

TO: Mayor Kelly and Members of Halifax Regional Council

SUBMITTED BY:   
George McLellan, Chief Administrative Officer

DATE: February 18, 2003

SUBJECT: Natural Gas Distribution - UARB Decision re: Heritage Gas

**INFORMATION REPORT**

**ORIGIN**

On February 7, 2003 the UARB approved the Heritage Gas franchise application to distribute natural gas within HRM and certain other municipalities. Within the next two weeks, Heritage Gas is working to finalize its business case to get approval from partners to proceed with natural gas distribution.

**BACKGROUND**

During 2002 HRM has worked with Heritage Gas to support its franchise application and efforts to create a business case to distribute natural gas within Nova Scotia. HRM would be the municipality with the bulk of natural gas distribution - approximately 60% of the volume of distribution.

Municipal taxation on natural gas is a complex and important issue for the following reasons:

- Taxation on natural gas assets/revenues represent a new revenue stream to municipalities
- Heritage gas desires one tax agreement with municipalities, and the Province concurs
- Heritage Gas is seeking to lower costs including municipal tax, to help make its business case.
- Provincial staff have indicated there is no business case to support a provincial subsidy; however the level of municipal taxation initially proposed by Heritage Gas amounts to a municipal subsidy.
- Other utilities, potentially residents, and other commercial taxpayers will be watching closely to see how the tax agreement Heritage Gas eventually receives compares to the level of municipal taxation they currently pay.

**DISCUSSION**

The Union of Nova Scotia Municipalities (UNSM) has established a sub-committee to examine possible methods of taxation on natural gas, with the goal of identifying a method that would be acceptable to all municipalities. If one tax agreement cannot be achieved between the municipalities and Heritage Gas, the risk exists that the Province will impose a taxation agreement on municipalities.

The UNSM subcommittee proposal to Heritage Gas is comprised of the following features:

- Regular taxation (commercial rate plus business occupancy) on assets outside the pipeline right of way, such as buildings
- Commercial rate plus business occupancy on high volume steel distribution pipes, with some special features such as straight line amortization over 40 years, a provision for inflation, and a floor such that the assets will never be depreciated beyond 50%.
- Taxation on revenues at 2% years 1 - 10, and 4% years 11 - 20.
- Encroachment fees and permits would be in addition to the 3 part tax.

**Possible Equity Interest with Heritage Gas**

HRM is exploring a nominal equity interest with Heritage Gas with the objectives of securing a voice to facilitate roll out within HRM to provide residents with natural gas at a reasonable cost with minimal disruption, and to receive fair value for HRM inputs to facilitate gas distribution. Additionally, achieving an equity interest would enable HRM to participate in profits generated from gas distribution.

HRM could make a capital contribution “in kind”, which could include the following features:

- Value of staff time, mostly engineering.
- Value of encroachment fees
- Fair market value of GIS services from HRM
- Fair market value of office space provided by HRM.
- Value of permit fees

Depending upon the strength of the HRM interest in an equity position, and the size and type of equity interest, the variables listed above could be adjusted or other variables could be added.

Some key issues that would have to be addressed if HRM pursues an equity interest are the public optics of investing in natural gas, and the permissibility under the MGA and with the UARB.

**BUDGET IMPLICATIONS**

If Heritage Gas chooses to proceed with distribution, distribution will start in the Burnside/Creighton Park area as early as summer 2003, and HRM will receive permitting/fee revenues, and whatever amount of tax is agreed upon under the method proposed in lieu of traditional property tax.

**FINANCIAL MANAGEMENT POLICIES / BUSINESS PLAN**

This report complies with the Municipality's Multi-Year Financial Strategy, the approved Operating, Capital and Reserve budgets, policies and procedures regarding withdrawals from the utilization of Capital and Operating reserves, as well as any relevant legislation.

**ALTERNATIVES**

N/A

**ATTACHMENTS**

Natural Gas Power Point Presentation - Council Briefing, Feb. 18, 2003

Additional copies of this report, and information on its status, can be obtained by contacting the Office of the Municipal Clerk at 490-4210, or Fax 490-4208.

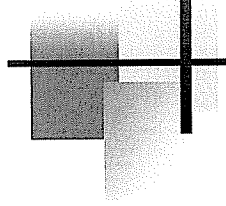
Report Prepared by: Cathie O'Toole, CGA - Executive Assistant, CAO's Office



Approved by: Dale MacLennan, Director of Finance Services

Mary Ellen Donovan, Solicitor, Legal Services

# Natural Gas – UARB Decision



HRM Council Briefing

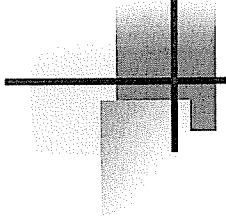
February 18, 2003



## Status

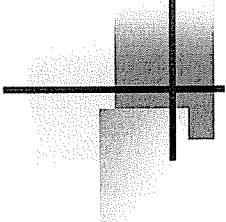
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- Feb. 7<sup>th</sup> - UARB approved Heritage Gas franchise application to distribute natural gas.
- The UARB decision has not yet received Cabinet approval. This should occur within next two weeks.
- Heritage Gas will then decide whether to proceed with distribution, based on the soundness of the business case.



