



Report

To: Mayor and Members of Council

From: Rodney Bouchard, General Manager Union Water Supply System

Date: March 28th, 2018

Re: Proposed Business Case for Restructuring UWSS into a Municipal Service Corporation

Recommendation:

That the Councils of the Municipality of Leamington, Town of Kingsville, Town of Essex and Town of Lakeshore, as owners of the Union Water Supply System receive this report;

That the Councils of the Municipality of Leamington, Town of Kingsville, Town of Essex and Town of Lakeshore, as owners of the Union Water Supply System endorse and adopt the Business Case for Restructuring of the Union Water Supply System into a Municipal Services Corporation as set out in Exhibit "A" of this report.

Overview of Union Water Supply System

The following provides an overview of the Union Water Supply System (UWSS) in regards to its history, ownership, management, and operation.

History

Any discussion of the Union Water Supply System (UWSS) needs to begin with the system's history. The history is important because it explains why the system has its present governance structure and its throws light on a number of issues that the UWSS currently faces.

The UWSS was created in the late 1950s by the Ontario Water Resources Commission (OWRC), a provincial body. The OWRC was created to assist municipalities with funding,

building and operating drinking water and waste water systems. The OWRC operated the treatment plant on behalf of the municipalities. Its functions were absorbed into the new Ministry of the Environment in 1972 and were transferred to the new Ontario Clean Water Agency (OCWA) in 1993.

The UWSS's original participants were the old municipalities of Leamington, Mersea, Gosfield South, Gosfield North, Essex and Maidstone along with H.J. Heinz. Kingsville and Rochester joined around 1970. Over time the service area expanded as water mains were built in the rural areas and the current service area occupies the southeast quarter of Essex County.

In the 1990s the Province did two (2) things which resulted in the current structure of the UWSS. First was the amalgamation of municipalities which reduced the number supplied by the UWSS from eight (8) to four (4). Second was the transfer of ownership of provincially operated drinking water and wastewater systems to the municipalities they served. In most such cases amalgamation meant that transfer was to a single municipal owner. Examples in Essex County are the Colchester South-Harrow water system which is now owned by Essex or the Lakeshore West wastewater system which is now owned by Kingsville. The UWSS was one of four (4) provincially operated systems that still served several municipalities even after amalgamations. In these cases ownership was transferred to the municipalities and governance to a Joint Board of Management.

Ownership

The legal ownership of the UWSS is vested in the four (4) municipalities as tenants in common with ownership share being in proportion to the volume of water they take from the system. The Transfer Order provides that the ownership share is fixed for four (4) years based on the average supply to each municipality over the previous four (4) years. The Transfer Order set the initial proportional ownership in January 2001 and it has been revised in 2005, 2009, 2013 and 2017. The next revision is scheduled for 2021, unless the Board decides to undertake an earlier review. The following table shows the ownership percentages since 2001:

	2001	2005	2009	2013	2017
Leamington	63%	59.9%	58.1%	56.11%	50.55%
Kingsville	27%	30.7%	33.4%	34.83%	40.33%
Essex	7%	6.5%	5.8%	6.04%	5.97%
Lakeshore	3%	2.9%	2.7%	3.02%	3.15%

This proportional ownership has consequences for the financial administration of the system and the municipalities.

In total, there are approximately nine hundred (900) kilometres of water mains in UWSS' service area indirectly servicing approximately sixty five thousand (65,000) residents and a substantial number of commercial, industrial, and agricultural customers. UWSS'

assets include a low lift pumping plant, a water treatment plant, a booster pumping station, in-ground reservoir at 2 locations, four elevated water towers, and approximately 130 kilometers of central (“transmission”) water mains. UWSS wholesales its water directly to the Municipalities. The Municipalities handle local billing and distribution.

Management

A Joint Board of Management (UWSS Board) was established under the Transfer Order to govern the management of UWSS. The UWSS Board meets once per month. The UWSS Board is composed of members appointed by the Municipalities in accordance with the Transfer Order. Each Municipality appoints at least one member, with additional members granted according to its ownership interest (i.e. 1 additional member for every 10% ownership to a maximum of 6 for any municipality). These members are generally, but need not be, municipal counsellors. There is no requirement for any professionals to sit on the Board.

At present there are twelve (12) members on the Board as follows:

Leamington 6	Kingsville 4
Essex 1	Lakeshore 1

The UWSS Board is exclusively responsible for the oversight of the UWSS notwithstanding the legal ownership of the system. It does so on behalf of the municipalities but has the autonomy to make decisions without requiring municipal approval. The UWSS Board is ultimately responsible for operating, maintaining, repairing, constructing and expanding the system. In particular it alone is responsible for regulatory compliance of the system.

