Canadian Petroleum Products Institute | Institut canadien des produits pétroliers

Presentation to the Standing Committee on Industry, Science, and Technology
On Gas pricing and Refining Margins

By

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June 2007

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Mr. Chair, Members of Parliament and to Canadians who have access to this hearing, on behalf of the members of the CPPI, thank you for inviting me to better understand your preoccupations with our industry.

I will keep my comments brief so as to answer as many of your particular questions as possible.

The CPPI is the national association of major Canadian companies involved in the refining, distribution and/or marketing of petroleum products for transportation, home energy and industrial uses. Collectively, CPPI member companies operate 16 refineries (representing over 80 per cent of Canadian refining capacity) and supply over 7,000 branded retail outlets with transportation fuels across Canada.

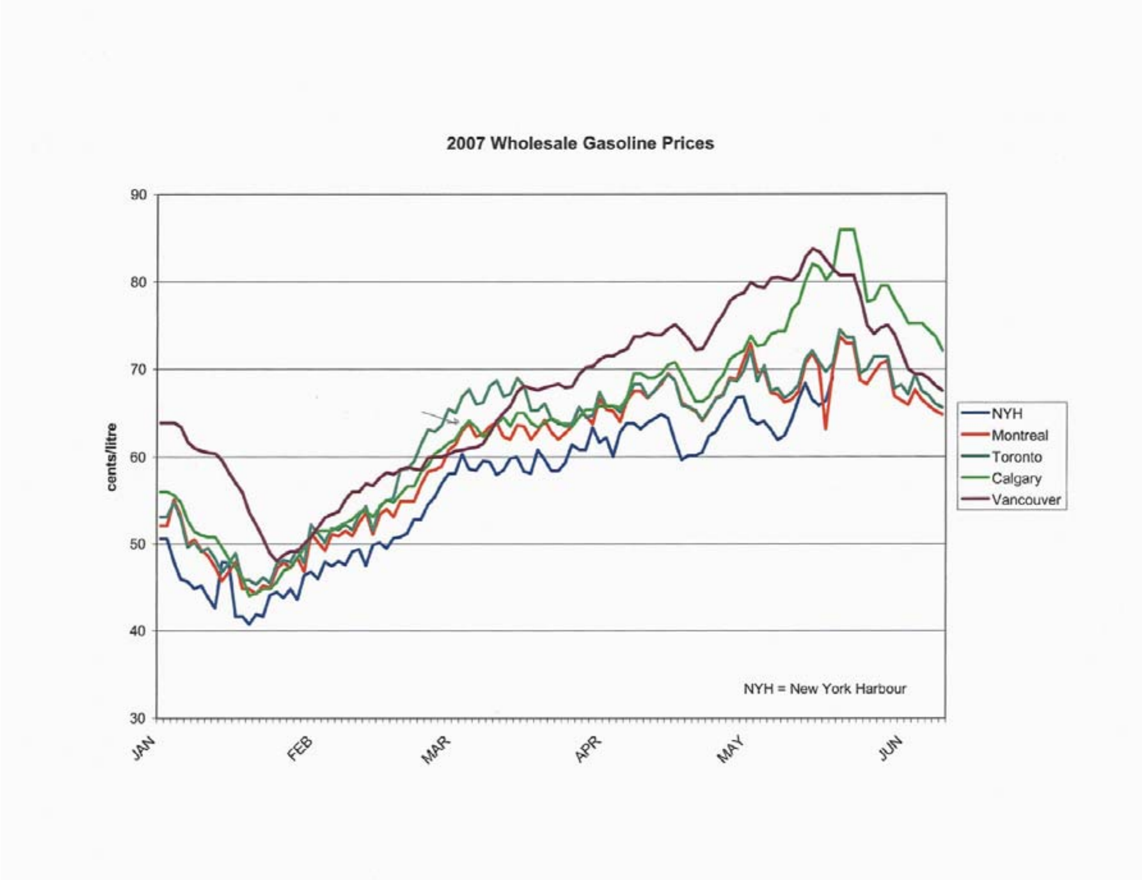
Our members are: Chevron Canada Limited, Husky Energy Inc., Imperial Oil Limited (Products and Chemicals Division), North Atlantic Refining Limited, Petro-Canada, Shell Canada Products, Suncor Energy Products Inc., Ultramar Ltd, Nova Chemicals (Canada) and Bitumar Inc. Our members operate refineries in British Columbia, Alberta, Ontario, Quebec, Nova Scotia and Newfoundland and Labrador. ARCO Products Canada Ltd. and Parkland Income Fund are marketers in western Canada.

