

**IN THE MATTER OF AN ARBITRATION UNDER SECTION 813.13
OF THE LOCAL GOVERNMENT ACT**

BETWEEN:

CITY OF VERNON

APPLICANT/
INITIATING PARTICIPANT

AND:

REGIONAL DISTRICT OF NORTH OKANAGAN
and DISTRICT OF COLDSTREAM

RESPONDENTS/
OTHER PARTICIPANTS

**STATEMENT OF POSITION
OF THE DISTRICT OF COLDSTREAM**

PART I. JURISDICTION

1. The Arbitrator's jurisdiction under s. 813.13 of the *Local Government Act* (the "*Act*") is to resolve the terms and conditions of a withdrawal by the City of Vernon ("Vernon") from the Greater Vernon Water Service (the "Water Service").
2. The Arbitrator has no jurisdiction under s. 813.13 of the *Act* to grant the relief sought by Vernon: that is, to resolve the terms and conditions of a withdrawal by Vernon from the "local distribution function" of the Water Service.
3. In the alternative, the Arbitrator's jurisdiction is not limited by the terms of reference proposed by the Vernon. The Arbitrator can, and should, consider the issues between the parties in light of the full history of their dealings, fairness to all parties and the interests of good governance of the Greater Vernon area. Moreover, the Arbitrator is not bound by Vernon's desire to withdraw from the "local distribution function" of the Water Service. It is open to the Arbitrator to find that Vernon must choose between continued full participation in the Water Service and complete withdrawal from the Water Service.
4. It is also open to the Arbitrator to find that, as a condition of complete withdraw or partial withdraw from the Water Service, Vernon must pay for the cost of such a withdrawal and compensate the remaining participants, having regard to the facts and principles set out below.

PART II. BACKGROUND FACTS

5. Prior to 2003, there were three water utilities in the Greater Vernon Water Utility Service Area, providing water to customers in Vernon, Coldstream, Areas B&C and a small number of customers outside those three areas:
- a. the Vernon Irrigation District (“VID”), which was taken over by the Regional District of North Okanagan in 1994 and renamed the North Okanagan Water Authority (“NOWA”); VID, later NOWA, served almost all of the irrigation customers and approximately 5,000 domestic customers within Vernon, Coldstream and Areas B&C; the primary water source of the VID/NOWA was Duteau Creek;
 - b. the City of Vernon Water Utility, serving primarily domestic customers within Vernon; the primary water source of the Vernon Water Utility was Kalamalka Lake (“Kal Lake”);
 - c. the District of Coldstream Water Utility, serving primarily domestic customers within the District of Coldstream; the primary water sources of the Coldstream Water Utility were Kal Lake and a well.
6. In 2002, each utility had a domestic customer base as follows:

	Residential	Industrial/ Commercial/ Institutional	Total
City of Vernon	11,980	720	12,700
District of Coldstream	1,905	20	1,925
NOWA	5,163	112	5,275
TOTAL	19,048	852	19,900

The NOWA domestic customers were split amongst several political jurisdictions approximately as follows:

City of Vernon	1,600
District of Coldstream	1,000
Areas B & C	2,500
Area D	25
Spallumcheen	150

7. The vast majority (99.4%) of irrigation water supplied to the Greater Vernon Water Service Utility Area came from NOWA. A small percentage of this irrigation water (less than 10%) served the Bella Vista area of Vernon. The remainder serviced Coldstream and Areas B&C.
8. Irrigation customers have different needs and priorities from domestic customers. Irrigation demand fluctuates more through the year and from year to year. Summer irrigation demand on the NOWA utility was approximately 15 times what it was in the winter. Domestic use also increases during the summer, but only by a factor of about two. Price stabilization and supply were priorities for the irrigation customers, while water quality was a priority for the domestic users.
9. Throughout the 1990s, the Province provided considerable support and encouragement to the parties to achieve a regional water authority. There were compelling reasons for a regional water authority, combining the three utilities:
 - a. The Province had provided NOWA with a mandate to establish a regional water authority and indicated that all new licensing in the Greater Vernon Water Utility Service Area would be provided to NOWA.
 - b. Vernon owned a limited number of water licences on Kal Lake, and without access to additional licence capacity, Vernon could not supply additional water for new development.
 - c. Coldstream and NOWA owned water licences on Kal Lake and Duteau Creek which could benefit Vernon's current and future needs.
 - d. The water from Duteau Creek, NOWA's primary source, was of poor quality and, although suitable for irrigation, not well-suited for domestic use. NOWA at first continued but later refused to continue a policy of the VID that had permitted VID/NOWA customers in Vernon to convert from Duteau to Kal Lake water.
 - e. All parties recognized that water quality improvements were needed and would soon be mandated by the Ministry of Health.
 - f. Vernon and Coldstream recognized that having different water utilities within the two municipalities was both inefficient and confusing for customers.
 - g. Areas B&C recognized that their expanding domestic customer base would require water quality improvements on an affordable basis while maintaining competitive rates for their agricultural customers.

