

**Select Committee on Petroleum Product Pricing**  
**Report from Danny Graham, MLA - Halifax Citadel – Sept. 1, 2004**

**Executive Summary**

I would like to first thank the many people who made the effort to prepare submissions to the committee. In addition, thanks to committee staff and caucus staff for their hard work and support.

I want also to express my appreciation to Chair Bill Dooks and my fellow committee members for their cooperation over these past two months. Although we have reached different conclusions about the best course of action, we have done so in a cordial atmosphere of respect that appears to be common to committee work, but all too uncommon in our work in the legislature.

It is always preferable to reach a unanimous consensus on issues such as these. My view of what we heard and read about these issues, however, leaves me far apart from other members, and I am therefore filing this minority report.

I am aware that two members of the liberal caucus, Mr. MacKinnon and Mr. Sampson have signed the majority report. This is not troubling since the committee work was not a partisan exercise. This amounts to a genuine difference of opinion. Undoubtedly it will make for lively caucus debate once it comes time for our full caucus to further consider these issues.

My hope is that the focus will be on the substance of our differences and less on the fact that there was disagreement. What matters is what the government chooses to do with these recommendations, and what benefit Nova Scotians ultimately receive from its action.

This committee was struck principally because of concern by Nova Scotians about the high price of gasoline in the spring of this year. Although issues such as the price of home heating fuel were to be considered, at the core of our mandate, we were to examine the issues around high gasoline prices and recommend possible approaches to lowering them.

The evidence before the committee strongly suggests that gasoline prices will *rise* if the recommendations of the majority report are implemented. In fact an examination of the majority report would show that the report provides essentially *little back-up support for its assertions that the changes recommended will lead to lower prices*. This could have been done by reference to the experiences in other jurisdictions that have tried divorcement or these regulatory approaches.

The majority is relying almost entirely on the *theory* of how these regulated approaches could work. When one examines the studies concerning the *practical experience* in

jurisdictions where they have been tried, however, it is clear that these approaches have lead to *higher* gasoline prices.

The core *recommendations of the majority* regarding gasoline prices are as follows:

- Immediate retail divorcement,
  - Immediate “below-cost” price regulation,
  - Immediate “one-rack-price” regulation; and
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- If retail divorcement is delayed or proves unworkable, move to a “PEI Plus” model of full regulation.

When one considers the combined effect of simultaneously implementing retail divorcement, below-cost legislation and one-rack-price regulation, Nova Scotia would be immediately and dramatically shifting to become the most regulated market in North America. The fourth (PEI Plus) approach would be even more radically interventionist, but it would only come into effect if retail divorcement is delayed or proves to be unworkable.

I have no difficulty with strong and even radical approaches being implemented down the road, but only if there is a reasonable possibility that they will help consumers. This can only be determined through a more detailed analysis of the possible benefits and drawbacks experienced by other jurisdictions. It is important that we properly build our case. In this summer exercise, we have barely scratched the surface of the ramifications of what is being proposed by the majority.

At the first committee meeting on June 30, 2004, (on page 8 of Hansard) I expressed my concern that if we are looking to prepare a substantive original report, the August 31 deadline was unrealistic. However, if we were looking to make general comments to the legislature and give Nova Scotians an opportunity to say their piece, this was a doable exercise.

If the province moves forward with strong regulatory action without considering the full ramifications of its choices, it will probably make matters worse – *through higher gasoline prices* – the very issue the committee was struck to address; or *through the closing of service stations* – the issue that was front and center with retail witnesses.

As I discuss later, the most reliable information we have concerning the actual experience with *retail divorcement* is that it *increases gasoline prices*. The majority has provided only the theoretical position that it could reduce prices, with no indication of where or how this theory has worked. I have additional concerns about whether it will lead to fewer gasoline stations.

The most reliable information we have about *below-cost pricing* (e.g. preventing stronger retailers from selling below refiner prices) is that it *increases gasoline prices*. Again, the majority has not pointed to any jurisdiction where it has lead to lower gasoline prices.

With respect to selling at *one-rack-price*, we know of no other jurisdiction that has tried this, so Nova Scotia would be charting new water. This is a form of partial regulation. Mike Duda, a Senior Policy Analyst with Service Nova Scotia advised us “partial (regulation) will create all sorts of problems that we don’t understand”. Mr. Duda, along with federal government officials have also warned that regulation inherently results in *higher costs*.

