Home Heating Oil: An Emerging Crisis in New Brunswick

Situation:
The home heating oil industry in NB is facing serious operational challenges as a result of imposed regulation on the price of home heating oil. Retailers cannot remain profitable and are exiting the market, rural consumers are not getting the service they need, and the province is missing energy efficiency opportunities.

Background:
In July, 2006 the Province of New Brunswick implemented the Petroleum Products Pricing Act. Both the Act and its regulation are a hybrid of models used in PEI and NL. The Government of Nova Scotia chose not to regulate home heating oil after accepting the rationale that regulation removes choice, and limits competition and consumer access to services.

The NB Chapter of the Canadian Oil Heat Association has prepared a report explaining this issue in detail. It is imperative the Premier’s Office be aware of the impossible operating conditions the industry is dealing with. This issue is especially timely, as the NB Energy Commission undertakes a review of energy policies for the future success of the province.

Independent third-party consultant Gardner Pinfold, hired by the NB Energy and Utilities Board, has on numerous occasions recommended that the regulation capping the margin be removed.

Key Facts:
• **The Current Fuel Margin Is Incorrect.** When the regulation was enacted, the wholesale margin should have been set at 8 cents per litre, instead of the current 5 cents. This error in calculation impacts the total retail margin.
• **New York Harbour Pricing Shouldn’t Be Used.** The regulation bases its maximum retail price off of the New York Harbour Cargo pricing, when most retailers purchase from Saint John rack wholesale pricing. During the winter months, the margin decreases by about 3 cents per litre – a period in which the majority of home heating oil is sold.
• **Small Retailers Have Shut Their Doors.** Since 2006, 10 retailers have shut their doors and two others were forced to exit markets in which they operated. This has resulted in a 22% loss of retailers in the NB industry, and many lost jobs.
• **Consumers Are Being Pinched.** Because of the retailer consolidation, consumers have little to no choice about their retail service provider. There is a significant reduction in the delivery of home heating oil to consumers in rural areas because retailers cannot afford to service these areas.
• **Biodiesel Will Further Squeeze Retailers.** The new mandatory federal requirement that home heating oil contain 2% renewable (biodiesel) content means that home heating retailers will face even tighter margins.
• **Detrimental Environmental Impact.** Home heating oil is more environmentally friendly than other forms of energy, but in its current state the oil industry is not being considered as a viable efficient alternative.

Recommended Action:
The only option for ensuring the future sustainability and viability of the NB home heating oil industry is to deregulate the price. The industry should be operating in an unregulated, free-market system. Anything less will see New Brunswick consumers, retailers and their employees continue to suffer under a system that is not working.

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March 4, 2011
The Canadian Oil Heat Association, New Brunswick Chapter

Home Heating Oil: An Emerging Crisis in New Brunswick

Background and Proposed Solution
March 4, 2011
Introduction

This report offers the government insight into the challenges faced by the home heating oil industry in New Brunswick as a result of imposed regulation on the price of home heating oil. This is an opportune time to discuss the emerging crisis in the home heating oil industry as the New Brunswick Energy Commission undertakes public consultations on the future of the energy sector in New Brunswick.

The background information and current operational conditions contained here will serve to highlight the need for the government to consider deregulating the price of home heating oil in order to improve conditions for consumers, and small business owners and their employees throughout the province.

The regulation of home heating oil is found within the New Brunswick Petroleum Products Pricing Act (PPPA). Although the intent of the regulation is to protect New Brunswickers from fluctuating fuel prices, the regulation is having a negative effect on home heating oil consumers and retailers alike.

Some of the many problems arising from the enforcement of the home heating oil regulation include:

- **The Current Fuel Margin Is Incorrect.** When the PPPA was enacted, fuel margins were not correctly set. There have been various whitepapers, written by independent third parties, submitted to the Energy and Utilities Board that state that the New York Harbour margin should have been set at eight cents per litre, instead of the current five cents, which has impacted the total retail margin.

- **New York Harbour Pricing Shouldn’t Be Used.** The regulation bases its maximum retail price off of the New York Harbour Cargo pricing, when most retailers purchase from Saint John rack wholesale pricing. New Brunswick retailers purchase their oil from the Irving Oil Refinery in Saint John, not from New York. During the winter months, the margin decreases by approximately three cents per litre – a period in which the majority of home heating oil is sold. “The heating oil data (New York Harbour spot and Saint John rack) indicate that the price spread has widened since regulation was introduced, rising by about 12% from an average of 2.7 cents per litre between January 2003 and June 2006 to 3.0 cents per litre between July 2006 and September 2010...the widening of the spread between the Saint John rack price and New York Harbour spot price reduces the retailer share of the overall margin” (Gardner Pinfold, 2010, p.25).