	Vernon	Coldstream	NOWA	TOTAL
Surplus at 2001	\$ 34,273	\$ 424,594	\$ 00.0	\$ 458,867
Capital Reserve	885,956	398,160	435,882	1,719,998
DCC's	1,946,598	131,923	201,849	2,280,141
Total Debt	<u>(4,233,442)</u>	<u>(101,580)</u>	<u>(760,000)</u>	<u>(5,095,022)</u>
Net Position	\$(1,366,844)	\$ 853,097	\$ (122,269)	\$ (636,016)

15. Vernon has benefitted significantly from its participation in the Water Service, including:
 - a. development in areas that could not have been supplied with quality water without access to a regional water supply;
 - b. additional taxation revenue and development cost revenue;
 - c. employment and economic benefits;
 - d. an extended operating contract for the water supply system and the distribution system for Vernon and Areas B & C.
16. Pursuant to the Master Water Plan, a number of capital works were initiated and a borrowing bylaw was passed in 2004. The costs of these capital works have been shared equally by the participants, and have required substantial and continual increases in rates between 2003 and 2009.
17. Since 2003, a treatment plant and a major reservoir have been built and the pump station on Kal Lake has been expanded. These completed capital works have been substantially to the benefit of Vernon with only very minor benefits to date to other jurisdictions. A proposed treatment plant on Duteau Creek, which would primarily benefit Coldstream and Areas B&C, has been started but not yet been completed.
18. The current Water Service is robust, fair and efficient. The Water Service supplies and distributes water in accordance with the agreed upon principles, in a manner which is in the best interests the region as a whole and promotes sustainable water quality and conservation.

PART III. STATEMENT OF ISSUES /
COLDSTREAM'S OBJECTIONS TO VERNON'S PROPOSAL

A. Increase in Distribution Costs

19. The model proposed by Vernon will result in a decrease in the distribution cost to the ratepayers of Vernon and an increase in the distribution cost to the ratepayers of Coldstream which is manifestly unfair. If Vernon is permitted to withdraw from the distribution function of the Water Service, a long term mechanism must be established to mitigate this cost shift.
20. Domestic customers in all three jurisdictions currently pay a uniform rate based on a minimal fixed base rate plus a volume charge of approximately 80 cents per litre. Under Vernon's proposal, the three new distribution utilities will pay the supply utility a single bulk rate based on volume, and then establish water rates for the customers within their respective jurisdictions.
21. The cost of continuing the current policy of stabilizing irrigation costs, which is essential to the survival the region's agricultural industry, will be borne in a disproportionate manner by the domestic users in Coldstream and Areas B&C. This is because Coldstream and Areas B&C have the majority of the agriculture within their jurisdictions, and comparatively little residential and industrial / commercial / institutional base to offset agricultural costs, whereas Vernon has a large residential and industrial / commercial / institutional base and very little agriculture.
22. The model proposed by Vernon will also be unstable, both for the supply utility and for the Coldstream and B&C distribution utilities. This is due to fluctuating irrigation demand, year to year and season to season. For Coldstream and B&C, irrigation water use will be in excess of 80% of the total. Fluctuations of up to 50% each year can occur in irrigation use. Non-irrigation use, on the other hand, is relatively stable. Thus the impact of seasonal and year to year fluctuations on supply and price will be felt disproportionately by Coldstream and Areas B&C.
23. Further, Vernon's proposal will result in Coldstream and Areas B&C paying for treated water which is of no benefit to their irrigation customers. This is because, while the Master Water Plan contemplated that irrigation and non-irrigation supply and distribution would be separated, so as to lower the capital and operating costs of treatment works for a combined system, a decision was made in 2004 to defer most of the separation projects in favour of higher treatment capacity. As a result, large quantities of treated water are currently transported to rural areas to meet irrigation needs, even through the treatment provides no benefit to the irrigation users. Coldstream maintains that the cost of this arrangement should be shared equally by all customers regardless of jurisdiction.
24. If the model proposed by Vernon is adopted, the "Devolution of Water Function from Greater Vernon Services to City of Vernon – Technical and Financial Report" relied on

by Vernon indicates that the rates for domestic customers in each jurisdiction for water would be as follows:

Vernon	\$0.73/m ³
Coldstream	\$2.18/m ³
Areas B & C	\$3.33/m ³

In dry years when agricultural demands will increase substantially, these rates could easily double for Coldstream and B&C. This is due to the fact that in the rural areas about 80% of the water consumed is for irrigation and the domestic rates would have to cover for this leveraged impact under Vernon's proposed model.