With respect to a PEI Plus model that is possible if retail divorcement stalls or fails, there was extensive discussion about the PEI part of the model, but very little regarding the “Plus” part. Dealing first with the PEI part: excluding tax, it is clear from a review of the reliable data that “islanders” pay *more* for gasoline under their regulated system, even taking into consideration transportation costs (when taxes are added they pay less, but this is irrelevant to the discussion of regulation).<sup>1</sup>

The feature of the “Plus” part of PEI Plus that concerns me most relates to the recommendation in the majority report concerning “fairness for the consumer and reasonable rate of return be guiding factors when the UARB sets the price...”. While the language sounds innocuous, I understand it to mean that the UARB may set the Nova Scotia price, irrespective of what the world price of crude might be or what the refiners asking price might be because the UARB, through an inquiry, may determine that the crude price is unreasonably high or the refiner price is unreasonably high.

I share the concerns of the majority about whether some oil companies have been oppressive in their business dealings with retailers. And I am also skeptical about their claims of being reasonable in their role concerning setting fair crude and refiner prices. But there are concrete steps, short of the PEI Plus approach, that should be taken if we stand any chance of “wagging the dog” that is “big oil”. We need to build our case carefully and develop government and industry allies around this daunting question. As expedient as it might be to suggest the Nova Scotia government can fix the problem of high fuel prices, this small province represents less than 1/1000 of the world market.

I make four recommendations to address my concerns about larger oil company dominance:

- File complaints with the federal Competition Bureau on behalf of retailers,
- Encourage the federal government to lower the standard of proof for prosecutions under the Competition Act,
- Give the Competition Bureau or a provincial arm of government the authority and resources to thoroughly investigate the activity of large oil companies in setting the crude and refiner prices, and
- Enlist other jurisdictions to join in this exercise and become allies.

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<sup>1</sup> MJ Ervin & Associates, 1997 Canadian Retail Markets Study, page 79. In addition, see chart Appendix C.

Provincial taxes on gasoline are much higher than the national average (see chart comparison Appendix A). In addition, as a result of increased Nova Scotia taxes (Budget 02/03) and increased pump prices, at the current rate, the provincial government is receiving approximately \$40 million more in gasoline taxes per year than it received two and a half years ago (based on provincial consumption of 1.2 billion liters per year). Accordingly, I recommend that government should:

- Explore ways of reducing fuel taxes,
- Explore using part of the tax windfall that comes from higher pump prices to support the continuation of a supply of gasoline to remote locations, and
- Support environmentally friendly alternatives to heavy petroleum product consumption.

With respect to the all-important environmental issues, while I was disappointed with the number of presentations we received, the recommendations of the majority are sound and very supportable.

The presentations before the committee have been valuable in establishing the challenges being faced by consumers, retailers and others in the industry. They form the foundation for the provincial government to take a more active role in addressing the concerns of Nova Scotians who want answers to the high price of fuel. I specifically set out steps that can be taken now to address some of these challenges.

As tempting as it might be to try to reduce these issues into strong messages and bold action, more work needs to be done before we can put our best foot forward on the broader range of complex issues.

I hope my comments and recommendations can be of assistance.

## **Retail Divorcement**

Retail Divorcement is the top recommendation of the majority report and is described in the majority report. It essentially involves forcing large integrated oil companies to reduce the degree of their industry integration by selling off corporately-owned service stations. In theory, removing integrated oil companies from the retail market would increase competition and reduce consumer prices. In practice, however, this approach appears to *increase gasoline prices*.

First, I would like to address the question of whether there has been enough information, before the whole committee to make a recommendation that retail divorcement is the best option. The committee is recommending that *after* divorcement has been tried, we should determine its effects and possibly move to more substantial regulation if it does not work out. This is strikingly like a “*shoot first, ask questions later approach*”.

It would be far more prudent to study the record in jurisdictions that have tried divorcement *before* making this sweeping recommendation. We could have learned about divorcement experiences through oral submissions, written submissions, an independent examination of other jurisdictions, or by a literature review of the studies that have examined the subject in detail. The committee simply has not undertaken this level of analysis.

