CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Legal and Risk Management Services
Financial Planning, Administration and Policy Division

TO:	Chair and Members General Issues Committee
COMMITTEE DATE:	November 6, 2024
SUBJECT/REPORT NO:	Hamilton Utilities Corporation and Hamilton Enterprises Holding Corporation - Financial Matters (LS20030(a) / FCS20092(a)) (City Wide)
WARD(S) AFFECTED:	City Wide
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SUBMITTED BY:	Lisa Shields, City Solicitor Legal and Risk Management Services Corporate Services Department
SIGNATURE:	
SUBMITTED BY:	Kirk Weaver Acting Director, Financial Planning, Administration and Policy Corporate Services Department
SIGNATURE:	

RECOMMENDATION

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 convert the remaining Hamilton Enterprises Holding Corporation ("HEHCo") debt into equity, with content acceptable to the General Manager, Finance and Corporate Services and in a form acceptable to the City Solicitor, including but not limited to: (i) HEHCo Share Subscription Agreement; and (ii) any other required documents and/or agreements.

EXECUTIVE SUMMARY

The City of Hamilton (the "City") is the sole shareholder of both Hamilton Utilities Corporation ("HUC") and Hamilton Enterprises Holding Corporation ("HEHCo").

Alectra Inc. ("Alectra") was formed on January 31, 2017. The City owns 17.31% of Alectra, which shares were, and continue to be, held through HUC.

In order to mitigate the tax risk following the creation of Alectra, Council approved restructuring the City's energy subsidiaries resulting in HUC divesting itself of all its assets except for its ownership of the City's shares in Alectra. All other non-Alectra related assets previously held by HUC were transferred to HEHCo and its subsidiaries. As a result, HEHCo owed approximately $40M to HUC. This debt was represented by four promissory notes.

In late 2020, representatives from HUC requested that the City approve a series of transactions intended to, among other goals, convert the four promissory notes into additional equity for the City in HEHCo. One of the primary purposes of this exercise was to eliminate the debt reflected on HEHCo's financial statements, thus allowing HEHCo the flexibility to obtain financing to pursue its operational goals.

On December 18, 2020 staff presented Report FCS20092 / LS20030 (attached hereto as Appendix "A") to Council and Council subsequently granted staff the authority necessary to implement HUC's proposals.

In September 2024, staff was advised by HUC representatives that they recently became aware of a discrepancy in the implementation of the above transactions, namely, that fair market value was used to calculate the value of the restructured assets while International Financial Reporting Standards (IFRS 3) require existing carrying values (i.e., book value) to be used in cases involving entities under common control.

As a result, approximately $13M in debt still remains on HEHCo's financial statements and one of the intended goals of Report FCS20092 / LS20030 to eliminate all of the debt on HEHCo's financial statements remains outstanding.

Staff is, therefore, seeking the necessary approvals to complete the process started in December 2020 by converting the remaining HEHCo debt into additional equity held by the City.

Alternatives for Consideration – See Page 6

FINANCIAL – STAFFING – LEGAL IMPLICATIONS

Financial: Based on the information provided by HUC representatives, there are no immediate financial implications, including tax implications, arising from the approval of Report LS20030(a) / FCS20092(a). The transactions required to complete the conversion of the remaining HEHCo debt into equity will require the use of City funds (approximately $13M) to initiate the transactions but it is anticipated that these funds will be returned to City accounts within the same business day.

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 District Cooling System Assets

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

To summarize the pertinent details of the transaction (refer to Appendix "A" for Report FCS20092 / LS20030 which provides a full accounting of the various transactions), in order to mitigate the rax risk the City loaned $8.1M to HUC ("City-HUC Loan"). HUC then loaned $8.1M together with an additional $2.4M to HCE for a total loan by HUC to HCE of $10.5M ("HUC-HCE Loan").

HCE provided the City with a corporate guarantee and *Personal Property Security Act* ("PPSA") security registration over the DCS assets to guarantee payment of the City-HUC Loan.

Alectra Merger and Restructuring of the City's Energy Subsidiaries

Alectra Inc. ("Alectra") was formed on January 31, 2017. The City owns 17.31% of Alectra, which shares were, and continue to be, held through HUC.

