CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT

Financial Planning, Administration and Policy Division and Legal and Risk Management Services

TO:	Hamilton Enterprises Holding Corporation (HEHCo) Shareholder Meeting
COMMITTEE DATE:	December 18, 2020
SUBJECT/REPORT NO:	Various Requests from Hamilton Utilities Corporation and Hamilton Enterprises Holding Corporation (FCS20092/LS20030) (City Wide)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	David McKenna, Ext. 4025 Kirk Weaver, Ext. 2878
SUBMITTED BY: **SIGNATURE:**	Nicole Auty City Solicitor Legal and Risk Management Services N. Auty
SUBMITTED BY: **SIGNATURE:**	Brian McMullen Director, Financial Planning, Administration and Policy B McMullen

RECOMMENDATIONS

(a) Conditional upon HEHCo substantiating the value of the four promissory notes to the satisfaction of the General Manager, Finance and Corporate Services, that Council approve the following steps to complete the restructuring of Hamilton Utilities Corporation (HUC) commenced in 2017, namely:

(i) conversion of the four promissory notes totalling approximately $40 Million, payable to HUC for assets sold by HUC to HEHCo subsidiaries, into equity requiring transfers through the City's bank account(s) with no material impact to the City;

(ii) discharge of the existing Personal Property Security Act security registration(s) over the District Cooling System assets separately granted by HCE and HUC to the City and the filing of new Personal Property Security Act security registration(s) over the District Cooling System assets granted by HIPCO-CUP to the City;

(iii) restructuring the flow of loan repayments related to the sale of the District Cooling System assets to align with the restructuring of the City's energy subsidiaries by entering into a Debt and Security Realignment Agreement between the City, HUC, HCE, HIPCO-CUP and HIPCo; and

(iv) assignment of the various site licences in relation to the District Cooling System assets from HCE to HIPCO-CUP;

(b) That Council approve the temporary contravention of the debt/equity ratio required by the HEHCo Unanimous Shareholders' Declaration with respect to HIPCO Portlands Projects Corporation's proposed $3 Million financing from Concentra Bank; and

(c) That the General Manager, Finance and Corporate Services, or their designate, be authorized and directed to execute on behalf of the City all documentation and agreements necessary to give effect to Recommendations (a), (b) and (c), all in a form acceptable to the City Solicitor, including but not limited to: (i) Restructuring Notes Acceptance Agreement; (ii) HEHCo Share Subscription Agreement; (iii) Receipt for HEHCo Share Certificate; (iv) Notes Payment Demand; (v) Receipt for Notes Payment(s); (vi) Guarantee Agreement (City and HIPCO-CUP); (vii) General Security Agreement (City and HIPCO-CUP); (viii) Termination Agreement re: existing HCE – City Guarantee Agreement; (ix) Termination of Personal Property Security Act security registration(s) over the District Cooling System assets separately granted by HUC and HCE; and (x) various ancillary agreements including Novation Agreements.

EXECUTIVE SUMMARY

The purpose of this report is to provide: (i) Council with the background information necessary to consider the proposals detailed in Recommendations (a), (b) and (c); and (ii) City staff with the authority necessary to implement the proposals detailed in Recommendations (a), (b) and (c).

The City of Hamilton is the sole shareholder of each of the Hamilton Utilities Corporation (HUC) and HEHCo.

HEHCo and HUC request that the City approve:

1. the temporary contravention of the debt/equity ratio required in HEHCo's Unanimous Shareholders' Declaration (HEHCo USD) to facilitate the proposed $3 Million financing that HIPCO Portlands Projects Corporation (HIPCO-Portlands), a HEHCO subsidiary, is currently seeking from Concentra Bank; and

2. the realignment of the debt, security and related agreements arising from the sale of the District Cooling System (DCS) assets and the restructuring of HUC commenced in 2017, which includes the:

   (a) conversion of the four promissory notes totalling approximately $40 Million, payable to HUC for assets sold by HUC to HEHCo subsidiaries, into equity requiring transfers through the City's bank account(s) with no material impact to the City;
   (b) discharge of the existing Personal Property Security Act (PPSA) security registration(s) over the DCS assets separately granted by HUC and HCE Energy Inc. (HCE) to the City and the filing of new PPSA registration(s) over those DCS assets granted by HIPCO-CUP Projects Corporation (HIPCO-CUP), a HEHCo subsidiary, to the City;
   (c) restructuring of the flow of loan repayments related to the DCS asset sale to align with the restructuring of the City's energy subsidiaries by entering into a Debt and Security Realignment Agreement between the City, HUC, HCE and Hamilton Infrastructure Projects Corporation (HIPCo); and
   (d) assignment of various site licences in relation to the DCS assets from HCE to HIPCO-CUP.

