



Isle of Man
Government

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**Summary of the Main Findings taken from the
2010 Liquid Fuel Price Investigation Report
(GD 0015/10)**

April 2010

Introduction

The Board of the Isle of Man Office of Fair Trading (OFT) determined in October 2008 that the prices charged for liquid fuels in the Isle of Man were of major public concern. The Board also saw that the level of price difference between the Isle of Man and UK average dealer prices had exceeded the level where the previous OFT Fuel Report had indicated a further investigation should commence. The Board therefore decided that an investigation into liquid fuel prices under Section 19 of the Fair Trading Act 1996 should be carried out.

This guide is an overview to give an idea of the main findings of the investigation which was carried out and to present some of its key findings. It also sets out to try and answer some of the public concerns, questions and possible public misconceptions in a less technical way than the main report. **The guide is not intended to be the authoritative statement on the full investigation findings; these should be sourced from the full report.**

The Board of the OFT appreciated that although by necessity any report carried out under Section 19 of the Fair Trading Act is an historic document, the factors which cause prices for liquid fuel in the Isle of Man are current and so remain valid today.

Set out below are some of the perceptions and questions commonly voiced to the OFT by members of the public and a summary of the findings in relation to them.

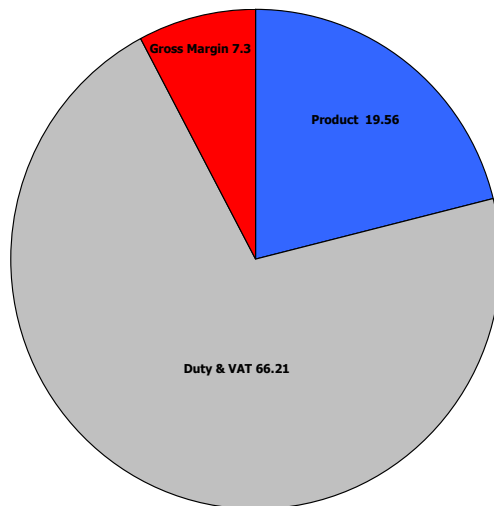
Common Perceptions and Questions: Fact or Fiction?

1. *"It's all just a rip off; they are all coining it in on the backs of the public."*

The Investigation's Findings:

- The Office of Fair Trading completed an extensive investigation into all the factors contributing to the price of road (petrol, diesel) and heating (kerosene) fuels on the Island. The findings are summarised over the following pages. As the investigation was carried out under the Fair Trading Act 1996 all the companies involved bringing liquid fuel were obliged to supply the documents and accounting information requested or face legal sanction.
- The pie charts below give a breakdown of the average price over the month at the pumps for petrol and diesel in January 2009. The charts show that the largest part of the pump price is made up of the duty and VAT paid by the consumer, which account for nearly two thirds of the pump price. The next largest part of the price is the cost of the fuel paid by the wholesaler to obtain the fuel. The smallest component of the pump price is what is known as the "gross margin".
- The gross margin covers the margin made by the wholesaler in bringing the fuel to the Isle of Man and the margin made by the filling station operator. The gross margin is the amount added to the wholesale fuel price, following tax and duty, which covers the costs and profits of the fuel wholesaler and fuel distributor. The gross margin can be split into the retail margin (costs and profits charged by the filling station operator) and the wholesale margin (costs and profits of the fuel wholesaler/importer). Further breakdowns of the wholesale and retail margins are given later on in this guide.

**Isle of Man -petrol price breakdown
(Jan 2009; average price over month 93.07 pence per litre)**

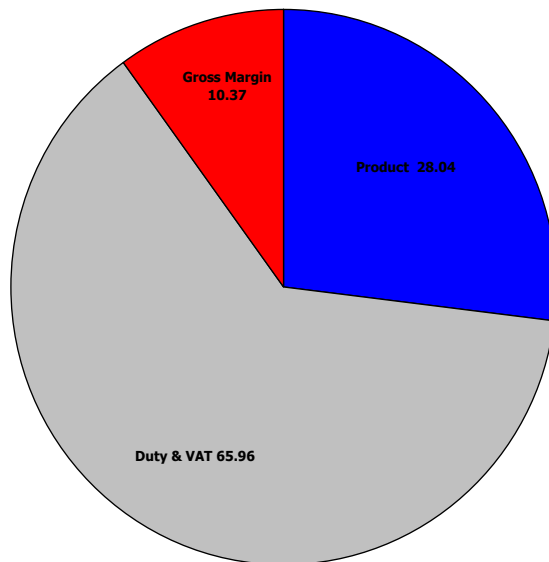


The **gross margin** can be split as follows:-

- retail margin
(costs and profits charged by the filling station operator)
- wholesale margin
(costs and profits of the fuel wholesaler /importer).

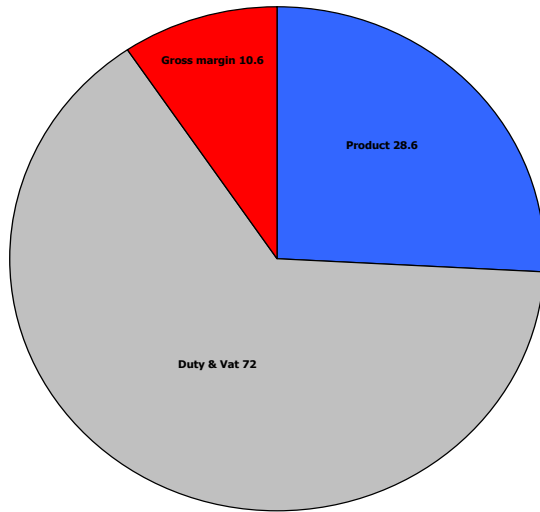
Further breakdowns of the retail and wholesale margins are given in questions 2 & 3 below