While the issue of retail divorcement was raised in committee hearings, two presenters came prepared to submit on this subject. One presenter was a Nova Scotia gasoline retailer who had no supporting documentation to show that divorcement was a desirable approach. The other presenter was Richard Taylor, the Acting Deputy Commissioner of the Federal Competition Bureau. Mr. Taylor cited a Federal Trade Commission report that concluded that in the US states where they have divorcement laws, “consumers paid 2.7 cents per gallon more” (Hansard, July 27, 2004, page 44).<sup>2</sup>

In an attempt to understand the ramifications of divorcement better, I have reviewed a study for the state of Hawaii, which examined the impact of divorcement in the 6 US states that have divorcement legislation<sup>3</sup>. The Hawaii study also provides a summary of studies done on divorcement. From this study and a review of the report summaries, there is a clear consensus (although not unanimous) that divorcement legislation increases gasoline prices.

These studies also raised concerns about divorcement leading to shorter service station hours, reduced services and fewer stations.

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<sup>2</sup> Also see Vita, Michael G., *Regulatory Restrictions on Vertical Integration and Control; The Competitive Impact of Gasoline Divorcement Policies*, Federal Trade Commission, July, 21, 1999.

<sup>3</sup> Regulating Hawaii’s Petroleum Industry, Chapter 15, Retail Divorcement.

It seems clear that divorcement will help some retailers who have strenuously argued that large companies are oppressing them. It also would likely help wholesalers like Wilsons. But ultimately would divorcement hurt consumers? In theory retail divorcement sounds attractive, but ultimately – *in practice* - it has been more harmful to consumers.

I am not ideologically opposed to retail divorcement. At a minimum, however, it is imprudent to recommend that divorcement be implemented without a clear sense of its potential benefits and drawbacks. Currently, much more analysis is required. I recommend that the benefits and drawbacks of retail divorcement be further explored.

*A broader analysis of industry options including retail divorcement, below-cost sales legislation, one rack pricing, refiner margins, and the price of crude, is recommended.* This analysis, which was not possible in the short duration of the committee hearings, could be done by government or by a committee with substantial resources and a longer timeframe.

### **Other Options that Protect Retailers**

The committee received testimony from many retailers who gave evidence of hard-ball business activity, where large suppliers are taking advantage of their strong negotiating position. In more troubling cases the evidence appeared to go beyond hard-ball business activity and verged on predatory price squeezing. *There should be a general complaint filed by the committee and/or government concerning the actions of suppliers to retailers by the federal Competition Bureau, under the provisions of the Competition Act.*

Rodney Grace, a co-owner of Bob's Shell service station in Bridgewater gave specific evidence to the committee that if he raises the price at the pumps, his oil company will increase their cost to him, in effect, squeezing his profit margin (Hansard, July 15, 2004, page 15). This practice was confirmed by the Richard Cormier, owner of H. Cormier Service Station in Cheticamp (Hansard, July 19, 2004, page 21). *There should be a complaint filed to the Competition Bureau regarding the specific allegations of price squeezing by the suppliers of fuel to the stations operated by Mr. Grace and Mr. Cormier.*

The standard of proof under the Competition Act is the criminal standard of proof beyond a reasonable doubt. Despite the frequency of anecdotal stories about the unfair actions of large oil companies, there have been few convictions under the Act. The criminal standard of proof beyond a reasonable doubt makes little sense and is too high. *The province should urge the Government of Canada to change the standard of proof to "clear and convincing evidence" which falls between the civil standard of balance of probabilities and the criminal standard of proof beyond a reasonable doubt.*

*I support the majority recommendation that the Federal Government reinstate the Competition Bureau's power to conduct a research inquiry.*

## **Regulation**

### ***Below-cost regulation***

The committee is recommending partial “regulation” with a below-cost legislation mechanism, similar to Quebec. Below-cost legislation prohibits deep-pocket gasoline retailers from selling at prices that are below rack cost. It is intended to prevent larger retailers from driving smaller retailers out of business.

Again, little evidence was presented to the committee and more study is needed before we introduce this partial regulation since it may increase prices. Richard Taylor, of the federal Competition Bureau submitted that in US States with below cost-sales legislation, *retail gasoline prices are higher*. No evidence or testimony was put before the committee that showed how below-cost legislation lead to lower prices.