Alternatives for Consideration – See Page 9

FINANCIAL – STAFFING – LEGAL IMPLICATIONS (for recommendation(s) only)

Financial: Based on the information provided by HUC staff, there are no immediate financial implications including tax implications arising from the approval of this report. The transactions required to complete conversion of the $40 Million in promissory notes to equity will require the use of $40 Million of City funds to initiate the transactions but it is anticipated that these funds would be returned to City accounts within the same business day. It does appear that these transactions will address the contravention of the debt/equity ratio requirement in the HEHCo USD. Under the proposed arrangement, approval would still be required from the City as sole shareholder for future financing that would cause HEHCo or any of its subsidiaries to exceed the 75:25 ratio. Outstanding loan amounts to the City would still be paid on the same schedule.

Staffing: N/A

Legal: Legal Services will review and advise on the documents, agreements and corporate resolutions necessary to carry out the recommendations.

HISTORICAL BACKGROUND

Sale of DCS Assets

On September 24, 2014, Council approved the sale of the City's District Cooling System (DCS) to HCE for a purchase price of $10.5 Million.

In order to complete that transaction and mitigate any concerns related to 'bonusing' contrary to the *Municipal Act, 2001*, the following steps were taken on or about January 1, 2015:

(a) the City and HCE entered into a Purchase and Conveyance Agreement whereby HCE agreed to purchase the DCS assets from the City for $10.5 Million;
(b) the City loaned $8.1 Million to HUC as evidenced by a loan agreement and a secured term promissory note, both in the amount of $8.1 Million;
(c) HUC loaned $10.5 Million to HCE, as evidenced by a promissory note in the amount of $10.5 Million;
(d) the City and HUC entered into a General Security Agreement in order to secure repayment of the funds loaned to HUC;
(e) the City and HCE entered into an Agreement of Corporate Guarantee and Postponement of Claim in order to secure repayment of the funds loaned to HCE;
(f) the City, HCE and HUC entered into a Payment Security Agreement;
(g) HCE and the City entered into an Energy Services Agreement; and
(h) HCE and the City entered into various Site License Agreements.

To summarize the pertinent details of the transaction, the City loaned $8.1 Million to HUC (City-HUC Loan). HUC then loaned $8.1 Million together with an additional $2.4 Million to HCE for a total loan by HUC to HCE of $10.5 Million (HUC-HCE Loan).

HCE provided the City with a corporate guarantee and PPSA security registration over the DCS assets to guarantee payment of the City-HUC Loan.

Since these loans were made, payments have been, and continue to be, made on time to the City.

Alectra Merger and Restructuring of the City's Energy Subsidiaries

Alectra Inc. was formed on January 31, 2017 by the merger of several municipally-owned utilities (Enersource, Horizon Utilities and PowerStream with Hydro One Brampton, Hydro One and Guelph Hydro subsequently joining). The City of Hamilton owns 17.31% of Alectra Inc., which shares were, and continue to be, held through HUC.

At the time of the 2017 Alectra merger, HUC also owned certain pieces of the City's other energy related assets. In order to mitigate tax risk, City Council approved restructuring the City's energy subsidiaries resulting in HUC retaining only ownership of the City's shares in Alectra. All other non-Alectra related assets previously held by HUC being transferred to other City owned subsidiaries. This restructuring plan was approved by the provincial Ministry of Finance.

Under that restructuring plan, HUC sold all its non-Alectra assets to HEHCo subsidiaries in return for four promissory notes payable to HUC for a total of approximately $40 Million (the Four Promissory Notes). The Four Promissory Notes are interest free and due on-demand (i.e. there is no set repayment schedule associated with the Four Promissory Notes). HEHCo's consolidated financial statements currently show the Four Promissory Notes as debt payable to HUC.

As a result of the restructuring, HIPCo became responsible for payment to the City of the City-HUC Loan and became entitled to receive payment of the HUC-HCE Loan. The City, HUC and HIPCo entered into an agreement in 2018 whereby HIPCo was substituted for HUC as the party obligated to pay the City-HUC Loan to the City because HIPCo became responsible for such payment as a result of the restructuring.