**Isle of Man -diesel price breakdown
(Jan 2009; average price over month 104.4 pence per litre)**



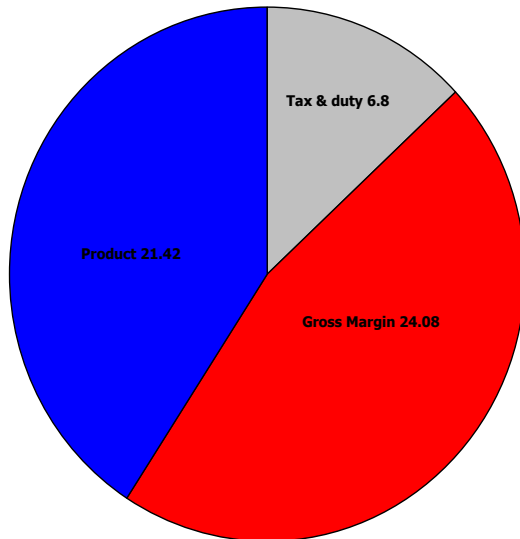
To compare, the chart below shows an estimation of the breakdown of the petrol pump price in the Scottish Highlands, Guernsey and Jersey:

**Scottish Highlands petrol price breakdown
March 2009, pump price = 112.ppl**



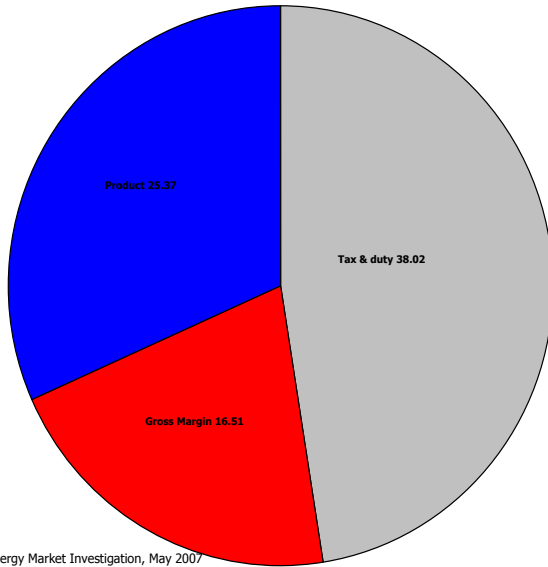
Source: Experian Catalyst

**Guernsey petrol price breakdown
November 2006, pump price = 52.3 ppl**



Source: States of Guernsey, Energy Market Investigation, May 2007

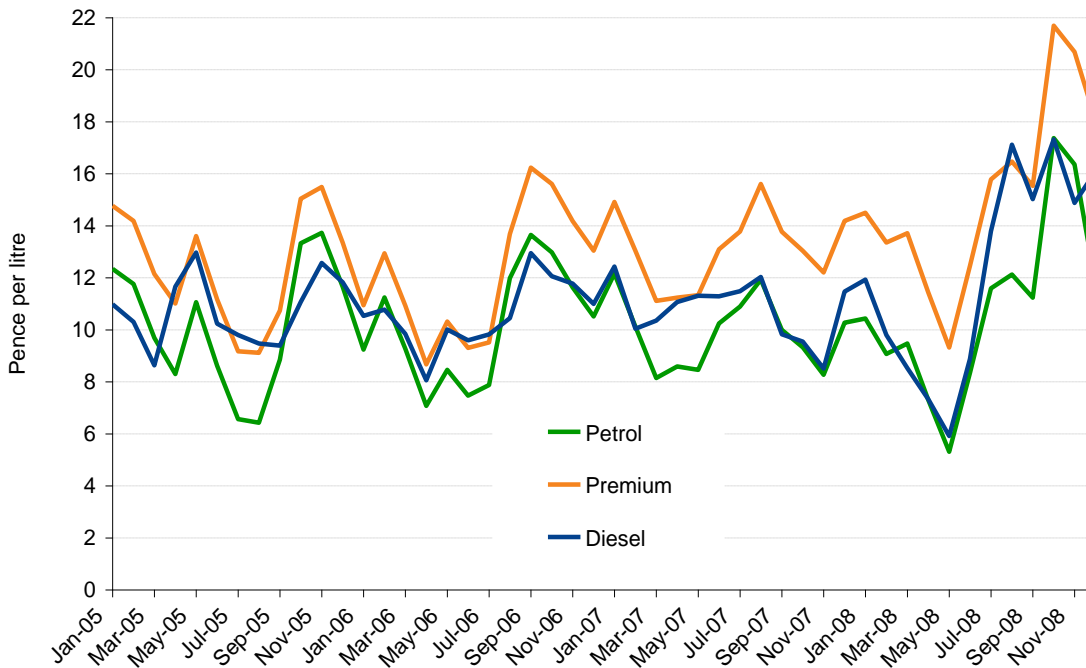
Jersey petrol price breakdown
November 2006, pump price = 71.9 ppl



Source: States of Guernsey, Energy Market Investigation, May 2007

Note: Since 2006, pump prices in both Guernsey and Jersey have risen, which will have affected the three components (i.e. product price , tax & duty and gross margin) shown in the pie chart, however as there have been no further Energy Market Investigations undertaken in the Channel Islands since 2007, there is no 2009 data available to compare directly with 2009 petrol price breakdown shown for the Isle of Man.

- The gross margin is the only part of the fuel price that the companies have any control over. The gross margin charged on road fuels has fluctuated considerably over the investigation period, as shown in the chart below:



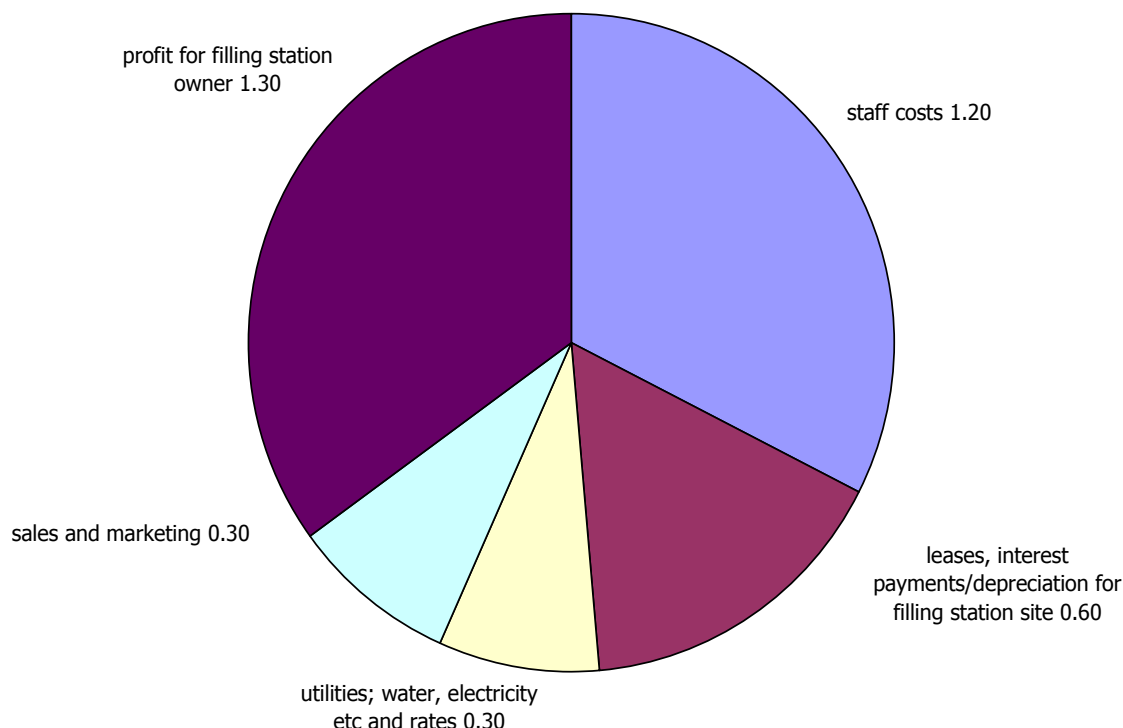
Source: Total IoM, Shell

2. "The filling stations make loads of money on petrol, that's why the price stays so high!"

The Investigation's Findings:

- The retail margin (total earnings by the filling station operator to cover operating costs plus profit) was on average **3.7 pence per litre (ppl)**. This does not appear to be unreasonable. The annual average profit per year for Island filling stations is £88,800. From this figure operating costs such as pump machinery and site maintenance costs, property overheads such as heating, lighting, staff wages and owners drawings have to be taken. It is clear then that if only road fuel was sold most stations would not be economically viable and this supports the trend of most stations to move into non-fuel activities, i.e. convenience stores, which provide higher margins.
- A breakdown of the average retail margin charged by filling station operators of 3.7 ppl in 2008 is shown below. Road fuel prices fluctuated significantly throughout 2008, average pump prices for unleaded were around 111 ppl and diesel 124 ppl. In this context the amount of actual profit accruing to the filling station owner is a very small component of the pump price.

Breakdown of average retail margin 2008 in pence per litre



3. "It's not just the filling stations; the wholesalers are ripping us off too."

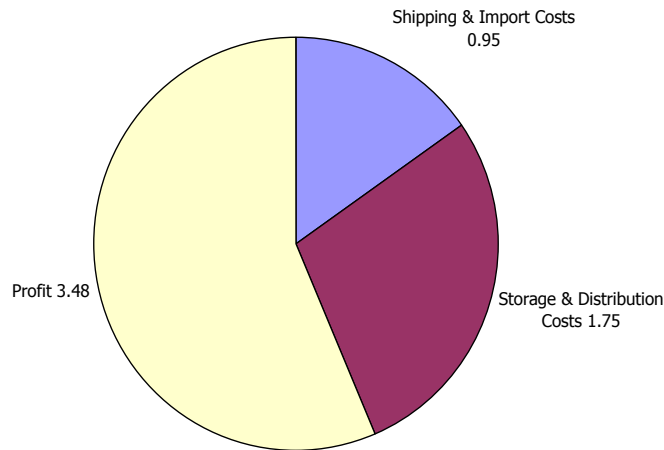
The Investigation's Findings:

- Over the investigation period the average wholesale margin (i.e. the price 'mark up' to cover costs of importation, storage, distribution and profit) achieved by the Island's road fuel suppliers was: **6.2 ppl for unleaded and 8.1 ppl for diesel**. Comparing with other comparable UK distributors showed the Isle of Man margin to be higher but not excessively higher. Research also found that some studies suggest that the level of margin achieved by

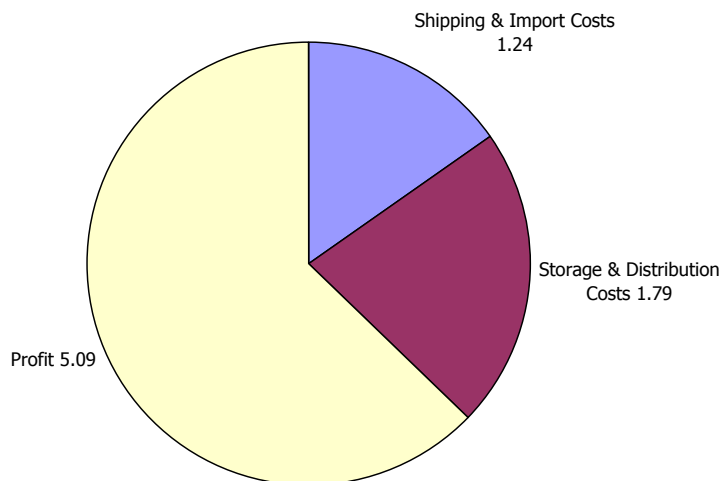
some UK distributors is unsustainable and will have to rise. Overall the level of wholesale margins achieved by our local distributors was considered a reasonable but not excessive return on their investment.

