



**Notes for an address by Peter Boag,
President,
Canadian Petroleum Products
Institute
Standing Committee on Industry,
Subcommittee on Oil and Gas and
Other Energy Prices**

August 27, 2008

Check against Delivery

Mr/Ms Chair, thank you for the opportunity to be here today to contribute to your deliberations on a very topical and important issue for Canadian consumers.

Far too often, when we contemplate the workings of the marketplace, there is a tendency to discount the role that information plays in ensuring that consumers are well armed to make choices about how to allocate their hard earned dollars.

And so your work and that of CPPI is important in ensuring that Canadians can make the best choices for them and their families.

As many of you know, the members of the Canadian Petroleum Products Institute are the major refiners and marketers of petroleum products in Canada. Collectively, they operate 16 refineries, and supply the bulk of transportation fuel choices across Canada. Their presence, products and services are a daily necessity for Canadians.

At the very root of their existence, my members are intensely competitive players who strive to provide high quality, affordable products, while making a fair return on investment.

They operate in a very challenging environment, with substantial public exposure. No other industry interfaces with the consuming public with a street level, transparent display of product prices in signs as large as you and I.

Three markets influence the cost of fuels at those stations, markets that are driven by the economic fundamentals of supply and demand.

The first two are international commodity and financial markets:

- 1) The global market for crude oil – thousands of daily transactions executed by traders around the world. It is well recognized that increasing global demand, especially from Asia and the Middle East, is fundamentally driving increases in crude prices. Just look at how many people are coming out of poverty in Asia in particular and the upward pressure on crude prices should be no surprise.

- 2) North American wholesale market for fuels. There is no unique Canadian fuels market. Wholesale prices in Canada are driven by product supply and demand balances in the overall North American market.

3) The third market is local retail market – the decisions of individual retailers in any given community at any given time. As of the 31st of December 2006, there were 13,772, retail gasoline stations operating in Canada; 4.2 outlets for every 10,000 Canadians. And with only roughly 30% of those retail outlets under the ownership of major refiners, there are more than 9500 decision makers involved in setting the posted price of fuel at gas stations across Canada.

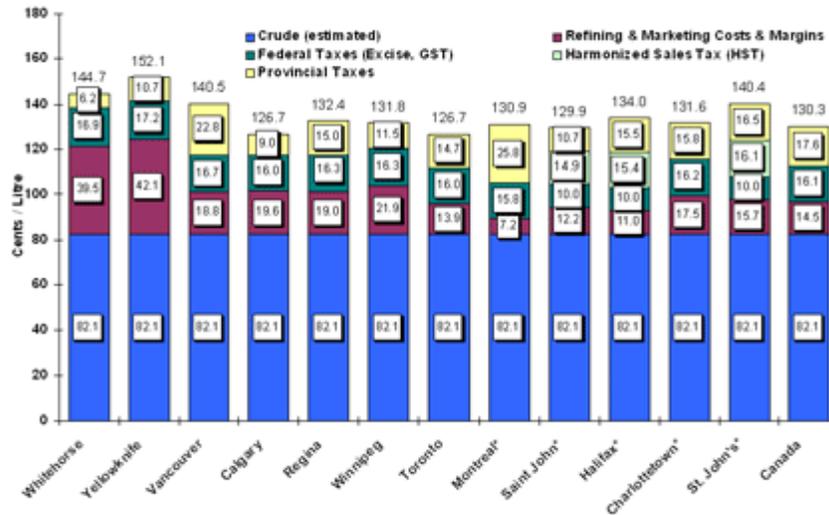
In the Atlantic Provinces and Quebec, there is also an overlay of provincial legislation and regulation that limit competition. In the Atlantic Provinces, they set a maximum pump price, either weekly, or twice a month. In Quebec, the Régie de l'énergie, sets a weekly floor price.

All three of these markets – global, North American, local - have shown considerable volatility in the last year – with Canadian pump prices reaching all time highs in July.

Canadians are right to want to know what is happening.