At the same time as the restructuring, the DCS assets were sold on a tax-free basis by HCE to HIPCO-CUP. The respective securities granted by HUC and HCE to the City in consideration for the City-HUC Loan remained in place and unchanged. The end result is a complicated situation whereby HIPCO-CUP owns the DCS assets, the DCS assets are subject to security granted by HUC and HCE (not HIPCO-CUP), the security over the DCS assets does not secure payment by HIPCO-CUP, HIPCO-CUP is not obligated to make any direct payments in relation to the debt it undertook to acquire the DCS assets, and HIPCo is obligated to pay the City-HUC Loan but HIPCo does not own the DCS assets (HIPCO-CUP owns the DCS assets), and therefore, HIPCo generates no operating revenue attributable to the DCS assets.

HUC and HEHCo Requests RE: Finalizing the Restructuring of the City's Energy Subsidiaries

HEHCo has requested City approval to:

(a) convert the Four Promissory Notes owed by HEHCo Subsidiaries to HUC into equity and eliminate the Four Promissory Notes as debt obligations on HEHCo's consolidated financial statements;
(b) restructure the flow of loan repayments related to the DCS asset sale to align with the restructuring of the City's energy subsidiaries by entering into a Debt and Security Realignment Agreement between the City, HUC, HCE, HIPCO-CUP and HIPCo;
(c) discharge the existing PPSA security registration(s) over the DCS assets separately granted by HUC and HCE to the City and file new PPSA security registration(s) over the DCS assets granted by HIPCO-CUP to the City; and
(d) assign various site licences in relation to the DCS assets from HCE to HIPCO-CUP.

HEHCo's Request in Relation to HIPCO-Portlands Project Corporation Borrowing

HEHCo is requesting shareholder approval for the contravention of the debt/equity requirement contained in the HEHCo USD in relation only to the HIPCO Portlands' proposed $3 Million financing from Concentra Bank.

The HEHCo USD stipulates that shareholder approval is required before HEHCo or a HEHCo subsidiary can borrow funds which would result in the debt/equity ratio of HEHCo and all its subsidiaries on a consolidated basis dropping below 75:25.

HUC representatives have advised City staff that HIPCO-Portlands - a HEHCo subsidiary - is currently seeking $3 Million in financing from Concentra Bank. As a result of the Four Promissory Notes showing as debt on HEHCo's consolidated financial statements, the debt/equity ratio of HEHCo and its subsidiaries on a consolidated basis would not meet the 75:25 ratio threshold required by the HEHCo USD if this financing is finalized. Shareholder approval is therefore required before HIPCO-Portlands can proceed with this proposed financing.

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

As outlined in this report.

RELEVANT CONSULTATION

These recommendations are the result of consultation between Legal Services and Finance staff.

ANALYSIS AND RATIONALE FOR RECOMMENDATION

HUC's and HEHCo's Rationale for these Requests:

1. HUC and HEHCo representatives rationalize their requests to finalize the restructuring of HUC commenced in 2017 as follows:

   (a) Conversion of the Four Promissory Notes into equity:

      (i) HEHCo's consolidated financial statements currently list the Four Promissory Notes as debt. Inasmuch as these financial statements capture HEHCo partially through the restructuring, the financial reporting at this intermediate stage presents an unattractive and inaccurate picture of HEHCo's financial position compared to the financial position of HEHCo once the Four Promissory Notes have been converted from debt to equity;

      (ii) converting the Four Promissory Notes from debt to equity would remove $40 Million of debt from HEHCo's consolidated financial statements and instead show $40 Million of equity. HEHCo's financial position would be improved, all without the need for a cash injection from the City; and

      (iii) the HUC loans to HEHCo (represented by the Four Promissory Notes) would be eliminated resulting in HUC becoming solely a holding company for the City's shares and interests in Alectra;

   (b) Realigning the flow of loan repayments related to the DCS asset sale to align with the restructuring of the City's energy subsidiaries:

      (i) the current loan repayment process is convoluted and requires payments to be made from one company to another until the payments reach the appropriate recipient;

(ii) realigning the flow of loan repayments so that payments are made by the parties obligated to pay directly to the parties ultimately owned money would simplify transactions;

(iii) this realignment directly and simply connects asset owner, lenders and borrowers such that HIPCO-CUP is a more attractive vehicle to raise money for worthwhile projects in the HEHCo group of companies that need financing. This in turn would reduce the demands on equity; and

(iv) realignment will also disconnect the DCS project from HUC therefore contributing to achieving the City's desire to restrict HUC's activities solely to Alectra related business; and