- The chart below shows a simplified breakdown of the average parts of wholesale margins charged over the investigation period in pence per litre

Unleaded



Diesel

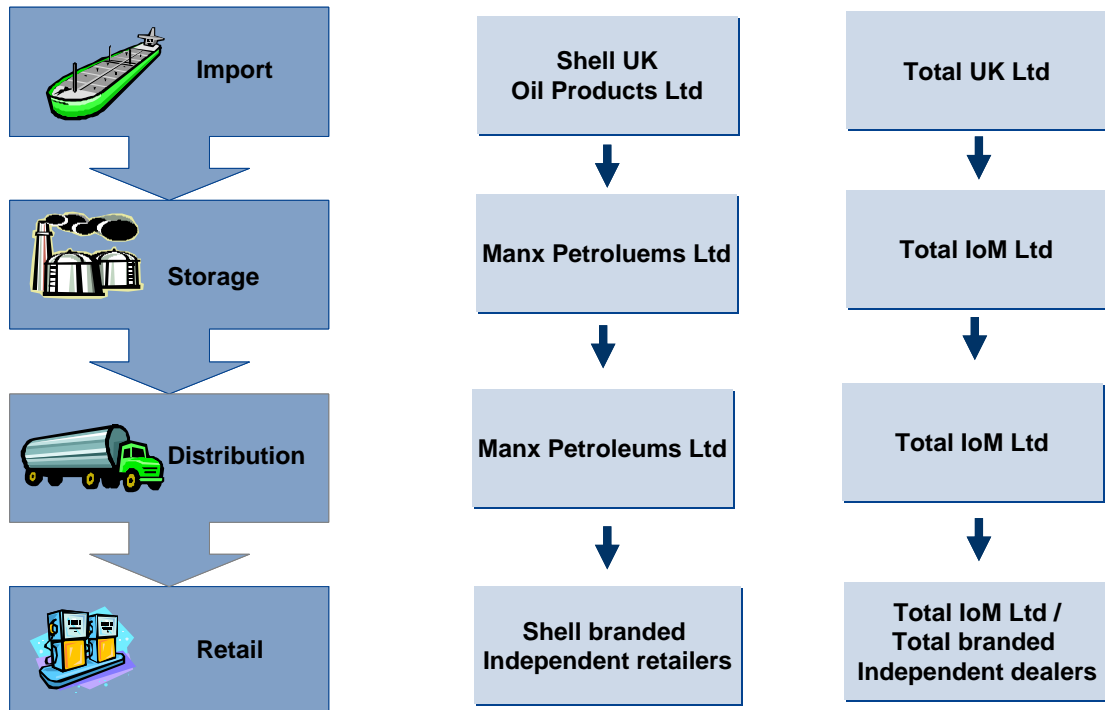


4. ***"Which companies are involved in bringing fuel to the Isle of Man and how does the supply chain operate?"***

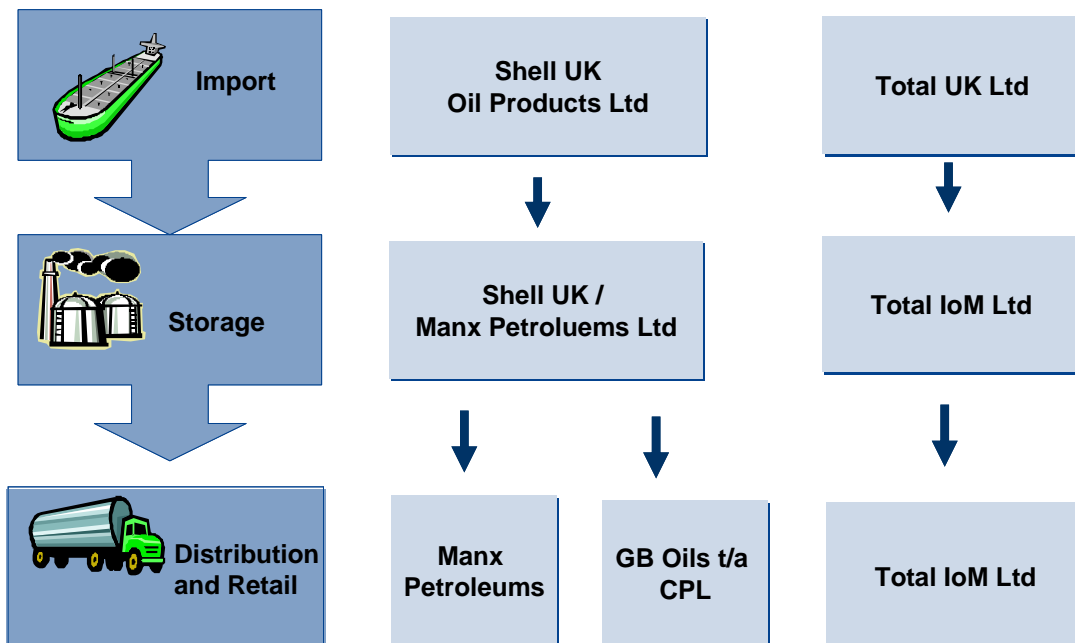
The Investigation's Findings:

- The following diagrams show the companies that were involved at each stage of the supply chain in bringing road fuels (petrol and diesel) and heating fuels (kerosene and gas oil) to the Island during the investigation period.

Road Fuel



Heating Fuel

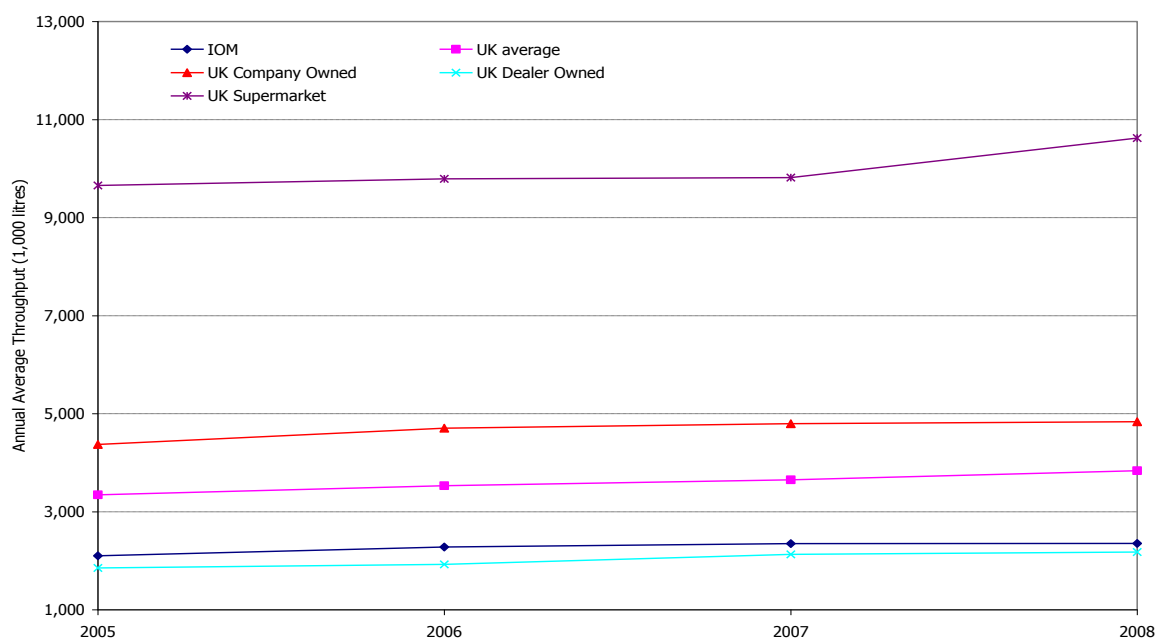


5. ***"The filling stations are quick enough to put the prices up, but they never seem to drop their prices that quick."***