In 2002, the UWSS Board created the position of UWSS General Manager to oversee the day to day duties and obligations of the UWSS. The UWSS Manager reports solely to the UWSS Board. However, since the UWSS is not a legal entity per say, it does not have the ability to conduct its own financial administration (i.e. accounts receivable and accounts payable) nor directly hire employees. Thus, the UWSS Board has retained the Municipality of Leamington, as the system’s largest “owner”, to carry out financial and human resources related administration purposes on its behalf. The UWSS’ finances are separate from those of the municipalities. The UWSS maintains its own bank accounts for this purpose. The UWSS’ revenue source is mainly from wholesale of treated water to

the four owner municipalities. A small revenue source is also generated from the lease of antennae space on the UWSS water towers to telecommunications providers.

One very important area in which the UWSS does not have any authority is for borrowing/incurred debt. The UWSS cannot borrow on its own authority. 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. Any UWSS debt must be carried on the municipal balance sheets in proportion to the system ownership share described above. The UWSS currently carries a debt of \$13.76 M (as of December 31, 2017) that consists of a loan (aka "Sun Life debt") that was secured by the four owner municipalities to "purchase" the UWSS assets from the Province of Ontario at the time when the UWSS was transferred to the municipalities. The UWSS is responsible for repayment of this debt but this debt is registered on the municipalities' balance sheets.

Operations

The Board currently contracts with the Ontario Clean Water Agency (OCWA) operations and maintenance of the UWSS. As an accredited operator, OCWA assumes most of the legislative obligations regarding UWSS, including such things as implementing a Drinking Water Quality Management System (DWQMS). OCWA's services do not extend to the four distinct distribution systems providing water to each Municipality. OCWA was the system's owner and operator before 2001 and has been retained as the operator since then. The current operating is a 5-year fixed-fee agreement that came into effect on January 1, 2014 and will expire on December 31, 2018.

UWSS Governance - A Review of What's Been Done

The following provides a chronology of the steps that have been undertaken since a review of UWSS governance was initiated in 2008.

2008-2009 Governance Review

The initial UWSS governance review was initiated in February 2008 and a Terms of Reference was developed to outline the purpose and anticipated goals of the governance review. As part of the Governance Review, external governance "experts" were retained by UWSS to facilitate the undertaking of the review. These included the following experts:

Dr. Karen Bakker - University of British Columbia: Dr. Bakker was retained based on her academic and published experience on water system governance with particular reference to Ontario. Dr. Bakker was assisted by a post-doctoral student, Dr. Karen Furlong.

Maria Kelleher - Kelleher Environmental: Mrs. Kelleher was retained based on her work experience with the Essex Windsor Solid Waste Authority on facilitating a discussion on governance

The work undertaken as part of this governance review included the following tasks:

- Governance Questionnaires - these were distributed to UWSS Board members, municipal councillors and municipal administration.
- Interviews - these were conducted with UWSS Board members and key municipal administration staff.
- Governance Review Workshops - these consisted of a “visioning” workshop and a “Governance Review” workshop that included UWSS Board members and key municipal administrative staff.
- Reports on Governance Review - The reports identified the main concerns and issues with the existing governance structure and identified next steps for resolving these issues.

The Governance Review reports by Maria Kelleher in 2009 following the workshops indicated a number of issues with the existing UWSS Governance. These included:

- Lack of Board authority for UWSS system. Municipalities need secure any debt and apply for government grants on behalf of UWSS.
- Lack of legal standing of the UWSS.
- Common asset issues; who owns what? Who is responsible for UWSS assets?

Although significant issues were identified and recommendations were provided to address these issues, a key takeaway from the 2008-2009 Governance review work was that there appeared to be very little appetite by many Board members and municipalities to undertake changes to the UWSS Governance.

2012 Governance Review

At the December 21, 2011 UWSS Board meeting, the Board agreed to undertake a review of the existing UWSS governance structure in 2012 to identify whether an alternative governance model/structure would be more suitable for the UWSS. This 2012 governance review was to build upon an earlier governance review that was initiated in 2008-2009 but never brought to closure.

At the May 16, 2012 UWSS Board meeting, the Manager presented report No. UWSS-19-12 Governance Review, which summarized the information, workshop reports, and documents that were generated as part of the 2008-2009 governance review. The intent of the report was to provide background information to newer UWSS Board members and a refresher to long standing Board members of the work undertaken as part of the 2008-2009 Governance Review.