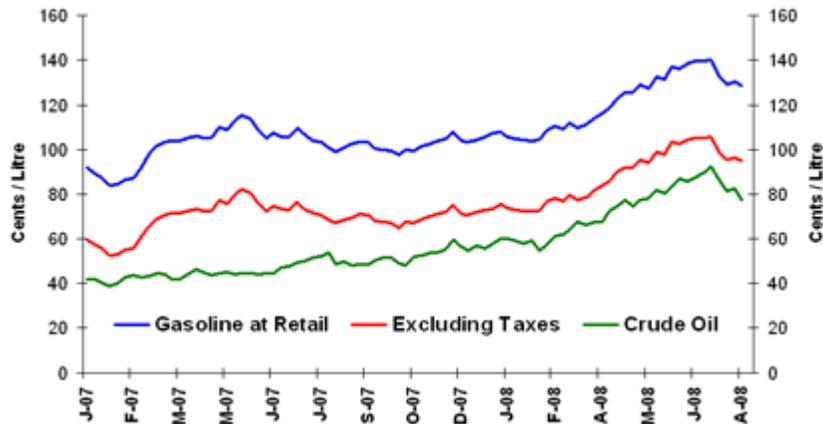
Crude oil is by far the single largest component of the pump price. Data prepared by Natural Resources Canada shows that at the current average Canadian pump price for regular unleaded gasoline of \$1.30 a litre, crude accounts for roughly 0.82 – just under 65% of the pump price. Pump prices changes in Canada over the past months closely track changes in crude oil prices set in the global market.

Regular Gasoline Pump Prices in Selected Cities 4-Week Average (July 22 to August 12, 2008)



Source: Fuel Focus Report August 15, 2008, Natural Resources Canada, 2008

Crude Oil and Regular Gasoline Price Comparison (National Average)



Source: Fuel Focus Report August 15, 2008, Natural Resources Canada, 2008

That same data shows that taxes are the second largest component of pump prices – on average 34 cents per litre across Canada - about 26 % of the that \$1.30 average Canadian pump price for regular unleaded gasoline as of the beginning of August.

Finally, that data shows that refining and marketing operations account for the smallest component of pump prices – today about 14.5 cents per litre, about 11% of the pump price.

Refining margins are substantially lower today than they were 1 year ago. I stress that margins do not equal profits! Refining margin is the difference between the price of crude entering the refinery and the wholesale price of fuel leaving the refinery. Profit exists (if any) after costs are paid.

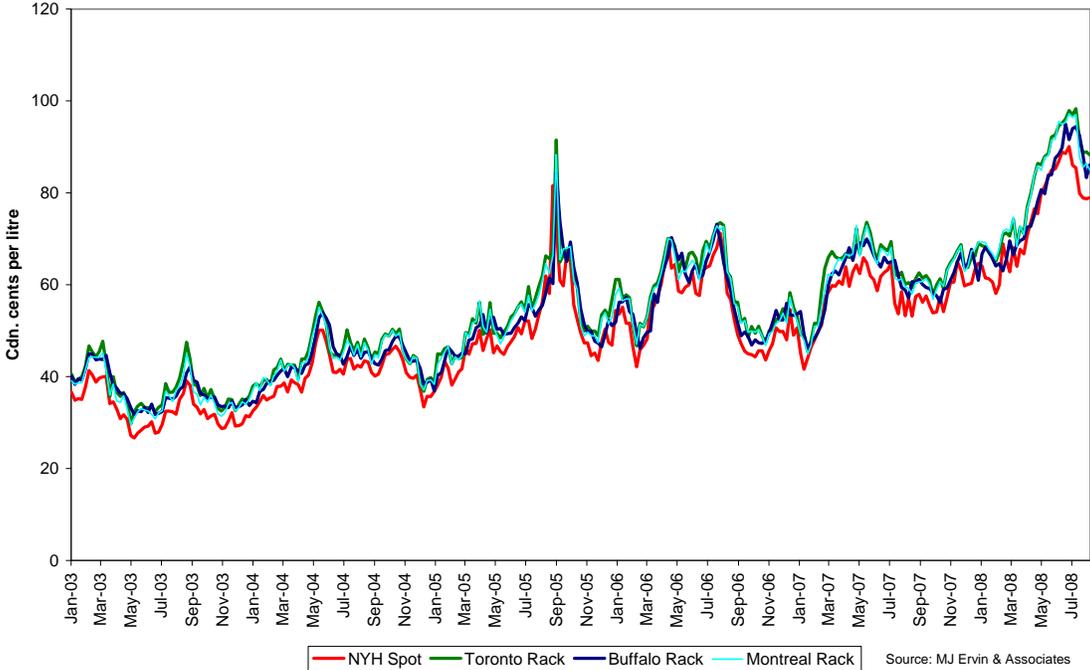
Refining margins today are hovering under 8 cents per litre, at about the same level as the national average marketing margin – the difference between the wholesale price exiting the refinery and the price consumers pay at the pump. Keeping in mind that refineries produce more than just gasoline, taken as a whole, a relatively uncomplicated refinery had a 12 month average margin of only 3.7 cents per litre.