- **Small Retailers Have Shut Their Doors.** Many retailers have exited the market because they cannot remain profitable under the regulation. Since 2006, 10 retailers have shut their doors
and two others were forced to exit markets in which they operated. This has resulted in a 22% loss of retailers in the New Brunswick industry.

- **Consumers Are Being Pinched.** Because of the retailer consolidation, consumers have little to no choice about their retail service provider. There is a significant reduction in the delivery of home heating oil to consumers in rural areas because retailers cannot afford to service these areas.

- **Biodiesel Will Further Squeeze Retailers.** The new mandatory national requirement that home heating oil contain 2% renewable (biodiesel) content means that home heating retailers will face even tighter margins. The government has announced July 1, 2011 as the date for the renewable requirement of the federal Renewable Fuels Regulation. This will create more expenses and operational difficulties for the home heating oil industry, further impacting its viability.

There are 70,000 domestic home heating oil tanks in New Brunswick. Because of the above factors, a disruption in the oil supply is happening, especially for rural consumers.

This report will demonstrate that deregulating the price of home heating oil, like in the province of Nova Scotia, will result in greater flexibility and stability of supply for consumers and provide the industry with the ability to operate successfully.

The New Brunswick Chapter of the Canadian Oil Heat Association would like to work with the Government of New Brunswick to keep the province’s home heating oil industry sustainable, profitable and better able to service New Brunswickers.

“Prices set in free and competitive markets give more accurate information to producers regarding their investment decisions, inform consumers about the value of the fuels they use and conserve energy resulting in environmental conservation.”

– Veronica Yu, President and CEO, Canadian Oil Heat Association
Background

On July 1, 2006 the Province of New Brunswick began price regulation on the sale of heating and motor fuels under the Petroleum Products Pricing Act (PPPA). Its attendant regulation is captured under New Brunswick Regulation 2006-41. Both the Act and its regulation provide the legal framework for the setting of maximum prices for petroleum products in New Brunswick (NBEUB website, 2011) and are a hybrid of models used in Prince Edward Island and Newfoundland and Labrador. It was at that time in early July that the maximum wholesale and retail sales margins, maximum delivery cost and the maximum full-service charge for heating and motor fuels, as set by the Minister of Energy, came into effect.

The main objective of the PPPA and its regulation was to create a pricing model to stabilize prices for consumers, with the proviso that “consumers should benefit from the lowest price possible without jeopardizing the continuity of the supply of petroleum products” (PPPA, c.35, s.1, 2007, p.3).

Independent consulting firm Gardner Pinfold was commissioned by the Energy and Utilities Board and submitted its most recent report in December, 2010. This is the third report of its kind, a third-party testament to the fact that the home heating oil industry in New Brunswick is operating under almost impossible circumstances. Observations by Gardner Pinfold are referenced throughout this report as evidence that a drastic change is needed.

The Nova Scotia Market – The Unregulated Atlantic Canadian Province

While gasoline prices in Nova Scotia are regulated, the Government of Nova Scotia chose not to regulate home heating oil. The Government, the home heating oil industry and various stakeholders accepted the rationale that regulation removes choice, and limits competition and consumer access to services.

How the Margin Price for Home Heating Oil is Set in New Brunswick – New York Harbour vs. Saint John Rack Pricing

The maximum price for home heating oil is established by calculating the benchmark price, which is set by the regulator every Thursday morning at 12:01 a.m. The benchmark price is based on the average New York Harbour spot price from the previous Wednesday to Tuesday. This is then added to the maximum wholesale price of five cents per litre. The maximum retail price is then added, which is a
A retail margin of 13 cents per litre. The total price is then calculated by adding the actual fuel delivery costs to the maximum retail price, five cents per litre. Finally, the harmonized sales tax is added.

It is broken down as follows:

- The benchmark price (set at the New York Harbour)
- The wholesale margin (5 cents per litre)
- The retailer margin (13 cents per litre)
- Delivery charge (up to 5 cents per litre)
- HST (13%)

The Province and the Home Heating Oil Industry

Retailers have expressed frustration at the entire regulatory framework. “This frustration arises in part from the view that heating oil should not have been regulated in the first place, and in part from the belief that government ‘got it wrong’ by setting the retail margin below the historic average when regulation was introduced” (Gardner Pinfold, 2010, p.33).

