



Date: March 9, 2023
To: Mayor and Council
Author: John Norton, CAO
RE: Union Water Supply System Inc. – Interim Board Appointment
Report No.:

RECOMMENDED ACTION

1. That _____ **BE APPOINTED** to the Interim Board of Directors of the Union Water Supply System Inc. until the earlier of September 1, 2023, or the appointment of the Permanent Board of Directors of the Union Water Supply System Inc.

BACKGROUND

Since the late 1990's, legal ownership of the Union Water Supply System (UWSS) was established by a transfer order issued by the Ministry of Environment. Legal ownership vested the four municipalities ("Municipalities") detailed below as tenants in common with an ownership share in proportion to the volume of water they take from the system. The Transfer Order provides that the ownership share is fixed for four years based on the average supply to each municipality over the previous four years. Ownership percentages, updated January 1, 2021, are as follows:

Leamington	53.00%	Kingsville	38.72%
Essex	4.92%	Lakeshore	3.36%

The UWSS Joint Board of Management (UWSS Board) was also established in the transfer order. The UWSS Board is responsible for the oversight of UWSS. Notwithstanding the legal ownership of the system, ultimately each of the municipalities have decision-making authority. The UWSS Board is responsible for regulatory compliance as well as the overall operation, maintenance, repair, construction and expansion of the system. The current UWSS Board is comprised of twelve members – 6 members from Leamington, 4 from Kingsville, 1 from Essex and 1 from Lakeshore.

The UWSS common asset listing, determined by the Provincial transfer order, included the plant, various watermains, booster stations and water towers. Essentially, all of the

capital infrastructure projects built by the UWSS prior to the transfer order became assets of the UWSS. All other assets of the system were to be owned by the municipality in which the physical pipes were located.

Until just recently, UWSS was an unincorporated collection of assets owned in common and used collectively by the four Municipalities. There are limitations to the existing governance structure for the UWSS. Any borrowing on behalf of the UWSS must be done by the four municipalities. This also includes obtaining grant funding from senior levels of government. All UWSS debt must be carried on the municipal balance sheets in proportion to the system ownership share.

DISCUSSION

Since 2017, Administration representing all four municipalities have been consulted in the development of this Financial Structuring Business Case as prepared by PricewaterhouseCoopers LLP's (PwC) and the UWSS General Manager.

As previously noted, this newly formed corporation will provide the UWSS with the ability to:

- Apply for grant funding separately from the Municipalities – no “competition” between UWSS and Municipal priorities;
- Borrow on its own to finance Board-approved capital expenditures;
- New UWSS debt is not attributed to the Municipalities, and does not affect municipal debt capacity;
- Customers will see the UWSS portion of their water cost separately on their bill.
- Water rates will continue to be set by the Board, in accordance with Board policies and provisions of Board-approved lending agreement(s);
- UWSS, not the Municipalities, will bear the risk of volume fluctuations and uncollectible accounts;
- UWSS will pay a service fee to the Municipalities for work done by the Municipalities as agents of UWSS (billing and collection services);
- A corporate UWSS would be liable for itself and provide better liability protection to municipal shareholders.

In 2022, Kingsville Council supported the business case for the restructuring of the UWSS into a Municipal Services Corporation (MSC) through CAO-2022-17 dated August 8, 2022.

Extensive work has continued with the UWSS Restructuring team (UWSS General Manager (Rodney Bouchard), PwC (Tom Garner), Willis Business Law (William Willis)) to draft the required documents to establish the new MSC. Administration from each of the four Municipalities have worked diligently with the UWSS Restructuring Team to protect the interests of their respective municipalities.

Willis Business Law, in consultation with the Municipality's Senior Administration, prepared the legal business case and documents needed to create and incorporate UWSS into a MSC under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001.

These documents include the Unanimous Shareholders Agreement, Water Services Agreement, Asset Transfer Agreement, Real Property Transfer Agreement and Municipal Access Agreement between the Municipality and the MSC.