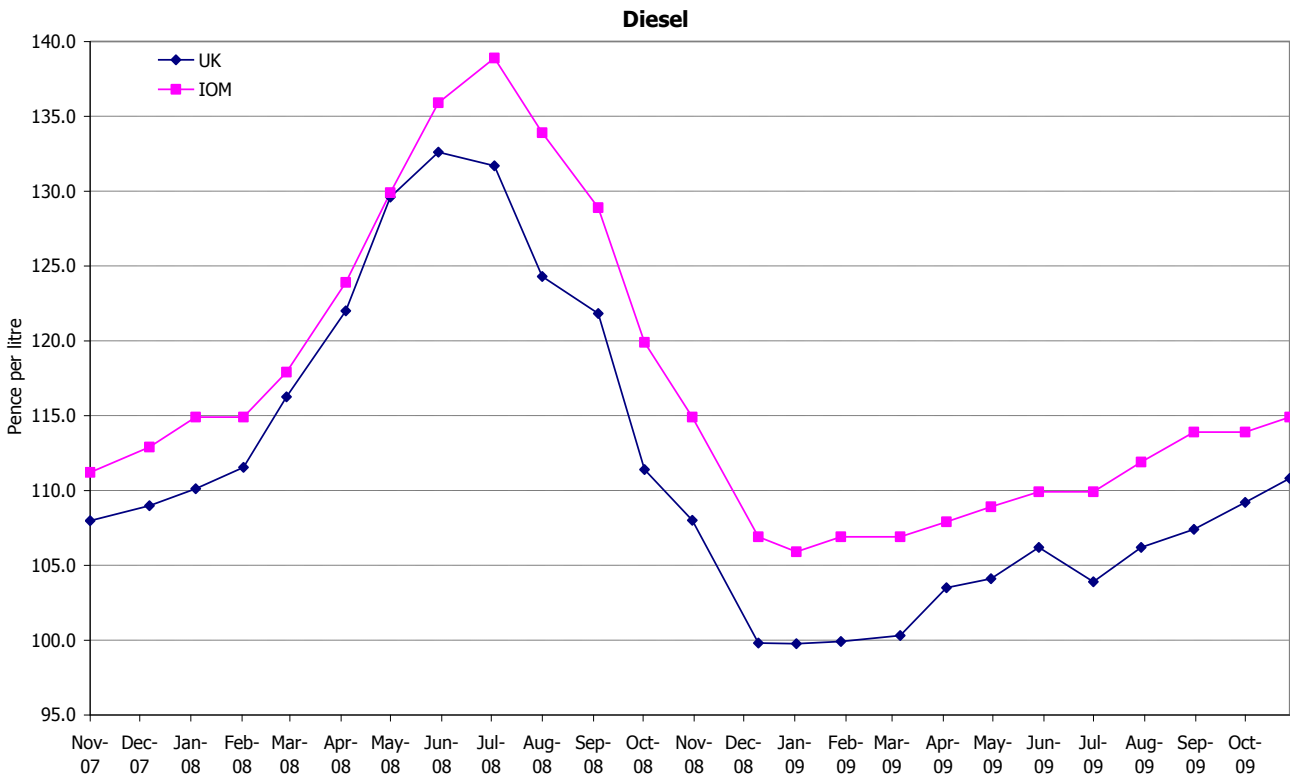
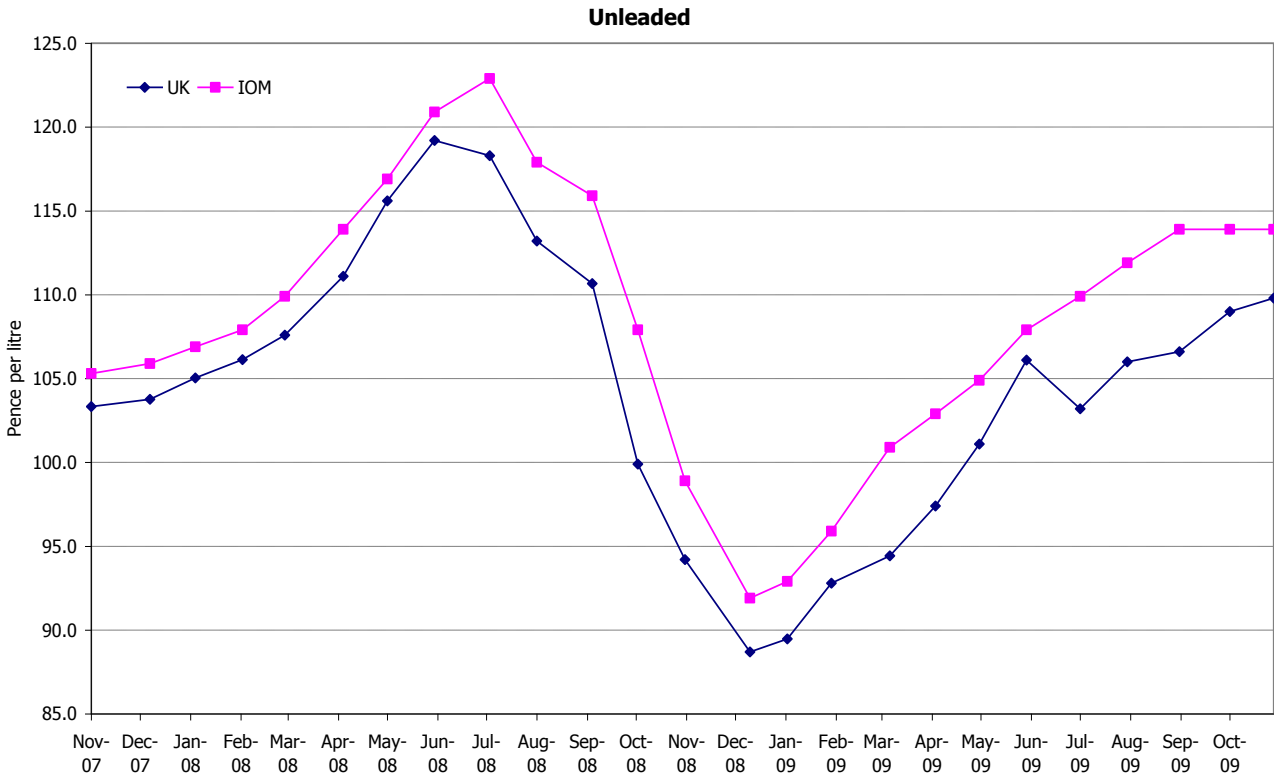
The Investigation's Findings:

- The main factor that causes prices to change so quickly and frequently at the pumps is changes in the wholesale price of fuel.

- Both crude oil and refined products such as petrol and diesel are traded on international commodity markets and changes in the price of the products in the market ultimately are translated into changes in the prices at the pumps. Unfortunately the commodity market for fuels is a particularly volatile one with prices changing on a daily basis.
- What this means for wholesalers of fuel and for filling stations is that it is extremely difficult for them to know how much the fuel is going to cost when they next have a shipment to the Island or delivery to the filling station.
- The investigation found that some of the impact of changes in wholesale price (both up and down) are absorbed by or retained by, the filling station or the distributor in an effort to 'smooth out' the price and avoid having to make large fluctuations in the pump price. The amount retained/absorbed by the filling station or distributor constantly changes as the fuel price fluctuates. This is also reflected in the chart above which shows how volatile the gross margins are for fuel.
- The investigation found that by adopting this fuel pricing mechanism some of the increase in prices is being borne by the Island's distributors or filling stations and similarly some of the decreases are retained.
- The change in pump prices is often ***less than*** the change in the wholesale price.
- The gross margin often moves ***opposite*** to the changes in wholesale and pump prices. **This is contrary to what the public believe, members of the public frequently phone the Office to complain about companies "profiteering" when fuel prices are rising.**
- From the examination of the information submitted by the companies, no evidence was found that the Island's retailers or wholesalers manipulate price changes to increase their profit margins.
- Filling stations in the UK sell more fuel than the average Isle of Man filling station. The higher volume throughput of fuel means that these filling stations have less "stock holding" issues to consider when changing their prices and are more likely to receive more frequent deliveries of fuel. These factors may explain how prices change, both up and down, more quickly in UK filling stations. The chart below compares the amount of fuel sold in the average Isle of Man filling station with the differing type of UK filling stations:



- The charts below show how Isle of Man pump prices compare with those for the average UK independent dealer:



6. "When the product price goes up, the wholesaler's storage tanks may already be full of fuel they bought at a cheaper price, surely they must be making more profit when this happens, so why don't they keep the price the same until the storage tanks are empty?"

The Investigation's Findings:

- Refined road fuels are a traded commodity and just like any product traded on a stock market the price of fuel changes virtually daily. *If, as suggested, when the price of wholesale fuel went up, the wholesaler did not pass the increase on until their tanks were empty, then consumers would pay less in the very short term but when the tanks were refilled at a higher price, the retail price would have to increase dramatically.*
- The investigation found that rather than have prices change by significant amounts (both up and down) the wholesalers monitor changes in the wholesale market price and adjust their prices on a more gradual basis. *This approach tends to smooth out retail prices in what is an extremely volatile market. If this monitoring was not undertaken prices would alter more frequently and would be subject to more extreme increases or decreases.*
- With regard to increases in prices caused by changes to the Excise Duty and/or VAT rate both of the Island's road fuel suppliers store their fuel, duty and VAT free and therefore pay duty & VAT only when fuel is removed from a storage tank and placed in a road tanker for delivery. They therefore cannot pay in advance and must pay whatever the rate of duty is on the day of removal. A tax rise therefore cannot increase the wholesaler's profits.

7. "I bet the wholesalers make more profit every year."

The Investigation's Findings:

- The last fuel price investigation was completed in 2006, looking at prices from 2001-2005. *A comparison to the profits achieved via a return on the capital employed and gross margin published in the previous report showed a downward trend. Although there may be many explanations for this downward trend, one reason could be that the wholesalers are absorbing some of the increased fuel costs rather than passing them on in full to the consumers.* The table below shows the profits earned by the companies involved, using a number of different ratios. All of the companies below submitted all of the statutory and management accounts requested to the investigation along with a large volume of other material.

Gross margins	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total	24.5	25.7	25.2	24.7	24.5	19.9	18.6	20.6	15.5
Manx Petroleums	17.4	19.2	17.6	17.5	17.4	13.3	12.3	13.4	9.6
Shell						18.1	15.6	14.0	13.5
Return on sales									
Total	6.1	7.7	6.2	9.0	6.1	6.8	6.5	8.8	6.6
Manx Petroleums	4.4	7.5	4.8	5.6	4.4	4.1	4.4	3.2	2.6
Shell						2.5	3.2	0.2	3.5
Return on capital employed									
Total	15.8	16.8	12.1	18.0	15.8	16.3	13.8	16.3	14.2
Manx Petroleums	19.1	29.5	17.4	14.4	19.1	16.1	16.6	9.8	10.7

8. "What about the price we pay to get fuel to the Island; I've heard that the ships either come in half full or only unload half as they are on their way to Northern Ireland and we're paying for it?"

The Investigation's Findings:

- The investigation found no evidence to support the perception that the Island is subsidising the cost of transporting fuel to Northern Ireland nor did it find that the fuel suppliers were bringing in 'half full vessels'. However the following points were established:
 - a. Both fuel distributors have to use the same company to transport fuel to the Island as they are the only company providing coastal freight services.
 - b. The shipping company will charge the fuel distributors for any unused space in their tankers when making deliveries, so it is in their interests to ensure that full shipments are received.