25. If Vernon is permitted to withdraw from the distribution function of the Water Service, a more equitable rate structure must first be established, or else a long term mechanism must be established to mitigate the higher rates paid now and into the future by the customers of Coldstream and Areas B&C.

B. Relative Contributions of the Parties to the Water Service

26. When the three water utilities joined in 2003 to become the Water Service, each utility was in a different financial position. The Coldstream water utility was significantly stronger financially than the Vernon utility. At the time, it was anticipated by Coldstream that all parties would benefit over the long term from a regional utility with adherence to the principles that were agreed upon. Consideration must now be given, if Vernon is permitted to withdraw from the distribution function, to the parties' relative positions pre-amalgamation.
27. Further, Coldstream contributed water licences and supply infrastructure to the Water Service which will be retained by the combined supply utility under Vernon's proposal. Compensation must be provided for a share of these assets if Vernon is permitted to withdraw from the distribution function.

C. Separation of Assets and Responsibilities

28. Vernon's proposal for the division of assets based on an assignment of assets to the bulk supply or local distribution systems is overly simplistic. Since the original systems comprised both supply and distribution, and upgrades have since been made at a regional level, it is very difficult if not impossible to separate in a fair and equitable manner what is supply and what is distribution.
29. Determination of responsibility for repair or water quality control based on a supply/distribution distinction is also difficult and not necessarily workable or efficient at an operations level.

30. The cost of separating supply assets from distribution assets and of reorganizing the Water Service at an administrative and operation level into a supply-only utility should be borne by Vernon. If these costs are absorbed by the new supply utility and passed on the distribution utilities, they will be borne disproportionately by Coldstream and Areas B&C, for the reasons set out above.
31. The start up costs for all three new distribution utilities should also be paid by Vernon.

D. Water Management Issues

32. Governance of the supply utility is a serious issue to be resolved if distribution functions are devolved to three separate jurisdictions.
33. Consistency in water management practices by the distribution utilities is also a serious matter where those practices may affect the water supply utility. Examples of this would include timing for irrigation turn ons and turn offs, implementation of restrictions during drought conditions, and backflow prevention (especially with distribution lines serving multiple jurisdictions). The successful management of these issues will depend on the separate distribution utilities setting standards and following practices, along with adopting bylaws, all matters outside the control of the water supply utility.

E. Lost “cushion” of available water supply

34. In 2002, water demands were approximately 60% irrigation, 40% non-irrigation. It is estimated that irrigation demands will not grow significantly over the next 40 years. On the other hand, non-irrigation demands are expected to increase by 125%, such that the usage split will be inverted with non-irrigation accounting for 60% of demand within the next 40 years. Due to the rural nature of their jurisdictions, only a small fraction (less than 20%) of this growth in domestic demand will be contributed by Coldstream and Areas B & C.
35. Prior to amalgamation, Coldstream had licensing and supply capacity to meet its needs for the long term. Combining with Vernon, which utilized a portion of this available capacity as its means for growth, has now resulted in a much smaller “cushion” of excess supply for Coldstream. As a result, Coldstream will now have to share in water restrictions during drought years and the cost of expanding the supply system that it would not have suffered if it had not amalgamated with Vernon. Compensation must be provided for these losses if Vernon is permitted to withdraw from the distribution function.

PART IV. PRINCIPLES FOR ARBITRATOR'S DECISION

36. The Arbitrator's decision should be governed by the following principles or factors:
- a. The original agreed on principles at time of forming the Water Service.
 - b. The parties' respective contributions to the Water Service, including cash (or debt), infrastructure and water licence capacity.
 - c. The benefits that have accrued to Vernon from its participation in the Water Service.
 - d. The negative impacts of any restructuring arrangement on the other participants.
 - e. The need for a robust governance structure for any continued utility component encompassing more than one jurisdiction (whether it be supply only as Vernon proposes or a combined utility).
 - f. Good governance of the Greater Vernon area, including:
 - i. uniform water quality;
 - ii. water conservation and good stewardship of the resource; and
 - iii. the importance of a healthy agricultural industry.