The new corporate structure, UWSS Inc., will achieve the following:

- Four owner Municipalities become shareholders of UWSS Inc. instead of owners in common. Ownership shares would be determined by water demand from each municipality.
- Ownership shares would consist of "tracking shares" that would be reviewed every 4 years based on water demand from each Municipality.
- UWSS Board of Directors would consist of 12 Board members. Each shareholder would appoint one Director to the UWSS Board. Shareholders would also appoint one additional Director to the UWSS Board for every 10 percent water demand for their respective municipalities.
- A maximum of two Directors appointed by each municipal shareholder would be either elected or employed municipal members. For example, the Municipality of Kingsville, will be able to appoint four Directors to the UWSS Inc. Board since it is a shareholder and also uses over 38% of UWSS water output. However, only two of the appointed directors can be an elected councillor or municipal staff. The other appointed directors would need to be independent of the municipal corporation.
- When appointing Independent Directors, municipal shareholders shall consider the required competencies of prospective Board members including, but not limited to, legal, accounting, information technologies and engineering competencies.
- A corporate UWSS would be liable for itself and provide better liability protection to municipal shareholders.
- Existing UWSS "common" assets would be transferred from joint municipal ownership to UWSS Inc. ownership. All disputes on asset ownership will be reduced. A policy will be developed between UWSS Inc and municipal shareholders on any new future watermain/ transmission infrastructure in regards to finance and ownership.

It should be noted that the legal and financial business case and associated restructuring documents, including the PwC financial plan, have been prepared with extensive collaboration with senior staff of the owner Municipalities.

The newly established corporation is not the privatization of the water treatment facility and system but rather a modernization of the UWSS. There are no private interests or third-party investments considered in the Business Plan which includes appropriate

measures within its governing documents to prevent such interests. The four current Municipalities will remain owners. Ownership will be as Shareholders rather than as tenants in common.

Since the last report (CAO-2022-17) to Council in August 2022, where Council approved the Policy on Asset Transfers in addition to the Business Case Study and Financial Presentation for Restructuring UWSS into a Municipal Service Corporation, work with the UWSS Restructuring Team and Senior Administration has continued to create the new Corporation.

The UWSS Inc. was incorporated pursuant to the Business Corporations Act (Ontario) on February 24, 2023. The articles of incorporation established a Board of Directors with a minimum of 1 Director and a maximum of 15 Directors. Rodney Bouchard, General Manager of UWSS was the only appointed Board of Director at the time of incorporation. The UWSS Restructuring Team has advised that in order to allow for sufficient time to seek independent and Council appointments to the permanent Board of Directors, an Interim Board with one representative from each Municipality would need to be established. The suggested appointees to the Interim Board, from the UWSS Restructuring Team, is the Mayor of each shareholder municipality. The purpose of the Interim Board is limited to the operational and administrative matters necessary prior to establishment of UWSS as a permanent operating to be managed by the Permanent Board including but not limited to matters related to appointment of officers, appointment of auditors, establishment of bank accounts, issuance of request for financing, and other operational matters required in furtherance of establishment of UWSS as a full operating entity in accordance with its purposes. The approval of the required corporate documents, including the Unanimous Shareholders Agreement, Water Services Agreement, Asset Transfer Agreement, Real Property Transfer Agreement and Municipal Access Agreement between the Municipality and the MSC will need to be approved by the Interim Board at its first meeting in March/April. This approval will allow the request for financing (RFF) to be issued. This will commence the process to secure financing for the debt financed portion of the capital program. This process will take 3-5 months to complete. Approval of any financing proposals would be the responsibility of the Permanent UWSS Board. The current timeline for release of the RFF is May 31, 2023, with the due date in early August.

The existing UWSS Joint Board of Management will continue in order to provide the support and necessary administration and approvals to operate the facility only if need be.