9. "Typical 'official investigation report' No wonder they never find anything wrong, I bet the fuel companies only give the OFT half 'the books' and keep the important stuff back."

The Investigation's Findings:

- As the investigation is carried out under the Fair Trading Act, the Office had the power to request that the companies involved in the investigation submitted all relevant information. The Office issued formal notices under the Act requesting the submission of named information and all companies complied with these notices.
- The notice requested the submission of a great deal of information in relation to the businesses operation. The information requested differed between the businesses depending on their involvement in the marketplace but typically the information supplied included details of: corporate structure, shareholders, statutory and management accounts, details of assets and infrastructure owned volumes of products supplied and prices charged, purchase prices for fuel, details of shipping costs, storage/distribution costs, customer numbers, fuel procurement strategy and details of capital expenditure and current capital expenditure commitments.
- In summary, every document that was requested from the companies involved was provided and full co-operation with the investigation was given. There was no evidence that any important documents were retained by them and not submitted. All of the documentation provided was analysed in depth by the expert analysts who provided support to the Office during the investigation. The information was examined by the highly qualified and experienced economists and financial analysts at Poyry Energy Consulting.

10. "Why does the OFT take so long to do these investigations?"

The Investigation's Findings:

- Price investigations under Section 19 of the Fair Trading Act are not undertaken lightly and there must be considerable public concern regarding a price before the Board will instigate an investigation. Once the investigation is commenced it is imperative that it is a thorough examination of how the company prices its products and the factors that influence the setting of its prices. To do this effectively a large volume of data and information is normally required from the company or organisation and then it frequently needs specialist analysis and comparison against similar products or services supplied in the UK or other comparable jurisdictions before a report is produced. Once the report is approved by the Board it is

submitted to the Council of Ministers (who will consider whether any further actions should be taken) and then the report is laid before Tynwald when it becomes public. Perhaps therefore understandably, the whole procedure will normally take up to 12 months.

- With regard to this liquid fuels investigation, following notification that the 5 pence per litre 'trigger' level of price differential had been breached in the summer of 2008 and conscious of the major public concern, at their October 2008 Board meeting the OFT Board directed that the OFT commence a price investigation under Section 19 of the Fair Trading Act. In accordance with Government Financial Regulations, a detailed specification for the investigation was drawn up of necessary specialist support and the tendering process followed with the specialist consultants Poyry Energy Consulting being appointed in January 2009. Notices to produce the required information were served on the various companies in late January 2009. Over the following months an extensive analysis was carried out by Poyry of all the submitted information. Following consideration and review of the work a draft report was completed in July 2009. This report was considered by the Board of the OFT at their next meeting in late August 2009. Considering the complexity of the issues and the volumes of data collected, a period of nine months to complete the investigation is believed to be reasonable. However, the danger with a 100 page, very technical report is that people would find this difficult to digest; with this in mind the Board of the OFT directed that the difficult task of producing a 'layman's guide' be undertaken. As this document had to be drafted, approved by the Board and sent to the Council of Ministers before publication this has taken further time.

11. "One thing I can never understand is if I see on the news that the price of crude oil is coming down, how come the price of petrol and heating oil doesn't come down at the same rate?"

The Investigation's Findings:

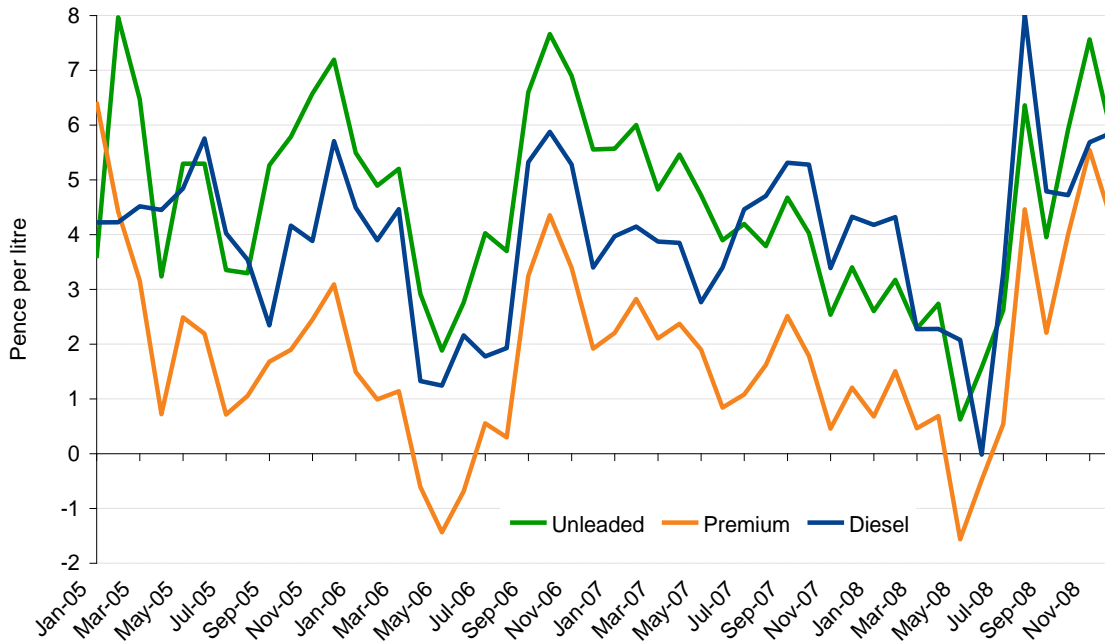
- The investigation noted that there are separate international traded commodity markets for crude oil and refined road fuels and heating oils and that these, whilst the refined markets are affected by the crude prices, also operate completely independently of each other, subject to their own demand and supply pressures. Quite surprisingly at one point during the period of investigation, the price of crude oil was higher than that of petrol. When one considers that the crude oil has to be extracted from the ground or seabed, transported to a refinery and converted to road fuel, then perhaps sent half way around the world to a distributor and then supplied to retailers, to have that price be lower than crude oil seems impossible, but it does clearly illustrate that the markets for crude and refined fuel products work independently.
- Whilst differences in wholesale market prices are still primarily driven by movements in the price of crude oil because of the independence of the refined commodity markets on occasion it is possible for the price of crude oil to be dropping but the price of road or heating oil to be going up (or vice versa). Therefore although the prices of crude and refined fuels normally follow the same trend e.g. either up or down, the rate of price change can be substantially different.

