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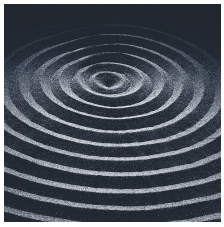

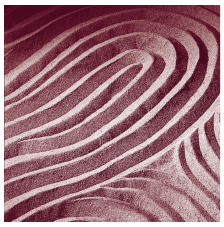

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Municipal Bonusing: What's Permitted and What's Not

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MUNICIPAL BONUSING: WHAT'S PERMITTED AND WHAT'S NOT

This paper discusses municipal "bonusing". It is divided into three parts.[1] Part 1 provides a brief, legislative history of the prohibition against assistance through the granting of bonuses, with some discussion of possible policy background for the legislation as it has evolved over time. Part 2 outlines, in relation to the current prohibition, situations where legislation expressly authorizes payments or grants by municipal government, and adds comments and points for discussion. Part 3 discusses some of the issues and challenges of meeting the requirements of the legislation within the current dynamic of municipal business and local government affairs.

PART 1: BONUSING IN A HISTORICAL CONTEXT

In spite of its etymology deriving from the Latin *bonum*, meaning "a good thing", the granting of bonuses is the subject of a general prohibition under municipal law.

Section 106 of the *Municipal Act, 2001*[2] (the "Act") sets out the prohibition as follows:

> (1) **Assistance prohibited -** *Despite any Act, a municipality shall not assist directly or indirectly any manufacturing business or other industrial or commercial enterprise through the granting of bonuses for that purpose.*
>
> (2) **Same** - *Without limiting subsection (1), the municipality shall not grant assistance by, a) giving or lending any property of the municipality, including money; b) guaranteeing borrowing; c) leasing or selling any property of the municipality at below fair market value; or d) giving a total or partial exemption from any levy, charge or fee.*
>
> (3) **Exception** - *Subsection (1) does not apply to a council exercising its authority under subsection 28(6) or (7) of the Planning Act or under Section 365.1 of this Act.*

Bonusing by a municipality is apparently not "a good thing", after all.

The Act provides no statutory definition of what is meant by the phrase, "through the granting of bonuses" or of its constituent parts. However, subsection 106(2) provides a non-exhaustive list of examples of transactions which are prohibited forms of assistance. As the examples indicate, these transactions are not limited to the payment of money, and may involve such things as guaranteeing borrowing, the giving or lending of property, or giving an exemption from a levy, charge or fee.

In addition to the exceptions expressly noted in Subsection 106(3) of the Act, Section 106 is immediately followed by a series of instances when certain forms of assistance may be provided

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[1] This paper was prepared jointly in parts by Rick Coburn, Thomas S. Melville, and Steven O'Melia, respectively, with the assistance of Maryann Besharat, Student-at-Law. The views expressed herein are those of one or more of the authors, and do not necessarily reflect the views of any other persons.

[2] S.O. 2001, c.25, as amended.

by the municipality. Some are excerpted below; the exceptions will be discussed in further detail in Part 2 of this paper.

Section 107(1): **General power to make grants** - *Despite any provision of this or any other Act relating to the giving of grants or aid by a municipality, subject to section 106, a municipality may make grants, on such terms as to security and otherwise as the council considers appropriate, to any person, group or body, including a fund, within or outside the boundaries of the municipality for any purpose that council considers to be in the interests of the municipality*.

Section 108(1): **Small business counselling** - *Despite section 106, a municipality may provide for the establishment of a counselling service to small businesses operating or proposing to operate in the municipality*.

Section 109(4): **Assistance** - *Despite section 106, a municipality may, except as may be restricted or prohibited by regulation, provide financial or other assistance at less than fair market value or at no cost to a community development corporation, and such assistance may include*,

(a) giving or lending money and charging interest;
(b) lending or leasing land;
(c) giving, lending or leasing personal property; and
(d) providing the services of municipal employees.