Retailers also feel the PPPA was written for the gasoline industry, and because home heating oil represents a much smaller portion of that industry, home heating oil should not be included in the regulation.

Market conditions for home heating oil in New Brunswick have changed dramatically since the inception of the regulation. Unless the regulation is repealed or an alternate solution is offered, the availability of home heating oil to New Brunswickers is in jeopardy, as is the sustainability of an industry that is vital to our province’s economy.

How This Regulation Hurts New Brunswickers

The home heating oil regulation is having a negative impact on New Brunswickers from an economic, environmental and societal perspective.

“Decisions that need to be made regarding our energy plan today are important to our future. These decisions will affect all New Brunswickers and will have a direct impact on our social and economic well-being as we move forward.”

New Brunswick Consumers

The exit of retailers from the market and the subsequent consolidation has had a negative impact on home heating oil consumers, especially those in rural areas. The following is a real story from real New Brunswickers:

Fundy Energy had operated in Fredericton since 1987 and employed two full-time employees and one part-time employee, whose combined salary was over $120,000 annually. The company delivered within a 100-km radius to rural areas including Minto, Mactaquac, Cambridge Narrows, Nackawic and New Maryland.

After years of trying to reduce expenses and overhead costs under the regulation, Fundy Energy closed its Fredericton business in 2010, forcing the lay-offs of its three employees. Because of the closure, some consumers in those rural areas had their home heating oil delivery schedules reduced from three times a week to once every two weeks. A former customer of Fundy Energy asked the company to return because he did not like the service provider he was forced to use. Fundy Energy could not help, because it could not afford the transportation costs to this loyal customer.

Should some of these rural New Brunswickers miss the delivery schedule or need oil delivered earlier, there is a real chance they will not be able to access service. Their plumbing may freeze, which could lead to burst pipes. And an emergency delivery of home heating oil can cost as much as $100 extra.

Home heating oil monopolies are not good for consumers.

New Brunswick Small Business Owners and Their Staff

For home heating oil retailers working within the confines of the margin while continuing to deliver to their consumers, every day is a challenge. In many cases, the enforced margin means an increase in the retailer’s transportation expenses to their rural consumers with no way to recover their costs. The home heating oil business “is a high cost business, particularly for companies operating in the more rural areas of the province where homes are few and far between” (Gardner Pinfield, 2010, p.8).

Because of incremental increases in operating expenses, those retailers still left in the market have had to:

- lay off hard working people, whose yearly salaries are between $35,000 – $55,000
• cut employees’ training, Blue Cross benefits, yearly bonuses, health and wellness allowances, RRSP contributions and sick days
• freeze employee salaries since 2006
• defer truck repairs and new truck purchases

According to the most recent Gardner Pinfold report (Dec., 2010), “regulation does not dictate or specify levels of service, and is not intended to strengthen supply infrastructure. By not stipulating a minimum margin at the wholesale or retail level, and by limiting the flexibility wholesalers and retailers have to adjust to changing conditions, regulation has the potential to create an unattractive economic environment for existing and prospective dealers. This is particularly the case for dealers operating in rural markets where transportation costs tend to be higher” (p. 15).

Unemployment is a Reality

Since 2006 when the regulation was implemented, 22% of small home heating oil businesses throughout the province have exited the market – resulting in unemployment for owners and their employees.

Because of competition in the market and reduced margins, two local Saint John heating oil retailers over the last five years were enticed to sell their businesses. In an effort to retain volumes that were decreasing due to competing energy alternatives and the increased price of fuel, Park Fuels Ltd. purchased the companies. Unavoidably, this consolidation resulted in the loss of 10 local full-time positions, and two additional positions were decreased from full time to seasonal.

Shoreline is another example of a company having to lay off people to reduce costs. Because of operational expenses, Shoreline was forced to cut the weekly hours of their office administrator, a loyal 20-year employee, from 45 to 32 – which significantly cut her wage. She is looking for new employment, but at over 50 years old and with limited computer skills, she will have difficulty finding a similar work environment.

The Impact of Biodiesel

The federal government is implementing a mandatory national requirement (the Renewable Fuels Regulation) that diesel fuel and home heating oil contain 2% renewable biodiesel content.

“The energy industry itself is a contributor to the New Brunswick economy, as energy companies are employers and taxpayers.”
The inclusion of biodiesel further exacerbates the near impossible operating conditions for home heating oil retailers. There are two serious problems with adding biodiesel to diesel fuel and home heating oil: the impact on how it will affect the price of home heating oil is unclear, and in cold temperatures biodiesel thickens and eventually solidifies.