Refiners have been squeezed by the significant increase in crude prices over the past few months. According to data from NRCan, and I quote,

“For the four week period ending August 12th, refiner margins were below 8 cents per litre at the national level and trailed last year’s levels by more than 9 cents”.

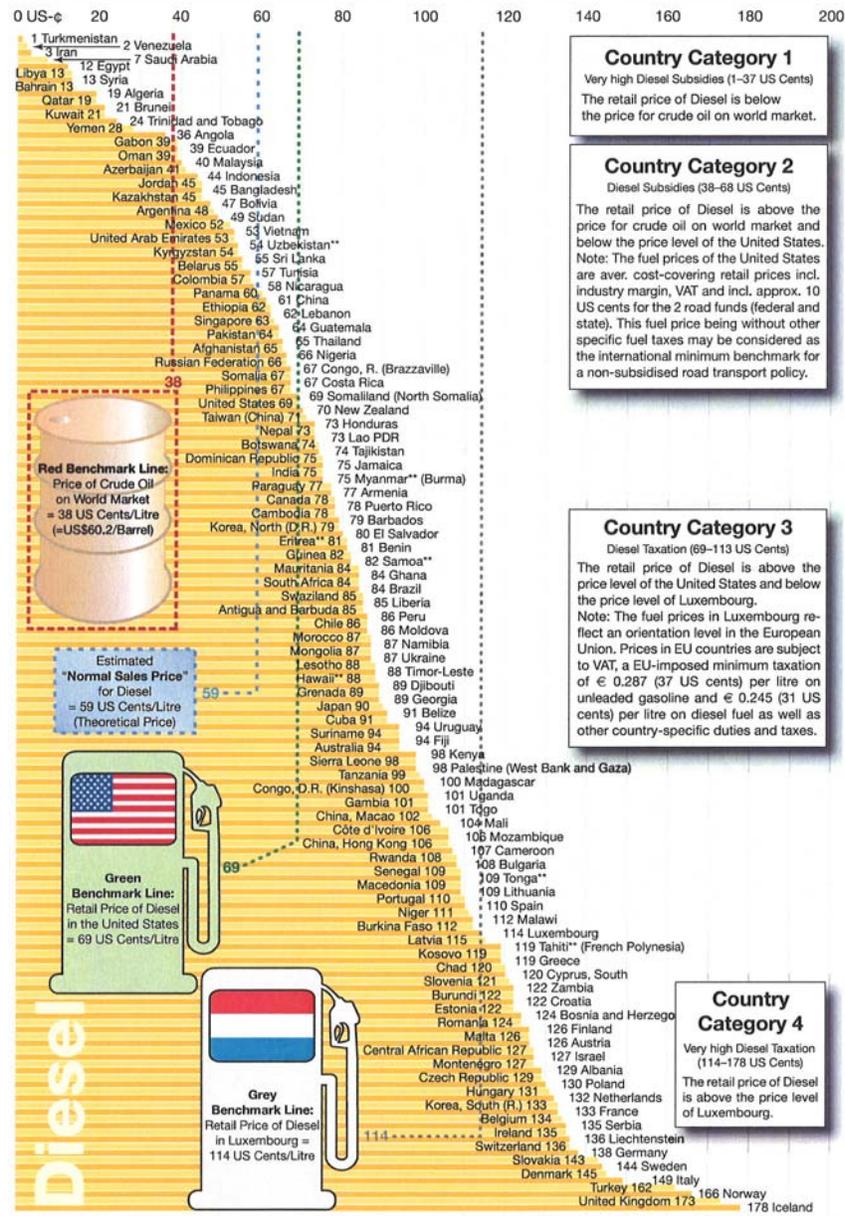
Weakening US demand has exerted downward pressure on North American wholesale gasoline prices. The most recent data available for NRCan (Aug 7/08) shows that on a national level, wholesale prices in the United States and Canada, are within 1 cent per litre of each other.