The committee attempted to have a Quebec official appear and explain the pros and cons of this approach, but this was not possible. Perhaps with more notice, outside the summer period, more could be learned about the Quebec experience before we recommend this approach.

### ***Single-rack -price***

The committee also wants to regulate a single rack price at the refinery gate. The committee knows of no other jurisdiction that has tried this novel approach. The possible impact is unknown. Again, there were virtually no submissions prepared on this point, and it was raised as a passing consideration.

The committee did hear strong concerns by federal and provincial officials that regulation increases costs. In this approach, it is easy to imagine how market inefficiencies could lead to higher prices for consumers.

In addition, this is a form of partial regulation and Mike Duda from Service Nova Scotia and Municipal Relations stated “My suggestion – from looking at this over time - would be that if the committee does choose to recommend regulation that it go to the full regulation route. Partial will create all sorts of problems that we don’t understand.”(Hansard, July 27, 2004, page 9)

### ***PEI Plus (full regulation)***

The committee is recommending that if retail divorcement does not work or is delayed, the government should go beyond the *initial regulatory process* it proposes to implement a *full regulatory process* that is like PEI, but which goes further to involve the UARB and factors in possible unfairness in the world price of crude and refinery costs.

There was indeed extensive discussion and analysis about whether to take the PEI approach, but relatively little analysis about whether and how the “Plus”enhancements

would work. It is important to note that when the majority speaks of referring the matter to the UARB to examine the broader question of “fairness for the consumers and reasonable rates of return to producers”, what it appears to be contemplating is exploring whether we can reduce the pump price irrespective of the price of the world price of crude and the margins enjoyed by refiners.

The price of crude oil has increased dramatically in relation to the costs of exploration and extraction. As well, the costs of refining crude oil have risen dramatically. These are significant concerns, but no significant evidence was presented, or analysis undertaken, by the committee regarding these two issues. Before a recommendation is made that addresses the price of crude oil or refining prices, a fully-funded investigation into crude prices and refiner margins that considers all possible solutions is necessary. This investigation could be undertaken in conjunction with other provinces also wanting to address the fuel price issue.

As mentioned, I share the concerns that the majority members have about the strength and profitability of large multi-national oil companies. *The Federal Competition Bureau or a provincial arm of government should be given the authority and resources to thoroughly investigate the activity of large oil companies in setting the crude and refiner prices.* But I am not prepared to recommend implementing an inevitable process that may lead to negative unknown consequences for Nova Scotia consumers.

What is being proposed with PEI Plus does not appear to have been tried by any other jurisdiction. With Nova Scotia representing less than 1/1000 of the market to which “big oil” supplies, we are not exactly starting from a position of strength. It would be an overstatement to suggest we are the proverbial tail trying to wag the dog. At best, we are a clump of hair on the tail of the dog.

The prudent course is to build our case through a more comprehensive analysis. Assuming that supportive evidence is discovered, the next step would be to develop allies in other jurisdictions and industry to bring pressure on these companies and other industry players to ensure that fairness for consumers may be achieved.

In all of this, we should not lose sight of the fact that the pre-tax price of gasoline is low in Canada, compared with other western countries (see chart Appendix B). In addition, the pre-tax price in Halifax is usually about the same as the national average (see chart Appendix A).

Moreover, according to an independent data collection agency “...since deregulating pump prices, the Halifax market, and likely others in Nova Scotia, has seen a *decline* in pump prices relative to other Canadian markets.”<sup>4</sup>

There is no supporting evidence in the majority report for the price of gasoline rising since deregulation or as a result of deregulation.

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<sup>4</sup> Supra fn. 1 (emphasis mine)

Since 1992 – the first full year of regulation - when one compares the pre-tax price of gasoline in Halifax with the price of gasoline in Charlottetown, the price in Charlottetown is 2.65 cents higher (see chart Appendix C). According to the largest wholesaler to PEI, 1 cent of this can be explained by transportation costs to Charlottetown (see letter Appendix D). Accordingly, Halifax still enjoys an advantage of approximately one and half cents per liter. On 1.2 billion liters, that translates into \$18 million dollars worth of savings to Nova Scotians. (To the extent that it could be argued that Halifax was not representative of Nova Scotia and Charlottetown of PEI, we heard evidence that *each* capitol city has lower prices than the rural average.)