(c) Discharge of the existing PPSA security registration(s) over the DCS assets separately granted by HUC and HCE to the City and filing of new PPSA security registration(s) over the DCS assets granted by HIPCO-CUP to the City:

(i) the existing PPSA security registration(s) over the DCS assets were separately granted by HUC and HCE to the City at the time of the DCS sale;

(ii) during the restructuring of HUC, the DCS assets were sold on a tax-free basis by HCE to HIPCO-CUP;

(iii) the existing PPSA security registration(s) held by the City and granted by HUC and HCE remain registered security interests notwithstanding that HCE no longer owns the DCS assets. In order to correct this deficiency, the existing PPSA security registration(s) should be discharged and replaced with new PPSA security registration(s) over the DCS assets to be granted by the current owner of the DCS assets—HIPCO-CUP—to the City; and

(d) Assignment of various site licences in relation to the DCS assets from HCE to HIPCO-CUP:

(i) HIPCO-CUP owns the DCS assets but is not party to the various licenses for the sites where DCS facilities are located. This step would rectify such deficiency.

2. HEHCo representatives' rationale for the HIPCO-Portlands Borrowing is as follows:

(a) shareholder approval would allow HIPCO-Portlands to secure financing;

(b) this financing would provide an injection of funds into the HEHCO group of companies which would increase the cash position of the HEHCO group of companies overall. This would offset the cost borne and paid within the HEHCo group of companies for the HIPCO-Portlands project and provide funds to be moved throughout the HEHCo group of companies for investment; and

(c) this financing would make the HEHCo group of companies more robust, nimble and self-sustaining resulting in the City's investment becoming more valuable.

Analysis of the HUC / HEHCo Requests

Based on HEHCo's 2019 Financial Statements, HEHCo, on a consolidated basis, would not meet the 75:25 debt/equity ratio requirement pursuant to the HEHCo USD were the proposed HIPCO-Portlands financing to be finalized. Therefore, approval of the City, as sole shareholder of HEHCo, is required to waive the debt/equity ratio requirement in order to finalize the proposed HIPCO-Portlands financing.

According to information provided by HUC staff and reported in HEHCo's audited 2019 Financial Statements, there was a negative equity position for this company. This is largely due to the existence of the Four Promissory Notes totalling approximately $40 Million owed by HEHCo subsidiaries to HUC. As contemplated in the 2017 restructuring, converting the Four Promissory Notes to equity would improve the financial position of the HEHCo group of companies.

If the Four Promissory Notes had been converted to equity in 2019 the debt/equity ratio for HEHCo would have been approximately 64:36 and within the designated threshold of 75:25. Undertaking the HIPCO-Portlands $3 Million financing would cause a reduction in the debt/equity ratio to approximately 66:34, still within the 75:25 limit.

In summary, regardless of the benefits proposed by HUC and HEHCo representatives by converting the Four Promissory Notes to equity, such steps would be necessary for HEHCo to be able to proceed with any financing without first seeking the approval of the City as sole shareholder. Conversion of the Four Promissory Notes will free up capacity for additional financing without shareholder approval until the 75:25 threshold is exceeded.

In order to convert the Four Promissory Notes to equity, the use of $40 Million in City funds will be required on the business day that the necessary transactions are undertaken. These funds would be returned to City accounts by the end of the business day that such transactions occur.

The determination of an appropriate debt/equity ratio varies between industries. Utilities companies can often have high ratios of debt to equity given the infrastructure requirements that require periodically making significant capital expenditures. It is generally understood that an organization's debt should not exceed 100% of its equity.

Staff is working with HEHCo and HUC to confirm the respective values of the Four Promissory Notes. The approval of the steps to be completed in the restructuring are conditional upon the confirmation of the value of the Promissory Notes to the satisfaction of the General Manager of Finance and Corporate Services.

ALTERNATIVES FOR CONSIDERATION

If Council does not support these transactions, the status quo would continue. Although quite complicated, the current payment structure generally works although the payment flows are convoluted. However, the PPSA security registration(s) are not registered against the appropriate assets so this should be corrected. Also, importantly, HIPCO-Portlands would not be able to finalize its proposed $3 Million financing from Concentra Bank.

ALIGNMENT TO THE 2016-2025 STRATEGIC PLAN

- Built Environment and Infrastructure
- Clean and Green
- Economic Prosperity and Growth

APPENDICES AND SCHEDULES ATTACHED

Appendix “A”– Organizational Chart re: City-owned Energy Companies