Regular Gasoline - Wholesale Prices



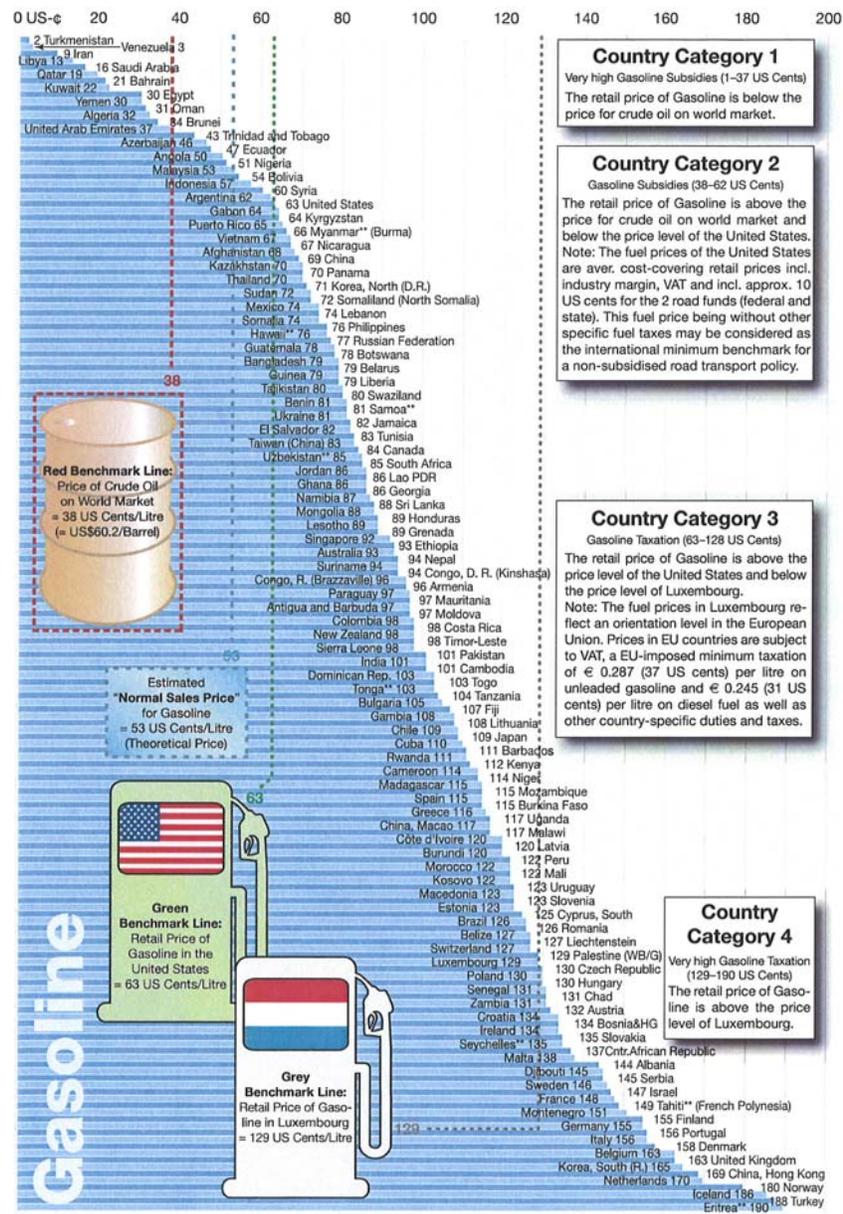
While it may be of little consolation to Canadians, the volatility we have recently witnessed is not unique to Canada. What is unique to Canada is that notwithstanding this turbulence, Canadians pay the second lowest in the western world for petroleum fuels. This is a function of a rigorous marketplace with a very efficient refining sector.

