August 9, 2012

Revenue / Debt Proposal Management Approach – Discussion Document

ISSUE

Ontario Tire Stewardship, Stewards, Waste Diversion Ontario and Ministry of the Environment officials have held meetings to discuss the implications on the tire program of the Minister's letter of February 9th and what changes might be made to the OTS program that would achieve full cost recovery going forward and would eliminate the existing OTR deficit, while at the same time achieving industry's objective of minimizing business disruption, ensuring transparency and offer a measure of cost certainty.

The added complication to finding acceptable solutions is that the OTR deficit continues to grow and without an immediate resolution will only exacerbate the ability to reach a reasonable settlement.

The purpose of this proposal is to outline the option arrived at through these discussions and to discuss the framework for a new revenue model and the management of the OTR debt in a manner which will meet the Minister's objectives and the needs of Stewards.

BACKGROUND

On March 7, 2012, the Minister wrote to OTS inviting Stewards to make further submissions on alternative approaches to achieving the objectives of full cost recovery and elimination of the deficit. The Minister expressly acknowledged that the MOE was prepared to listen to alternate solutions on how to address accumulated surpluses and deficits, and could provide flexibility on the length of time required to pay off the deficit.

Over the past number of weeks tire stewards and other stakeholders have worked to formulate an industry consensus that could achieve the Minister's objectives in a way that minimized market disruptions, protected the financial integrity of OTS and kept the Ontario tire program as one of the most successful diversion programs in Canada.

STEWARD CONSIDERATIONS

1. Tire stewards have a vested interest in seeing a reasonable solution to the current issues within the OTS program. Stewards are looking for a balanced, sustainable program with predictable and manageable costs going forward and in doing so, are willing and able to take full accountability for solving the problems of the past, without prejudice and without acknowledgement of any financial obligation of past program deficits.

2. Stewards are opposed to retrospective billing as inherently unfair and legally questionable. That said, Stewards have a genuine interest to find solutions that can work for all stakeholders because they feel it is important to demonstrate the industry can work together to solve its own problems, which is the true mark of industry stewardship.

3. The accumulating financial surplus in the on-road tire portion of the program can and must be reduced and will result in a reduction in Passenger & Light Truck tire stewardship fees. Similarly, the structural deficit in OTR needs to be curtailed by increases in the rates applicable to these products.

4. Stewards do not support a Quarterly billing approach as it is too bureaucratic, complex and inefficient. That said, Stewards could support a revenue approach that would include an annual reconciliation that would effectively achieve the same objective of full cost recovery but would be less disruptive to the market.

MOE CONSIDERATIONS

1. The MoE is seeking the development and implementation of a revenue model which does not rely on forecasts or estimates. In its estimation the use of these in the development of program “fees” is at the root of the financial and political issues encountered by the programs. While not expressly stated the concept of “approved fees” calculated on industry estimates is clearly not a viable option going forward from the government’s perspective, and their desire is to see all billings be linked back to actual costs.

2. Steward communications regarding the imposition of retrospective obligations have encouraged the MoE to be open to alternative options for managing the accumulated debt. There is apparently a new willingness to consider allowing programs to manage the debt on a go-forward basis on even an extended timeline (5-10 years would seem to be an acceptable timeline for payment of the accumulated debt), albeit with a clear plan and targets for pay down of the debt going forward.

3. The mechanism for the implementation of this new model (i.e. through a Fee-Setting Methodology (FSM) change or through the passing of a regulation) is still up for discussion, though the government does seem to be leaning to the regulation route for expediency. However there does seem to be some flexibility on the form and content of the regulation, with the possibility that it may only include details on the revenue model, and leave the structure of the debt management plan up to OTS.

FULL COST RECOVERY PROPOSAL

Based on OTS outreach to Stewards a full cost recovery funding model that includes monthly per unit fees to Stewards for the calendar year based on their supply into the market could be accepted by the industry. In addition, Stewards could accept an annual reconciliation at the end of the fiscal year to address any variance between the amount paid by Stewards and the actual program costs. The reconciliation would be debited to the Steward’s account, proportionately based on market share, calculated using actual supply during the period.

This proposal only gives Stewards cost certainty after the annual reconciliation and therefore does bring an element of risk to Stewards, but it is deemed a manageable risk and a reasonable compromise. This full cost recovery model respects the Minister's desire to ensure cost recovery and will eliminate the prospect of future deficits and surpluses.

Based on the discussion OTS would annually calculate Tire Stewardship Fees (TSFs) based on prior year actual costs and prior year actual reported supply. Stewards would remit the appropriate TSFs monthly, based on units supplied into the market (as is the current practice). At the end of the year OTS would undertake a reconciliation of actual costs compared to remittances by Stewards and any Deficts / Surplus would be recovered / returned from Stewards through an invoice or refund payment.

This model also assumes the elimination of the tire category "silos" in the Used Tires Plan (UTP), blending the categories and resulting in a cost calculation model based entirely on weights units (Kgs, PTEs, or Tonnes). Note this does not imply the elimination of the tire group categories for the purposes of reporting and remitting the TSF.

TSF Calculation

$$\textbf{2013 Cost / PTE} = \frac{\textbf{2012 UTP Costs}}{\textbf{2012 UTP Actual Supply in PTEs}}$$

Annual Reconciliation Calculation

Steward's 2013 Reconciliation Amount	**=**	**2013 Actual Costs**	**-**	**2013 Actual Revenue**	**x**	**Steward's 2013 Market Share based on reported Supply**

Note that while the MoE did not explicitly come out an acknowledge that this model would result in a "fee" being administered by the program, it did acknowledge that the OTR tires would have to carry a significantly larger quantum of cost, in proportion to the true costs of delivering this stewardship program.

OTR DEBT RECOVERY PROPOSAL

The proposal to address the accumulated debt is for OTS to establish a formal "loan process" between the existing On-Road Tire (ORT) and Off-Road Tire (OTR) programs, which would allow the existing debt to be carried by the program but for this debt to be gradually paid off by the OTR program.

OTS would establish a loan "account" within the program and allocate a sufficient portion of the ORT program surplus to this account to be able to fully cover the accumulated OTR program debt. Going forward the OTR cost allocation (fee) would include a dedicated cost for the purposes of repaying this loan. This amount would be added to the OTR TSFs following the calculation of the per PTE fees (as adding it to the "general program budget" in a blended model would result in all tires carrying a portion of this cost).

$$\textbf{2013 OTR Cost / PTE} = \frac{\textbf{2012 UTP Costs}}{\textbf{2012 UTP Actual Supply in PTEs}} + \frac{\textbf{2013 Debt Repayment Amount}}{\textbf{2012 OTR Actual Supply in PTEs}}$$

The amount to be repaid each year, and this the timeline over which it would be repaid, would be set at the discretion of OTS based on an estimation of the impact on the TSF and the prior year's financial performance of the program.