We recognize that our industry is under the spotlight. For most Canadians, we are the indispensable enabler of the drive to work, to school, the transportation of paramedic and fire services, home heating fuel, the Saturday cutting of the lawn. We provide quality products, proven performance, and our complex facilities operate safely and reliably. We make our products affordable by keeping our costs down. We are also those who face consumer reaction head on with price signs larger than I am tall.

Affordability of our products is one key question that faces consumers, consumer advocates, social activists, environmentalists, scientists, engineers and economists, as well was public policy decision makers.

We understand your interest in gas prices and refinery margins. I hope today to provide you with a straightforward explanation of this complex topic.

The first chart presents movements in gas prices in four major urban centres compared to the New York Harbour wholesale price for gasoline. This is proof that we operate in a North American market place for this commodity.

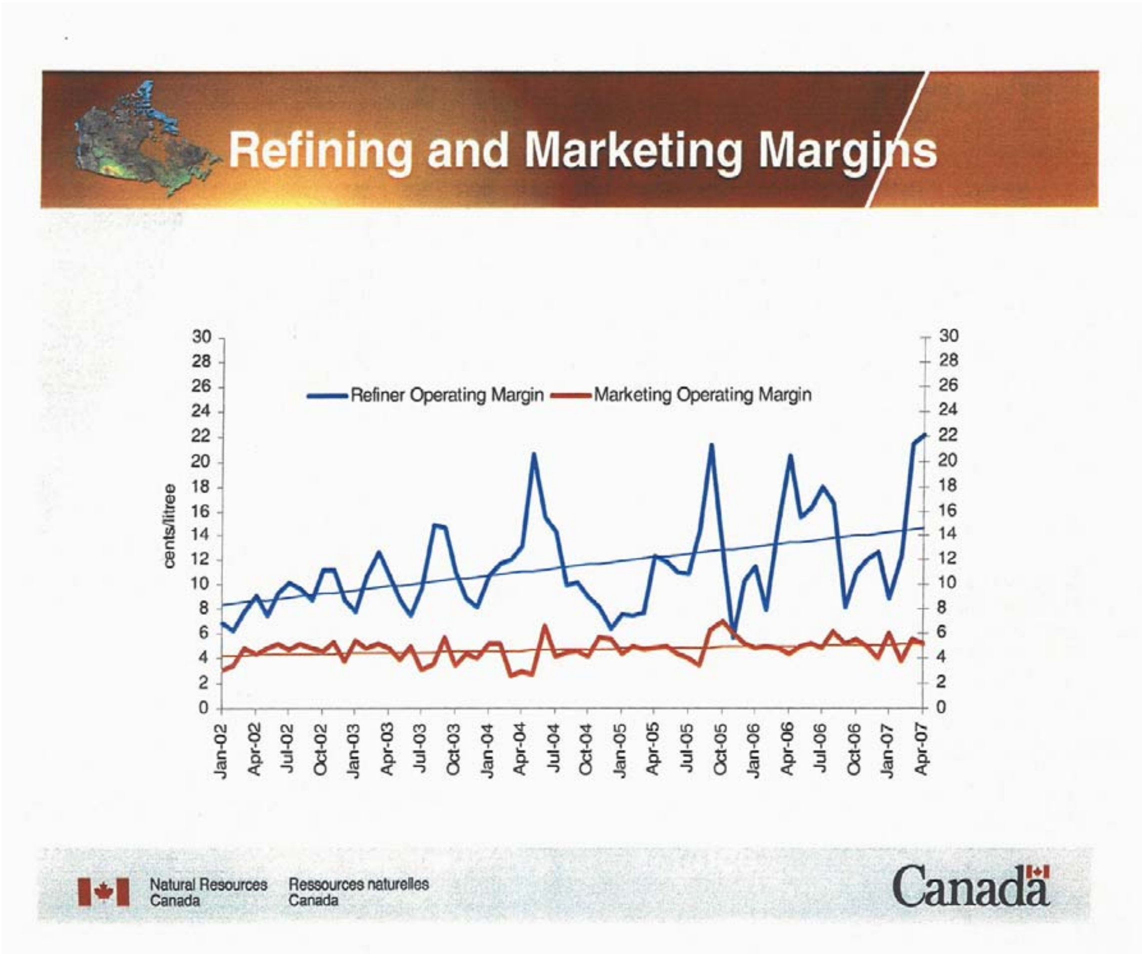


And a component to this phenomenon is speculation.

> To quote Natural Resources Canada, "News of the recent declines in stock levels, combined with the earlier than usual up-tick in gasoline demand, has market analysts speculating about possible gasoline shortages this summer. This