## UARB Reference Municipal Taxation

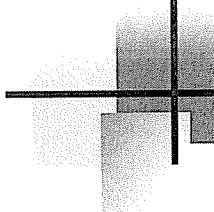
“The Board continues to be of the view that excessive municipal taxation or fees will detract from the ability of a franchise holder to build out a distribution system, thereby delaying the distribution of natural gas in the Province. The Board awaits, with interest, the outcome of negotiations in this matter.” (p. 84 UARB decision)



## HRM Impact

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- HRM has worked closely with Heritage Gas to promote the distribution of gas in HRM.  
For example:
  - engineering services
  - construction of a gas line in the Troop Ave. extension
  - access to GIS, mapping information
  - facilitated tax discussions with Province, Heritage and UNSM



## UNSM Natural Gas Subcommittee

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- UNSM Goal – Develop a tax model for Natural Gas that will be equitable to municipalities with varying levels of assets and revenues.
- Heritage Gas desires one taxation agreement with all municipalities. The Province appears to support this goal.

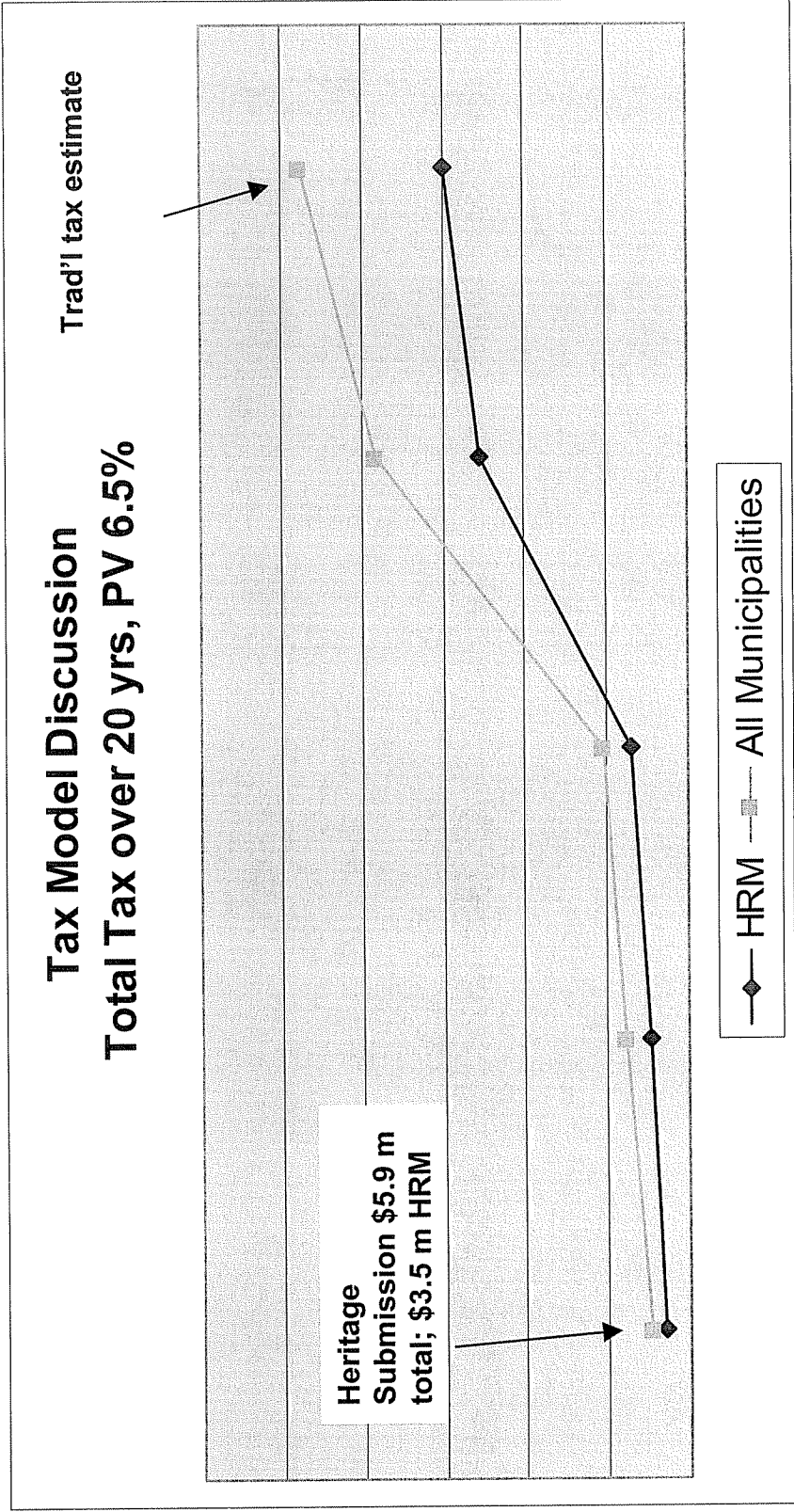


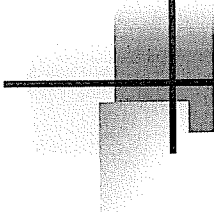
## 3 Part Tax Model

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- 1) Regular tax on assets outside the right of way (Comm rate + B. Occ.)
- 2) Fixed formula asset taxation on high volume steel distribution assets, with some special features in the formula.
- 3) Taxation on unbundled distribution revenues. (2% yrs 1 – 10), (4% yrs 11 – 20)

# Tax Negotiations to Date





## Next Step

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- UNSM will present a counter-proposal to Heritage Gas on the tax issue.
- HRM is discussing the possibility of a nominal equity interest in Heritage Gas, based on capital contributions in kind.