12. "All I know is that every time I get off the boat at Heysham or Liverpool, petrol is at least 6p per litre cheaper; why can't it be the same price in the Isle of Man?"

The Investigation's Findings:

- The average difference between UK and Isle of Man average pump prices over the investigation period was 4.3 ppl for petrol and 3.8 ppl for diesel. This is based on a UK national average which includes supermarket prices. Supermarket filling stations are

approximately five times larger than the average Isle of Man retailer. In addition to their economies of scale their business model is totally different in that they may make a lower margin on road fuel because the consumer may have bought many of the other products they sell which attract higher margins. They may also sell their fuel as almost a loss leader to attract custom. The scale of the UK supermarket share of the road fuel market is so large that they can use these types of cross subsidisation pricing policies. The difficulty for independent dealer owned sites in the UK is that they be geographically close to a supermarket filling station and are therefore forced to keep their price close to the supermarket price in order to compete for business. The chart below shows how the size of the price difference between the average UK and Isle of Man prices fluctuates considerably:



- The investigation found that comparing with the average UK dealer owned site, the annual average differential for both fuels was around 3.0 – 3.3 ppl over the investigation period.
- Another reason why the Isle of Man prices for road fuel are unlikely to be able to compete with those in the UK is because of increased costs. These cost which can be measured are:

Importation and shipping costs	0.8 – 1.5 ppl
Smaller scale of operation (smaller tanker sizes)	0.3 – 0.8 ppl
Lack of wholesale product competition & limited retail competition compare to UK ('supermarket effect')	0.5 – 1.0 ppl

Total 1.5 – 3.3 ppl

However there are other factors which cannot be measured but will undoubtedly cause the price of road fuel on the Island to be higher than in the UK:-

- UK wholesale business is not very profitable, backed up by recent UK studies (and/or higher on-Island distribution costs)
- Higher costs of operating in the Island (two storage depots and terminals exist on the Island, when the volume could be served by one)
- Diseconomies of scale from the lack of support services and specialist contractors
- Higher number of filling stations per head on the Isle of Man

- The 'bottom line' is that because of the economies of scale, increased transportation and storage costs, larger overheads and reduced competition, the local suppliers are unlikely to be able, either now or in the future, to charge the same prices as in the UK.

13. "What about heating your house? My bill for a tank full seems to go up every winter."

The Investigation's Findings:

- As you would expect the investigation found that similar to road fuels, most of the changes in the price of heating oil were caused by the change in the wholesale product prices.
- Margins for both gas oil and especially kerosene rose over the period of the investigation. The effective gross margin averaged 8.1 – 9.5 ppl for kerosene and 3 – 4.2 ppl for gas oil. Margins have increased since the previous OFT investigation.
- Margins are higher for kerosene as it is sold mainly to domestic households, which tend to be less responsive to price changes and they cost more to serve. Gas oil is high volume, low margin business catering to the commercial sector which is more price conscious.
- Though the profit margins identified for kerosene are high, there is a high level of transparency in pricing. This is in part due to the fact the Office of Fair Trading conducts regular price comparisons for the local suppliers and publishes the information obtained in the Comparative Heating Schedule. Because refilling a home heating tank is a high outlay expense consumers tend to "ring round" the suppliers and consumers are also willing and able to switch between fuel suppliers based on price. This encourages local competition and the level of discounts the suppliers are prepared to make.
- The investigation compared the annual difference in prices between the UK and the Isle of Man and these ranged between 6.6 – 8.9 ppl for kerosene and 2.6 – 6.2 ppl for gas oil respectively. Although on face value these seem high, the investigation found that up to 6.3 ppl for kerosene and 3.6 ppl for gas oil can be accounted for by 'Isle of Man' factors e.g. higher cost of transportation and storage, higher overheads of the fuel suppliers, the necessity to use smaller road tankers than in the UK, less competition. Taking these factors into account, although a reasonable return is being made by our local suppliers, it is not excessively higher than that made by suppliers in the UK.

Conclusions and Next Steps

As mentioned above in answering the 'perceptions and questions' the investigation found that the main cause of price changes at the pumps is changes in the cost of the wholesale fuel. There was no evidence to support the perception that price increases were driven by the Island's wholesalers or filling stations seeking solely to increase their profit margins. The investigation does not suggest that prices faced by the consumers are unreasonable.

The profitability analysis conducted suggests that the companies in this sector are not making excessive profits and the gross profit margin made shows a downward trend between 2005 – 2008 and a significant decline in the profit margin achieved compared to 2001 – 2004. Averaging the gross profit margin achieved by both companies for each 4 year period shows that for 2001-2004 the gross profit margins achieved were: Total 25.02% & Manx Petroleums 17.92% but the average percentages achieved for 2005-2008 had reduced to: Total 18.65% & Manx Petroleums 12.15%. Similarly, profitability ratios (such as the return on sales or the return on capital employed) have broadly declined compared to the previous OFT investigation.

Whilst at times, the level of the differential with the UK may be high, taking into account the higher overheads and operating costs that are inevitable in supplying liquid fuels in an Island location and the lower intensity of competition compared to jurisdictions like the UK where supermarket chains hold a large market share, these differences can largely be explained. The investigation also found that in comparison to perhaps more similar markets such as Eire and the Channel Islands the price of fuel on the Island (adjusted for indirect taxation) was either comparable or in fact lower.

In terms of the 'next steps' the investigation has highlighted the necessity to review prices on the Island over a long period and that initiating price investigations in an extremely volatile market has to be carefully judged. It is intended therefore that the OFT will continue to monitor the differential between local prices and those charged in the UK on a weekly basis against an eight week rolling average with the results published monthly. The OFT will also look at when and how it may be necessary to re-evaluate the benchmark comparator for price differentials to ensure the system takes into account future local operating conditions. Full details of the Conclusions and Recommendations are contained in Section 9 of the full report.