has sent speculators and traders scurrying to the market to secure contracts for summer delivery. This trader activity has driven up wholesale prices of gasoline across North America and, subsequently, prices at the pump. Prices are likely to remain high until inventory levels begin to build or analysts are comfortable that there will be enough gasoline to meet summer demand". ***(NRCAN, Petroleum Product Market Outlook, 2007)***

This is not something that we do; rather, it is a reality of commodity trading.

In terms of refinery margins, the second chart presents movement in margins. It is volatile, but there is no question that margins are averaging upward.



Gasoline margin-marketing margin 1

In public policy terms, this parliament and previous parliaments have mandated fuel policies whose financial impact in terms of fiscal expenditures has been about the magnitude of a high speed rail corridor between Montreal and Toronto and in a much shorter period of time. In mandating a low sulphur requirement for gasoline and diesel, approximately $5 billion in expenditures were made to re-configure manufacturing processes.

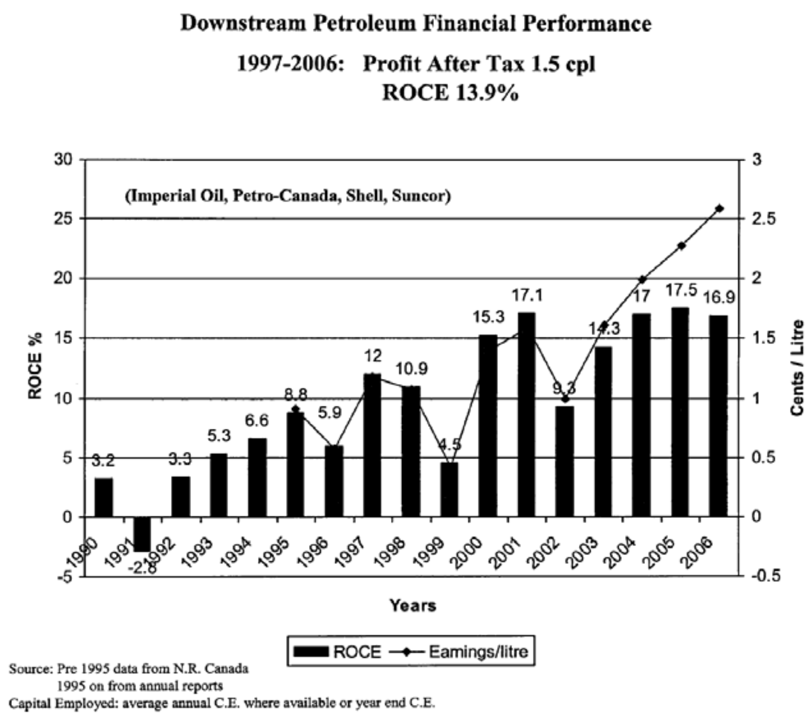
We worked in collaboration with government officials to achieve this policy and managed to achieve this public policy goal this while protecting Canada's competitive advantage in the production and distribution of fuels for Canadians.