On July 5, 2012, a special meeting of the Board was held at the Essex County Civic Centre to present and discuss possible alternative governance structures for UWSS. At this meeting, the Manager provided a presentation to the Board on possible alternative

ownership and governance structures for the UWSS that would address the main issues and drawbacks with the existing governance structure such as:

- Lack of legal standing for the UWSS;
- Inability to take on debt or financing;
- Inability to directly own UWSS assets;
- Ineligibility to receive senior government grants;
- Lack of authority and decision making powers of the UWSS Board over the entire UWSS system;

The identification of alternative ownership/governance structures for UWSS required that different ownership models and corporate structure model be considered. As part of this presentation, the Manager considered and evaluated the following ownership and corporate structure models:

Ownership Models:

- As-Is: - UWSS plus 4 (or less) owner municipalities
- Source to Tap: - All one system; treatment and distribution combined into one utility
- Single municipality/County Ownership: - Common system purchased and operated by a single municipality. This option also discussed the potential of the County taking over the system

Corporate Structure Options:

- Local Joint Board - this is the current structure
- Municipal Services Board (MSB)
- Municipal Services Corporation (MSC)
- New “wish” list option - Special Legislation by Province

The evaluation of the various Ownership Models, Corporate Structure Options, and Expansion of Service Area resulted in the identification of 12 alternative governance structures for UWSS and the benefits and drawback of each alternative. The restructuring of UWSS into a Municipal Service Corporation (MSC) was identified as the governance structure that provided the most benefit for UWSS.

Following the UWSS Manager’s presentation on *UWSS Ownership and Corporate Structure Options* the UWSS Board endorsed the recommendations to:

- Undertake a financial feasibility evaluation of the alternative governance structure options;

- Discuss and share the UWSS governance review information with senior administration and Council of the municipalities of Leamington, Kingsville, Essex, and Lakeshore;
- Discuss and share the UWSS governance review information with staff from MMAH, MOE, and any other provincial government entity as needed to the undertaking of a feasibility evaluation of any potential UWSS restructuring;
- Retain a financial consultant to assist with the undertaking of the financial feasibility evaluation of any potential UWSS restructuring.

2014-2015 Governance Work - Legal Review of UWSS Structure

In the Spring of 2014, The UWSS consulted with its solicitor, Deborah Rollier of Ricci, Enns, Rollier & Settingington LLP to initiate a legal review of the existing structure of the UWSS in regards to governance and possible restructuring. A legal team with expertise in corporate and business law, real estate law, and water and wastewater related laws was assembled. The legal team included the UWSS Board Solicitor, Mr. William Willis of Willis Business Law (formerly with McTague Law Firm LLP at the time of review) of Windsor, Ontario and Mr. Andrew Roman of Roman Law Corp of Toronto, Ontario.

The legal team prepared a preliminary report in May 2015 that provided a legal review of the existing UWSS Governance Structure. This report included legal opinion and recommendation for improvements to the UWSS organizational structure in regards to its existing governance, legal identity and status, liability protection, and capacity for self-financing, issuance of debt, etc. The main recommendation of the report proposed that the restructuring of UWSS into a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001 would address the identified issues.

A Special Meeting of the UWSS Board was held on May 7, 2015 to present the legal team's preliminary report on UWSS Restructuring. The Chief Administrative Officers (CAOs) and/or senior municipal water department staff from the municipalities of Leamington, Kingsville, Essex and Lakeshore were also present at this meeting. The preliminary report on UWSS Restructuring was presented for information and discussion purposes.

The legal team's report on UWSS Restructuring was summarized in UWSS Report *UW19-15 UWSS Restructuring* that was presented at the UWSS Board meeting of May 20, 2015. The following report recommendation was endorsed by the UWSS Board:

That the UWSS Board investigates the necessary process to re-structure the Union Water Supply System (UWSS) and associated assets into a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001;

2017-2018 Governance Work - Financial and Legal Business Case for Restructuring

At the June 21st, 2017 UWSS Board meeting, the UWSS Board approved a budget of to complete a financial analysis and development of a Business Case for the restructuring of Union Water Supply System (UWSS) and associated assets into a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001. UWSS retained PricewaterhouseCoopers (PwC) to complete this work.

UWSS also retained Willis Business Law of Windsor, ON to revise the May 2015 legal review on the existing UWSS Governance Structure and proposed restructuring. The revised legal report also serves as a legal business case for UWSS Restructuring purposes.

Financial Restructuring Business Case

PwC initiated the development of the UWSS Restructuring Financial Business case in July 2017. On October 19th, 2017, UWSS and PwC held a workshop with senior administrative staff from the municipalities of Essex, Kingsville, Lakeshore and Leamington. The purpose of the workshop was to obtain information from the municipalities on financial administration/ cooperation with UWSS, proposed options for restructuring UWSS in regards to financial systems, etc.

A similar workshop was held on October 20th, 2017 with the UWSS Board members. The focus of this workshop was to obtain Board members opinions, thoughts, concerns, etc. in regards to financial restructuring of UWSS.

PwC provide its draft report titled "Union Water Supply System Financial Structure Business Case" to the UWSS General Manager on November 14, 2017, which had been revised to include comments by UWSS and Willis Business Law. The PwC report concluded that a financial restructuring of UWSS was possible to achieve the following:

- Have the 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

The PwC report details a financial structure for UWSS 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.

