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Ontario Access to Natural Gas Act, 2018 (Bill 32)

**Proposed Natural Gas Expansion Support Program
Submitted to the Ministry of Energy, Northern
Development and Mines**

**By the Canadian Propane Association
November 30, 2018**

Propane. A game changer for a low-emission Canada now.
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Submission Overview

The Canadian Propane Association (CPA) welcomes the opportunity to participate in the consultation on Ontario's proposed Bill 32, *Access to Natural Gas Act, 2018 (Bill 32)*, authorizing the creation of a rate-payer funded cross-subsidization Natural Gas Expansion Support Program.

The CPA is the national association for Canada's propane industry. In Ontario, members include producers, wholesalers, transporters, equipment manufacturers, retailers, distributors and associated sectors in financial services.

The CPA works with governments and regulators on policy issues that affect the propane sector, such as providing affordable and low-emission efficient energy to consumers. The CPA provides key services such as an innovative platform for industry members to collaborate on best practices, providing industry training through the **Propane Training Institute** and emergency response for propane and flammable liquids thorough **Emergency Response Assistance Canada**.

Approximately 100,000 Ontario households rely on propane as their primary and affordable source of heating fuel. Not only that, propane is also used in commercial, transportation, industrial and agricultural applications all across the province. Almost half - about 45% - of propane used in Canada occurs right here in Ontario.

Many of our members operate family-run businesses in small towns and rural communities across Ontario. They form the very fabric of the communities in which they live. They volunteer their time, donate to local sports teams and most important create good paying local jobs.

Propane is abundant and available now, with over 140 large storage facilities and 817 small storage sites across the province. Propane has the largest network of alternative fueling stations in Ontario, with 100 locations and 1,800 in Canada.

In presenting this submission, the CPA considers the following overarching principle as crucial to developing public policy:

"In all its policy, government must ensure a level playing field – with no exemptions, no exclusions, and all participants treated fairly and equally."

While CPA members are sure that the intent of your government is to provide Ontarians with real energy choices, the effect of allowing natural gas utilities to subsidize expansion through taxing existing customers, even at a later date, is not a fair market-based approach. Pursuing that course of action amounts to supporting a corporate subsidy that will increase costs in the long run and ultimately will not be financed by private money but rather by Ontario's natural gas customers. The utilities' shareholders must pay for the up-front costs before they are to recover their investments through billing existing customers in addition to charging their new customers for the additional costs. Furthermore, clear limits must be set through the regulation.

With this in mind, in order to ensure fairness and to maintain competitiveness, the regulation's design must be adequate and must safeguard the above-mentioned principle and should be based on the following:

Eligible projects

36.2(1), 36.2(2), 36.2(6)(a)

Subsidies must only be available to support expansion projects:

- which have not already been subsidized;
- which are true expansion projects, providing access to communities that never had access before (and not for customers who previously had access available but simply chose not to connect)
- which are not merely improvements, upgrades or minor extensions to existing distribution systems;
- which will serve a critical mass of new customers (>50), so that this program cannot be used to provide individual one-off special deals for preferred customers or small groups of preferred customers
- which are certain to be used, and not simply funded based on an assumption that it will be used; the CPA does not want subsidies funding *white elephants* or projects which are then abandoned for lack of customers; natural gas utilities must show the public and the Ontario Energy Board the connected customers first, then get their subsidy;
- for which the collected subsidy funds will actually be used. The CPA does not want that a surcharge be imposed and then find out that the project never got built, or that the actual cost was different than the value used to calculate the surcharge.
 - The process of allowing a gas distributor to provide its own “cost estimates”, which then serve as the basis for setting their rates or subsidies, has long been controversial and, deliberately or not, led to overcharging.
 - Since the surcharge is going to be collected over decades, there is no reason to rush into setting the amount. Let the gas distributor build it, pay for it, and then once all of the costs are actually known (i.e. after completion of construction), then calculate and charge the surcharge to recover and compensate real costs actually incurred.
- which have a profitability index $<1.0^1$, which means expansion projects not currently being built because the revenues would not cover the costs (and new customers simply won't pay the amount it would take to cover the costs). These are the only projects which need / should get a subsidy. Projects which are profitable on their own do not need a subsidy. **Without this provision, every new project in Ontario would be subsidized**, even Southern Ontario urban projects that don't need it
- which are not LNG systems or related in anyway form or shape to providing equipment or installation for the transportation sector. The OEB issued a very definitive explanation as to why LNG projects are not appropriate candidates for subsidies (and do not require subsidies). See page 22 of OEB Decision EB-2016-0004 for full analysis.

¹ https://www.oeb.ca/oeb/_Documents/Regulatory/EBO%20188%20Decision_AppB_Guidelines.pdf

Consumers eligible to benefit from rate protection

36.2(2), 36.2(6)(b)

This program is intended to help those previously without gas access. For this reason, existing customers should not be eligible, to gain gas access.