The proposed By-laws for UWSS Inc. contemplate that the permanent Board, once established and votes apportioned to the Directors appointed by each of the Municipal Shareholders (The Corporation of the Municipality of Leamington, The Corporation of the Town of Kingsville, The Corporation of the Town of Essex, and The Corporation of the Town of Lakeshore) the Permanent Board will be comprised as follows:

Municipality	Number of Directors to be Appointed	Minimum Number of Independent Board Members
The Corporation of the Municipality of Leamington	Six (6)	Four (4)
The Corporation of the Town of Kingsville	Four (4)	Two (2)
The Corporation of the Town of Essex	One (1)	Not applicable
The Corporation of the Town of Lakeshore	One (1)	Not applicable

Kingsville Senior Administration continues the review to finalize the required legal documents and recommends establishing the new corporation for the benefits outlined in this report for the UWSS Inc. Board of Directors to approve.

FINANCIAL CONSIDERATIONS

The appointment to the interim Board has no direct financial impact however certainly there are financial implications with the transition to a MSC as highlighted below.

PwC has developed the financial model and plan for the UWSS Inc. for 50 years into the future. The financial model is founded on the principals of cost recovery rather than a return on equity model similar to the electricity industry. This plan accommodates the proposed UWSS Inc. capital plan for 2023-2031 that is valued at over \$120 million and includes a new reservoir #3 at the plant, replacement of some large watermains, expansion of Cottam Booster and construction of a new membrane “peaker” treatment plant. This plan is based on a lower annual base bulk water rate increase than is currently being used in the existing approved financial plan.

The financial benefits for the UWSS Inc. that will be realized of a MSC include but are not limited to:

- UWSS Inc.’s ability to independently obtain grants from senior governments;
- Become a credit worthy entity with the ability to secure its own debt;
- Become financially independent from the owner municipalities;
- Develop a financial planning structure that would address future capital requirements without creating “rate shock” to the end users customers;
- As a Government Business Entity (GBE), the UWSS Inc. financials would be proportionately reported on the municipality’s financial statements as an investment, adjusted annually by dividends (if declared) and net income (loss).

Each Municipality will provide billing and collection services as agents on behalf of UWSS Inc. and remit those billings back to UWSS Inc. To maintain the required segregation and financial independency of the Municipality and the new UWSS Inc. in order to qualify as a GBE, the Municipality will no longer provide Financial and Accounting Services to UWSS Inc. UWSS Inc. plans on securing such financial support for the new corporation in the near future. The Municipality will assist with the transition

and continue providing these services until the financials are completed including a mid-year 2023 Financial Close and Audit as required.

The main risk, although satisfied through the discussions with the UWSS Restructuring Team, relates to bad debts of the UWSS Inc. treatment portion of the water charge. Currently, the Municipality is permitted to transfer all outstanding water (treatment and distribution) bad debts (uncollected charges) to property owners as a priority lien on the property to which the supply was made. Under the new corporate structure, only the Municipality's portion of the outstanding distribution water debt will be transferrable to property taxes. The UWSS Inc. treatment portion of the bad debt will become the responsibility of the new corporation and will be recovered through a specific customer class bad debt provision within the UWSS rates along with system losses, specific to each Municipality. The importance of the bad debts being attributable to the specific customer class and each municipality is that the typical residential customer will not be required to pay for the bad debts of the large user customer classes (commercial, industrial and greenhouse) rather similar customer class types will share the bad debts and potentially recoveries of the new corporation.

The PwC report details a financial structure for UWSS Inc. that can achieve the above criteria and outlines an implementation plan and schedule for the structure. It should be noted that the PwC report stipulates that the recommended financial structure and associated benefits can only be achieved if the UWSS legally restructures into a corporate entity first.

ENVIRONMENTAL CONSIDERATIONS

Not applicable.

CONSULTATIONS

PREPARED BY:



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