CISA
Commissioner

Christopher Pike, LL.B., FCIP
Commissioner

Cheryl Blundon
Board Secretary

INTERIM ORDER **M09952**

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE PETROLEUM PRODUCTS PRICING REGULATIONS

- and -

IN THE MATTER OF AN APPLICATION by the Minister requesting that the Board undertake an investigation under s. 24(2)(c) of the *Petroleum Products Pricing Regulations* about the sufficiency of the current wholesale margin for self-service and full-service gasoline and diesel

BEFORE: Roland A. Deveau, Q.C., Vice Chair

INTERIM ORDER

WHEREAS the Minister of Service Nova Scotia and Internal Services filed a letter with the Nova Scotia Utility and Review Board dated December 22, 2020, making an application under s. 24(2)(c) of the *Petroleum Products Pricing Regulations* to request that the Board undertake an investigation about the sufficiency of current wholesale margin for self-service and full-service gasoline;

AND WHEREAS the Minister advised that industry has recently expressed concerns that the current wholesale margin is not enough to guarantee security of supply in the current challenging COVID-19 global environment;

AND WHEREAS in s. 24A(1) of the *Regulations*, an "emergency situation" means a situation that in the Board's opinion threatens the security of the petroleum supply, including any of the following:

(a) a disruption to the supply of a petroleum product resulting from an increase in the rack rate charged to wholesalers and wholesaler-retailers that leads wholesalers and wholesaler-retailers to not sell a petroleum product because they are not receiving a sufficient wholesale margin;

(b) a shortage of supply of a petroleum product to wholesalers and wholesaler-retailers that affects one or more zones;

AND WHEREAS, under s. 24A(2) of the *Regulations*, in an emergency situation the Board may make an interim order to temporarily prescribe interim fixed wholesale prices, maximum retail prices or minimum and maximum retail mark-ups until the public hearing or inquiry required by subsection 24(3) can be held;

AND WHEREAS, as part of its regulatory oversight, the Board monitors the petroleum product market in the Province, including but not limited to the relationship of the daily New York Harbour spot price (NYH) and regulated prices set by the Board as compared to Halifax wholesale rack prices (Rack);

AND WHEREAS the Board has observed that, over an extended period, there has been an increased differential between the NYH and Rack, which has caused an erosion of the wholesaler portion of the wholesale margin under the price setting regime set out in the *Regulations*, and this has been further exacerbated by decreased sales volumes caused by the COVID-19 pandemic;

AND WHEREAS the increased differential between the NYH and Rack was confirmed in a report filed on December 8, 2020, by Kent Group Ltd., the Board Counsel's consultant, in Matter M09823;

AND WHEREAS the Board is satisfied that an emergency situation may exist in the Province, which could threaten the security of the petroleum supply, including a shortage of supply of a petroleum product to wholesalers and wholesaler-retailers that affects one or more zones, and that an increase in the wholesale margin is warranted on an interim basis pending the completion of a full investigation by the Board;

IT IS HEREBY ORDERED THAT:

1. The wholesale margin for self-service and full-service gasoline and diesel are increased, on an interim basis, by 2.50 cents per litre (cpl), up to a total of 9.15 cpl.
2. The increase to the wholesale margins approved in this Interim Order shall be incorporated into the Board's weekly setting of regulated petroleum product prices, effective 12:01 a.m. on Friday, January 8, 2021.
3. This Interim Order shall remain in effect until further Order of the Board.

DATED at Halifax, Nova Scotia, this 30th day of December, 2020.

Clerk of the Board