Customers who can connect to pre-existing gas distribution systems cannot not be eligible, as this program is intended to generate the construction of new expansion projects, helping to fund the gas distributor's construction costs, not to provide a financial windfall for previously constructed assets.

This program must be for residential consumers only. Business and industrial customers should not be eligible. Businesses must be able to compete on their own against competitors in the same line of business or industry elsewhere in the province. Those competitors might be paying lower energy prices, but may be paying higher real property rent in order to locate in an area that already has gas access, or those competitors might be located in a rural area where no natural gas expansion has been proposed, and therefore will continue to pay unsubsidized energy rates for alternate fuels.

The Government cannot mandate that some commercial businesses will have their input costs subsidized by other customers, while a commercial competitor down the road receives no such subsidy. This will distort the economic markets for every non-monopoly product and service in Ontario.

Consumers obligated to pay surcharge

36.2(4), 36.2(6)(e), 36.2(6)(f)

In the absence of a regulation, Section 36.2(4) provides that all gas consumers would pay the surcharge.

The intent of the program is to socialize part of the cost of expensive rural and remote expansion. There is no compelling reason to exempt any consumer from the socialization of this cost. Granting targeted exemptions only risks skewing markets, and ensures that the remaining non-exempted customers each have to pay a higher surcharge.

Spreading the costs among the all consumers (including expansion customers) ensures the fairest result with the lowest possible surcharge.

Rules for rate reduction calculations

36.2(2), 36.2(6)(c)

New customers are being subsidized so that they don't have to pay rates that are significantly higher than the rest of the Province. But the subsidy should never result in rates which are actually lower than the rest of the province.

This program should not be used to make existing customers subsidize the cost of a new customer's new gas furnace, or any other conversion or upgrade or replacement or connection cost which every other customer in the province has pay for themselves.

Maximum annual amount of subsidy

36.2(6)(d)

There has to be a limit to this program.

Otherwise thousands of kilometers of pipe could be built all at once, resulting in a massive surcharge to gas customers that could outstrip current gas bills in the same way that Global Adjustment now outpaces electricity charges. If this were to happen, even those who are supposed to benefit from price protection will suffer, because any savings they realize from their own gas expansion system will be fully usurped by the surcharges they have to pay to subsidize dozens of other gas expansion projects.

A \$100 million limit translates to an average \$27 increase per year per customer to pay for the subsidy. Anything higher will cause more harm to the 3.7 million existing customers than benefit to the few thousand expansion customers.

Rules for surcharge calculations

36.2(6)(g)

Typically, the Board will assess and approved just and reasonable rates under Section 36(2) of the Act (the "**Standard Rates**"). The Standard Rates would normally be sufficient, if collected over a specified period of time (the "**Standard Period**"), to compensate the distributor for its reasonable and competitive capital costs associated with the project, its reasonable and competitive operational costs associated with the project, and a reasonable rate of return.

For a qualifying investment which has been designated as such by the Board, the Board will instead determine the just and reasonable rates in accordance with Section 36.2(2) of the Act, instead of 36.2(2) (the "**Reduced Rates**"). Those rates may reflect a rate reduction from the Standard Rates. The difference between the amount collected by Reduced Rates over the Standard Period and the amount that would have been collected by Standard Rates over the Standard Period represents the total lost revenue that the distributor requires in order to be fully compensated for its reasonable and competitive capital, operations and returns on the qualifying investment (the "**Lost Revenue**").

This Lost Revenue will be recovered through a surcharge imposed on all consumers pursuant to Sections 36.2(3) and (4) of the Act (the "**Surcharge**").

Next, the Board should determine a reasonable period over which the Lost Revenue will be recovered (the "**Recovery Period**"). The Lost Revenue may be broken down into segments for different types of capital as appropriate, each with different Recovery Periods. In no event should any Recovery Periods ever be permitted to exceed the expected life of the associated asset for which the capital cost was incurred. Otherwise equipment will eventually need to be replaced with new equipment before the old

equipment has been paid off, leading to a spike in gas rates when customers have to pay for new equipment and retired equipment at the same time. Nor should any Recovery Period ever exceed the Standard Period.

Using appropriate consumption forecasts, the Board should next determine the volume of gas expected to be consumed by all Surcharge-paying customers (those prescribed under Section 36.2(4)) during the Recovery Period (the “**Forecasts**”). The total Lost Revenue amount is then divided by this total forecasted consumption volume to arrive at a cost per unit of gas. This is the amount of the Surcharge applicable to the qualified investment in question.

Throughout the Recovery Period, it may turn out that the Forecasts were not entirely accurate. If less gas is delivered than was forecast, the Surcharge collected during the Recovery Period will not be sufficient to cover the entire original Lost Revenue amount. In such case, subject to Board approval, the Recovery Period should be extended and the Surcharge should continue to be levied until the original Lost Revenue amount is recovered in full (but there should never be any adjustment to the Lost Revenue amount, which is determined once and for all when the project achieves commercial operation). Similarly, if the more gas is delivered than was forecast, the original Lost Revenue amount will be fully recovered by the Surcharge before the end of the Recovery Period. In such case, the Recovery Period and the Surcharge should end early, as soon as the Lost Revenue amount has been recouped.