The price of biodiesel is higher than the percentage of its content in the fuel; therefore, if biodiesel is making up 2% of the total product, it could, in fact, influence up to 10% of the total cost of the final product. The fact that it thickens during peak season when home heating oil is sold creates significant technical feasibility challenges.

Due to the current regulation, New Brunswick small business owners are suffering, home heating oil consumers are complaining, energy efficiency policies are lacking, and the situation will progressively worsen. There are no winners.

“The New Brunswick home heating oil industry cannot survive under this regulation. Our market is shrinking, our expenses keep climbing – yet the margin remains the same. Businesses will keep closing and small retailers and consumers will ultimately pay the price.”
– William Gould, President, Canadian Oil Heat Association, New Brunswick Chapter

The Effect of the Regulation on the Environment

The Government of New Brunswick is advocating for energy efficiency. Through Efficiency NB, the promotion of savings through lower energy use is just one economic benefit from an investment in cost-effective energy choices (Consumer Back grounder on Energy, 2011, p.22). Home heating oil is more environmentally friendly than electric power, but in its current state under the regulation the oil industry is being crippled and is not being considered as a viable efficient alternative. Heating oil dealers face the challenge of selling into a market where consumers have the option of choosing alternative fuels, so selling prices are governed not just by regulation, but also the price of fuel substitutes (Gardner Pinfold, 2010, p.5).
Background and Recommendation for the Emerging Home Heating Oil Crisis in New Brunswick

Options for Consideration

1. Remaining with the Status Quo – the Future Impacts of the Regulation

Should the regulation remain in effect further consolidation of home heating oil companies will occur, a monopoly situation will result, consumer choice will be further reduced, and in many cases, consumers will not be able to get the service they need when they need it.

Small New Brunswick home heating oil businesses will close, their staff will lose their jobs, and during the cold winter months consumers will have to use whatever oil retailer is operational or other more expensive and environmentally poor choices to heat their homes.

2. Deregulating the Price of Home Heating Oil

Currently, there is an adequate amount of competition for home heating oil in New Brunswick. The current regulation is in place to protect consumers, but having other energy options available – such as natural gas, wood, propane, geo thermal, solar, heat pump, pellets and electricity – will keep the market stable – benefitting consumers and retailers both.

Following Nova Scotia’s model, deregulating the price would allow for a free market environment and healthy competition in the home heating oil industry. It would ensure that consumers are not affected by a disruption of continuous supply.

The home heating oil small business owners will be better able to remain in business, employing New Brunswickers and contributing to the economy, while its consumers would be better protected and serviced.

Recommendation

The only option for ensuring the future sustainability and viability of the New Brunswick home heating oil industry is to deregulate the price. The industry should be operating in an unregulated, free-market system. Anything less will see New Brunswickers – consumers, retailers and their employees – continuing to suffer under a system that is not working.

Conclusion

The members of the New Brunswick Chapter of the Canadian Oil Heat Association are pleased to present this report to the Government of New Brunswick. It is our intention to work together to secure a
better future for the home heating oil industry and the 70,000 New Brunswickers who rely on that industry to heat their homes.
References


February 13, 2011

New Brunswick Energy and Utilities Board
PO Box 5001
15 Market Square, Suite 1400
Saint John, NB E2L 4Y9

Dear Sir/Madam,

The Canadian Oil Heat Association supports the market-based approach to determine prices for heating oil in Canada. While today’s market changes rapidly, most evidence suggests that eliminating competition through regulation, while making prices more stable, does not lead to lower fuel prices for consumers. A market-based approach allows competition to thrive and allows the price of heating oil to be most competitive. Overall, the market-based approach helps ensure that the amount of fuel available and the amount needed by consumers and business are balanced at a competitive price. It serves the best interests of all consumers.

All provinces are recommended to adopt a market-based approach to heating oil prices. This means that the governments rely upon competitive markets to determine prices. Prices set in free and competitive markets:

- Give more accurate information to producers regarding their investment decisions;
- Inform consumers about the value of the fuels they use;
- Conserve energy resulting in environment conservation.

We fully support our New Brunswick Chapter of the Canadian Oil Heat Association on their submission for a market-based approach to determine prices for heating oil in the Province of New Brunswick.

Please feel free to contact me for further information.

Sincerely,

Veronica Yu
President & CEO
Canadian Oil Heat Association