5.5.1 Retail prices of diesel in 171 countries
as of November 2006 (in US cents/litre)



From "International Fuel Prices, 2007, 5th edition, German Federal Ministry of Economic Cooperation and Development

5.5.2 Retail prices of gasoline* in 171 countries
as of November 2006 (in US cents/litre)



International Fuel Prices 2007 provided by GTZ

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From "International Fuel Prices, 2007, 5th edition, German Federal Ministry of Economic Cooperation and Development

CPPI acknowledges the important role that the federal government plays in ensuring a competitive marketplace and in particular, we congratulate this committee for the important work it has done over the years with its review of the Competition Act.

In conjunction with a very professional and knowledgeable Competition Bureau, it is our contention that Canadians can have confidence in a marketplace framework that truly defends the rights of consumers. Two recent developments are the announcements by the Competition Bureau regarding *Enforcement Guidelines on Predatory Pricing* (July 2008) as well the Bureau's advisory, *"Rising Pump Prices May Fuel Gas Saving Device Claims"*.

As the federal government looks to further improvements to the Competition Act, CPPI will be a responsible partner in identifying opportunities for further improvements to marketplace framework laws.

For a moment, Mr/Ms Chair I would like to bring to your attention and that of Canadians, some of the factors that affect the cost of fuel produced and sold in Canada – factors and costs unrelated to increasing the amount of fuel produced.

Some of these costs are justified by environmental considerations but they are costs nevertheless:

The decision to "desulphurize" fuel resulted in environmental expenditures in the order of \$5 billion by Canadian refiners.

In April of this year, the government eliminated the Federal Excise Tax Exemption on the blending of renewable fuels.

In Nova Scotia, the provincial government imposes a fee on retailers under its price regulations framework. (.09 cents per litre)

Looking ahead, the federal government proposes to place potentially costly hard caps on NOx, Sox, VOC's and PM emissions. In our very preliminary assessment, few US refiners (the stated objective is convergence with comparable US refinery emission performance) could possibly meet these requirements and we don't even know if Canadian refiners can actually meet these requirements without shutting down by 2015 – the government's target year under its proposed plan.

Conclusion

We understand Canadians' concerns and frustrations with fuel price volatility. At the same time, this is the best evidence of a marketplace delivering choice of quality products at the lowest cost possible.

Global supply and demand factors are the principle drivers of fuel prices and while CPPI does not study all international dimensions, it is clear that demand for fuel products is likely to rise in regions like Asia where people are buying their first car.

Taxes are the second biggest component of pump prices and while it is not the role of CPPI to evaluate taxation levels, this component is the largest single discretionary element to the cost Canadians pay.

There are other government policies that are driving costs up, some with sound scientific reasons to improve the environment, others questionable.

Our industry is committed to providing Canadians with quality fuels, at the lowest possible cost, from safe and reliable facilities. We can also provide you with insights on conservation tips to stretch your hard earned dollar.

At the end of the day, Canadians are best served by a competitive marketplace; today they pay the second lowest prices in the western world.

I invite you to visit www.believeinit.ca to find out more about transportation fuels in Canada.

Thank you.