If there are 40 expansion projects at a given time, there will be 40 distinct Surcharges (in different amounts because the capital costs, Lost Revenues and Recovery Periods for each project are different). At any given time, the sum of these 40 or so Surcharges is the per-unit amount that consumers should see on their bills (the “**Total Contribution Rate**”).

The Total Contribution Rate will change periodically. Each time a new qualifying investment is completed, the Total Contribution Rate will increase because a new individual Surcharge will be added to the calculation (in the example, it will become the total of 41 Surcharges instead of 40 Surcharges). And each time a project’s Lost Revenues have been fully recovered (at the end of the Recovery Period as adjusted), the Total Contribution Rate will decrease because the applicable Surcharge will be dropped from the calculation (in the example, it will become the total of 39 Surcharges instead of 40 Surcharges).

The foregoing process will ensure that distributors will never over-recover or under-recover for their expansion projects, and will minimize the opportunity for accounting games or policy changes that are to the detriment of consumers, as there is no opportunity to seek changes to the Lost Revenue amount or to the size of the Surcharge, once determined. The only variable that changes is the duration of the surcharge, and such changes are based on empirical facts – once the Lost Revenues (a fixed number) have been collected in full, the surcharge ends.

Payment provisions for the Total Contribution Rate (interest, late payment, payment instalments) should be the same as for any other charge on a consumer’s bill.

Excess moneys (over-collected surcharges)

36.2(6)(h)

If the provisions proposed above related to:

- the expansion project being fully built and operational before subsidies are imposed (i.e. before the Reduced Rates are determined, the Lost Revenue is calculated, and the applicable Surcharge is added to the Total Compensation Rate) ; and
- Surcharges ceasing once the Lost Revenues have been recovered

then there will never be any over-collection, and you won't need regulations to deal with what happens to extra money.

In the absence of these two provisions, there will inevitably be more surcharges collected than spent – essentially over-taxation. The gas companies will figure out a way not to refund it. Even if they did refund it, it would be overcharged today and refunded to completely different people in 30 years from now. This potential for over-taxation should be avoided by implementing the recommended provisions.

Information and reports

36.2(5), 36.2(6)(j), 36.2(6)(k)

This process must be transparent and monthly to ensure that surcharged customers are not paying more than they should, that gas distributors are not collecting more than they should, that surcharges collected are properly distributed to the gas companies that actually incurred the costs, and that everyone can easily understand who is being subsidized, who is subsidizing and the amounts in question. This transparency will bring discipline to the process and help ensure that the surcharge remains as low as possible. Beware the experience of Global Adjustment, where there was no transparency or breakdown and as a result every possible cost has been thrown in, leading to close to \$10B in effective “taxes” each year.

OEB's role

36.2(6)(i)

While the regulation should set out the basis upon which subsidies and surcharges should be applied, collected and allocated, the specific amounts for applicable to each project should be reviewed, considered and determined by the Board based on real time project and revenue information supplied by the companies. Part of this must ensure that gas distributors are required to justify the expenses that they expect to be subsidized – did the gas company spend more than they needed to, or pay uncompetitively high prices for equipment, believing that any such lack of economic discipline will be overlooked once the costs are spread out among 4 million customers? Some of these determinations may require formal applications and hearings, with opportunities for submissions to be tested, while others might not.

In each case, however, full transparency is critical. Customers who are interested should have the ability to understand what they are paying or saving and why they are paying or saving it.

Collection and distribution of surcharges

36.2(6)(l)

If every gas customer in Ontario is liable to pay the surcharge to fund the subsidy, as proposed (and which is already the default process under Section 36.2(4) of the Act), allocation mechanisms will have to be established to ensure that those gas distributors who collect the surcharges (those with the existing customers) are obligated to transfer appropriate amounts to those who are entitled to the compensation for lost revenues (those with the expansion projects).

The Regulation can either set out the appropriate mathematical formula and direct the Board to apply and enforce it, or the Regulation can set out the general principle and direct the Board to determine and implement the formula.

We have not set out a recommended detailed formula in this document as it will vary greatly depending on which other elements of this proposed Regulation are adopted or rejected.

Form of gas invoices

36.2(6)(m)

Every gas distributor who issues an invoice for providing gas distribution services to a consumer must clearly and prominently show on the invoice, as a separate amount from any other amount on the invoice, the amount of the invoice that is reasonably attributable the consumer's contribution for lost revenues

The above disclosure would be consistent with the principles prominently espoused by the current Minister of Infrastructure in his Bill 146, the *Transparency in Gas Pricing Act, 2017*. In the Minister's words to the Legislature on September 21, 2017: "Transparency in taxes and fees is necessary to hold politicians accountable. [This] is about commons sense and basic fairness."

We support the Minister's principles.

For questions, clarifications and further discussion on this submission and topic, please contact:

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