On a straight comparison with PEI (no Plus), the trade-off becomes clearer. Is the stability of pricing for 15 days (the minimum timeframe for prices to remain constant in PEI) worth the one and a half cents per liter, or \$18 million in savings? As with anything, there are other potential variables, but I submit this is as close as we can get to quantifying the straight trade-off between the current Nova Scotia approach and the current PEI approach.

A healthy debate is welcome in this regard. Perhaps Nova Scotians would be happy with the trade-off. Indeed, I find some features of regulation attractive. The most compelling is possible consumer peace. Prince Edward Islanders appeared to be less upset about the spring pump increases than Nova Scotians, but this could be explained by their lower pump price, because of lower provincial taxes.

### **Remote locations**

The committee heard evidence that the number of service stations has been declining in Nova Scotia, particularly in rural Nova Scotia – and this trend could continue. The most troubling aspect of this relates to whether coastal communities like Canso and places along the Cabot Trail would continue to have service stations.

For example, XTR Energy, currently provides fuel to remote areas that might otherwise not have a service station and has locations in:

- Economy
- Merigomish
- St. Peters
- River Hebert
- Rawdon Gold Mines
- Cape North
- Neil's Harbour
- Half Island Cove
- North Brookfield
- Shubenacadie
- Margaree
- Springhill
- Hopewell

- Liverpool
- Scotsburn
- Salmon River
- Inverness (Fuel Stop)
- Wreck Cove (Fuel Stop)
- Havre Boucher (Fuel Stop)

On July 20, 2004, Ken Wootten, the owner of XTR Energy, appeared before the committee in Truro. Mr. Wootten indicated that if the PEI regulatory system is put in place in Nova Scotia, he would be out of business. To be fair, the majority is not proposing every feature of the PEI model, but the concerns underpinning Mr. Wootten's concerns continue. Accordingly, service to these remote communities may be in jeopardy under any approach like PEI.

Remote gasoline stations provide an important lifeline to remote communities throughout Nova Scotia. All members of the committee are sympathetic to the challenges of gasoline stations in these communities staying open. I do believe that government has a role in ensuring the continuation of supply of what is virtually a necessity to these remote communities. *I recommend that some means of supporting "remote locations" should be explored by the government.*

### **Taxes**

When a comparison is made between industry costs of gasoline in Nova Scotia as compared with the Canadian average, Nova Scotia is more heavily taxed (See chart Appendix A). On an annualized basis, the provincial government is receiving approximately \$40 million more in gas taxes than it did two and a half years ago as a result of the increase on gasoline taxes of 2 ¢/liter in April 2002 and the increasing HST revenues as a result of the higher price of gasoline. For every ten cent per liter increase in the price of gasoline, the Province makes \$9.8 million. *I recommend that government explore ways of reducing fuel taxes, and support environmentally friendly alternatives to heavy petroleum product consumption.*

### **Environment**

An important consideration is our dependency on fossil fuels. This is a local and a worldwide problem. Many of our concerns regarding the price of fuel are directly related to need for fuel. *While I was disappointed with the number of presentations we received, the recommendations of the majority are sound and very supportable.*

### **Summary**

It is not necessary for the committee to set a concrete framework for a new regime. The committee has valuable, but still limited information. The evidence supporting regulation

is largely anecdotal. The committee's role is to act for the public good and the public's interest. The best evidence before the committee suggests that the majority recommendations of retail divorcement and regulation, in its various suggested forms, will cost consumers millions and lead to unknown and unintended consequences. Retail divorcement and regulation could also lead to the closure of service stations – perhaps in more remote communities. That being said, it is important to further pursue these issues.

The primary mandate of the committee was to explore the high price of fuel and make recommendations. I believe that before any legislative change can be recommended, we need to be fully informed of possible benefits or drawbacks for Nova Scotians.

After hearing from the presenters and researching these issues, I do not believe that the committee is in a position to know the full effects of a major legislative change, but it does now have grounds to take action to address short-term concerns and begin to better address long-term challenges.