$5 billion private sector dollars in a private sector operated and competition driven modern infrastructure - we will continue to make similar investments as a full partner with you as we take on new challenges with climate change and clean air.

For a few moments, consider the business environment in which the Institute's members operate:

- Our principal input is crude oil – a commodity determined by a global pricing system sourced from multiple areas of the world.
- Taxes. As complicated and expensive as the CRA definition of the amount of gasoline used to denature ethanol to the GST collected on the final tally. In the former, our members, independently, bear the cost of administering a public decision. If you think it's easy, try plotting and adding the cost of denaturant inputs against a tax schedule.
- Refinery margin is the differential between crude input cost and the price at which fuel is sold wholesale, essentially a commodity market (the North American fuel markets) on top of a commodity market based (crude oil) on thousands of transactions all over the world, by the hour involving futures and derivatives and so on. It is a margin, which is not to be confused with a profit and for at least one CPPI company, ranged from zero in December of 2006 to 10.7 cents when I wrote this brief.
- Marketing, those services for which consumers are attracted to beyond price (groceries, motor services, location etc.)

Nevertheless, the fact remains, that over the last ten years, after tax profits have averaged about 1.5 cents per litre.



The Canadian fuel infrastructure is alive and best serves consumers in a fully competitive marketplace. Nevertheless, a confusing policy environment is not conducive to investment decision making.

- Removing the tax exemption on renewable fuel mixes should be revisited because it increases the cost of fuel vis-à-vis the United States.
- The underlying assumption in the latest data provided by Environment Canada suggests that we will need to supplant future consumption with imports. With fixed caps on criteria air contaminants, we cannot grow to meet demand. Even though our members possess technologies to produce the cleanest fuel possible. We are being asked to exceed performance requirements of our principal competitors in the United States at significant cost.
- In respect of GHG's, the uncertainty over the pricing of CO2 credits beyond the short term continues to be a challenge. What we know is that an 18% reduction target by 2010 for all large industrial emission sources, along with a 2% per year escalation of the target thereafter, will create a large domestic demand for CO2 credits. This coupled with diminishing access to compliance options over time will impose large costs on our sector, which will not have to be borne by our US competitors. This will erode our ability to compete.
- In implementing the renewable fuels policy, major costs have already been incurred to respond to each jurisdiction.

As for price fluctuations, who doesn't hate them? As frustrating as price fluctuations can be, they are evidence of the biggest savings over time for consumers. In fact recent studies in Nova Scotia suggest that price regulation, while causing few movements in price, costs consumers more than the rest of the country.

But please don't ask us to do what we can't. That is, not behave like a global commodity market where the rule of supply and demand prevails. Successive studies, among others, by the Competition Bureau and the Conference Board of Canada have concluded that Canadians have benefited economically even though it can be a frustrating retail experience at any given time.

Historically, Canadians have had the second lowest cost gas prices in the western world. Whether that is good or bad in public policy terms is for you to decide. But our business is to provide Canadians with the lowest cost fuel at the highest quality and safely, and our industry has an excellent track record of doing exactly this.

There is heightened interest in what we do and how we do it. CPPI welcomes that. Because upon closer look, our product maybe a commodity but its safety, cleanliness, and low cost is a function of the incredible minds and integrity of the people that work for our members.

Just like using different light bulbs, and efficient furnaces, there are things that can be done that make consumption more efficient. Follow CAA guidelines for fuel conservation. Yes. Tire pressure does matter. Don't speed.

Thank you.