Legal Advice on UWSS Restructuring

Willis Business Law provided their Legal Advice on UWSS Restructuring in a letter report dated October 26, 2017. This legal advice report revised the original opinion provided by William Willis in May 2015. The Legal advice recommends the restructuring of UWSS into a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001.

The UWSS General Manager provided a copy of the PwC Financial Restructuring Business Case and Willis Business Law Legal Advice on UWSS Restructuring report to the CAOs of the four owner municipalities in an email dated November 20th, 2017. The email indicated that these documents were being provided for review and comment by senior administration at each of the four owner municipalities.

The Legal Opinion and the draft UWSS Restructuring Financial Business Case reports were presented to the UWSS Board at the February 21, 2018 UWSS Board meeting. As an action item from this meeting, the UWSS Board provided direction to form an executive committee including the UWSS Board Chair, the UWSS Board Vice Chair and the UWSS General Manager to present the proposed UWSS restructuring materials to the Councils of the Municipalities of Leamington, Kingsville, Essex and Lakeshore (i.e. the UWSS owner municipalities).

UWSS Restructuring - What Problems are We Trying to Solve?

The restructuring of the Union Water Supply System into a Municipal Services Corporation is being proposed to solve a number of problems including the following:

Access to grant funding

- UWSS cannot apply on its own; Municipalities must apply for grants on behalf of UWSS;
- If done via the Municipalities, UWSS applications may “compete” with other Municipal priorities for grant funding

UWSS Capital Works Program Funding

- UWSS has significant capital requirements in the coming years (i.e. \$30 million + in next 10 years);
- Wholesale water revenue to owner municipalities is basically the only revenue source for UWSS;

- Annual revenue includes capital expenditure as an item to be recovered in rates
- UWSS has cash reserves, but once these are depleted there is no source for replenishment;
- Without direct access to debt financing, funding of large scale capital works are difficult to fund without significant water rate increases.

UWSS Debt

- If debt is used to fund capital, this debt is attributed to the Municipalities and registered on municipal balance sheets;
- UWSS has no corporate existence, so it cannot borrow on its own;
- All new debt is attributed to the Municipalities and reduces capacity to borrow for other uses
- The existing Sun Life debt is attributed to the Municipalities

Proposed Solution - UWSS Municipal Services Corporation

The proposed solution to address existing issues associated with the existing UWSS Governance Structure is to establish UWSS as an incorporated entity that would consist of a Municipal Services Corporation under Section 203 and Ontario Regulation 599/06 of the Municipal Act 2001. For the sake of this report, the hypothetical corporation will be called UWSS Inc.

UWSS Inc. would be owned by the Municipalities as shareholders and governed by a unanimous shareholders agreement. The new corporate structure would consist of the following:

- Four owner municipalities become shareholders of UWSS Inc. instead of tenants in common. Ownership shares will be determined by water demand from each municipality.
- Ownership shares will be reviewed every 4 years based on water demand from each municipality
- Board of Directors will initially consist of municipal elected councillors from the four municipal shareholders. The process to appoint Board members will remain the same as it is currently; 1) Each municipality will appoint 1 Board member as a shareholder member; 2) Additional members will be appointed based on water consumption with each municipality appointing one member for every 10 percent water demand; and 3) No municipality will have more than half of the Board representation. Thus with a Board of 12 directors, no municipality will have more than 6 Board representatives.
- Existing UWSS assets will be transferred from municipal ownership to UWSS Inc ownership through an agreed upon Asset Transfer Policy. A New Asset Policy will

be developed between UWSS Inc and municipal shareholders on any new future watermain/ transmission infrastructure in regards to finance and ownership.

The new corporate structure of UWSS Inc. would also include the following changes to the existing commercial and financial structure:

- UWSS can apply for grant funding separately from the Municipalities - no “competition” between UWSS and Municipal priorities
- UWSS can 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, collection, and associated accounting)
- A corporate UWSS would be liable for itself and provide better liability protection to municipal shareholders

Concluding Remarks:

The legal review of the UWSS governance structure completed by Willis Business Law, LLP in October 2017 provides sound reasoning from a legal perspective that the UWSS and its owner municipalities would benefit from a governance restructuring of UWSS into a corporate entity such as a Municipal Services Corporation. Should that occur, the PwC Financial Restructuring Business case recommends a financial structure that appears to be financially sound and would provide future financial stability to UWSS, its ratepayers, and its municipal shareholders. The result would be a resilient and sustainable corporate water utility that is municipally owned, able to self-finance and incur debt; can obtain senior government grants for water related works; and provides increased liability protection to its shareholder municipalities, Board directors, and UWSS staff.

Respectfully submitted,



Rodney Bouchard, General Manager
Union Water Supply System Joint Board of Management
rb/kmj