In order to mitigate the tax risk following the creation of Alectra, Council approved restructuring the City's energy subsidiaries resulting in HUC divesting itself of all its assets except for its ownership of the City's shares in Alectra. All other non-Alectra related assets previously held by HUC were transferred to HEHCo and its subsidiaries (refer to Appendix "B" for the Organizational Chart). As a result, HEHCo owed approximately $40M to HUC as represented by four promissory notes (the "Four

Promissory Notes”). Prior to the December 2020 transactions, HEHCo’s consolidated financial statements showed the Four Promissory Notes as debt payable to HUC.

The end result of the post-Alectra merger restructuring and the DCS asset sale (refer to Appendix “A” for Report FCS20092 / LS20030 which provides a full accounting of the various transactions) was a complicated situation whereby HIPCO-CUP (a subsidiary of HEHCo) owned the DCS assets, the DCS assets were subject to security granted by HUC and HCE (not HIPCO-CUP), the security over the DCS assets did not secure payment by HIPCO-CUP, HIPCO-CUP was not obligated to make any direct payments in relation to the debt it undertook to acquire the DCS assets, and HIPCo was obligated to pay the City-HUC Loan but HIPCo did not own the DCS assets (HIPCO-CUP owns the DCS assets), and therefore, HIPCo generated no operating revenue attributable to the DCS assets.

The December 2020 Transactions – HUC and HEHCo Requests RE: Finalizing the Restructuring of the City’s Energy Subsidiaries

On or about December 18, 2020, pursuant to Report FCS20092 / LS20030, Council provided approval to:

(a) convert the Four Promissory Notes owed by HEHCo 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.

The above transactions were successfully implemented in December 2020 and it was staff’s understanding at the time that the matter was concluded.

September 2024 – Discovery of Outstanding Debt on HEHCo's Financial Statements

In September 2024 staff were advised by HUC representatives that they recently became aware of a discrepancy in the implementation of the above transactions, namely that fair market value was used to calculate the value of the restructured assets while International Financial Reporting Standards (IFRS 3) require existing carrying values (i.e. book value) to be used in cases involving entities under common control.

As a result, approximately $13M in debt still remains on HEHCo's financial statements, rendering the intended purpose of Report FCS20092 / LS20030 to eliminate all of the debt related to the restructuring on HEHCo's financial statements incomplete.

To achieve the intended purpose of eliminating all of HEHCo's debt related to the restructuring, the following steps should be undertaken:

1) The City will subscribe for and be issued additional shares in HEHCo in an amount equal to the outstanding debt related to the restructuring that remains on HEHCo's financial statements;

2) The City will pay for the additional HEHCo shares via wire transfer;

3) HEHCo will pay the outstanding debt owed to HUC via wire transfer using the aforementioned funds received from the City;

4) HUC will declare a dividend to the City in the amount received from HEHCo for the aforementioned debt repayment; and

5) HUC will pay the dividend to the City via wire transfer.

Staff are seeking the necessary approvals to complete the process started in December 2020 by converting the remaining HEHCo debt into additional equity held by the City. Approval of the recommendations in this Report will grant staff the delegated authority to execute the necessary agreements and documents from the City's perspective. HEHCo and HUC will each require a shareholder meeting and a board of directors meeting to grant the necessary corporate approvals and effect the necessary transactions.

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(S)

The intent of Report FCS20092 / LS20030 was to eliminate all the debt related to the restructuring on HEHCo's financial statements. This goal was not accomplished since approximately $13M in debt related to the restructuring remains on HEHCo's financial statements. The steps outlined above are, therefore, necessary to accomplish the intended purpose of Report FCS20092 / LS20030 and conclude this matter.

Additionally, the HUC Shareholder Declaration states that, generally speaking, HUC is to have no business except that which relates to Alectra. By continuing to hold receivables attributable to the HEHCo debt HUC is in contravention of its Shareholder Declaration and steps should be taken forthwith to bring HUC into compliance. Providing staff with the delegated authorities outlined in the recommendations of this Report will allow staff to take such necessary steps.

ALTERNATIVES FOR CONSIDERATION

If Council does not support the recommendations in Report LS20030(a) / FCS20092(a), then approximately $13M of debt owed to HUC will remain on HEHCo's financial statements. Since the debt is reflected as a receivable on HUC's financial statements, HUC will be in contravention of its Shareholder Declaration which requires it to have no business except that which relates to Alectra.

APPENDICES AND SCHEDULES ATTACHED

Appendix "A" to Report LS20030(a) / FCS20092(a) – Report FCS20092 / LS20030

Appendix "B" to Report LS20030(a) / FCS20092(a) – Organizational Chart RE: City-owned Energy Companies