Section 110(3): **Assistance by municipality** - *Despite section 106, a municipality may provide financial or other assistance at less than fair market value or at no cost to any person who has entered into an agreement to provide facilities under this section and such assistance may include*,

(a) giving or lending money and charging interest;
(b) giving, lending, leasing or selling property;
(c) guaranteeing borrowing; and
(d) providing the services of employees of the municipality.

It is interesting to note that while assistance may be provided "despite section 106" in most of the above instances, the general power to grant under Section 107 is conferred "subject to section 106".

Brief Legislative History

Legislative treatment of the granting of bonuses can be traced at least as far back as 1871, when there was an amendment to the *Act Respecting Municipal Institutions of Upper Canada*, permitting municipalities to pass by-laws:

> "*for granting bonuses to any railway and to any person or persons, or company, establishing and maintaining manufacturing establishments within the bounds of*

> *such municipality, and for issuing debentures payable at such time or times, and bearing or not bearing interest, as the municipalities may think desirable for the purpose of raising money to meet such bonuses*."[3]

The authority for granting bonuses was enlarged in 1873 when the *Act Respecting Municipal Institutions in the Province of 0ntario*[4] municipalities to grant money, land or aid in the form of a bonus to specified commercial enterprises and others, including:

i. agriculture and other societies;

ii. manufacturing establishments;

iii. road companies; and

iv. indigent persons and charities.

This scheme was largely discarded in 1892[5] when parts of the provision empowering municipalities to aid manufacturers and manufacturing establishments were repealed. C.R.W. Biggar, the author of the Municipal Manual of 1900 wrote: "[a]ttempts to nourish manufacturing industries by means of the artificial stimulus of bonuses taken from the pockets of local taxpayers usually produced an unhealthy condition in the body politic and ended in disappointment and loss."[6]

To this point, the history of bonusing seems to reveal two things. Firstly, that bonuses were initially authorized as a means nourishing local prosperity through the public purse - a proclivity not entirely unique to 19th century legislators. Secondly, that through experience of disappointment such efforts came to be viewed as improvident and misguided. However, this disillusionment came gradually and did not cause the idea of bonusing to be abandoned right away.

At the turn of the century, two new bonusing regimes were introduced in the *Municipal Amendment Act* of 1900. Municipalities were authorized to grant bonuses in aid of any manufacturing industry with the assent of two-thirds of all ratepayers[7], and were also authorized to grant bonuses for the promotion of manufacturing within the limits of the municipality, provided that no by-law could be passed for a manufacturer who proposes establishing an industry of a similar nature to one already established unless the owners of such established industry gave their consent in writing.[8]

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3 O.Prov. C. 1871 (34 Vict.), c.30 at s.6.

4 O.Prov. C. 1873 (36 Vict.), c.48 at s.372(4)(5)(6) and (7).

5 *An Act respecting Bonuses by Municipal Corporations in certain cases*, O.Prov. 1892 (55 Vict.), c.44 at s.1.

6 C.R.W. Biggar, *Municipal Manual*, 11th ed. (Toronto: Carswell,1900).

7 *The Municipal Amendment Act*, O.Prov. 1900 (63 Vict.), c.33 at 9.

8 *Ibid* at s. 9.

The system of authorized bonusing introduced in 1900 also did not survive. The debates from this period indicate dissatisfaction with the results of bonusing incentives. Firstly, they encouraged unhealthy competition between municipalities. Secondly, the incentives did not produce lasting results. In 1924 the power of municipalities to grant bonuses was much reduced, being limited to the granting of a fixed assessment for up to 10 years and only for those person(s) carrying on business in manufacturing, including iron works, rolling mills, works for refining or smelting ores, grain elevators, a beet sugar factory and a tobacco drier.[9] This limited regime appears to have remained in place until 1961.

What had begun as a good thing, had eventually come to be viewed as a bad idea. A general prohibition against bonusing was finally introduced in 1962, in a form that resembles Subsection 106(1) of the current legislation. This prohibition read as follows:

> *248a. Notwithstanding any general or special Act, a council shall not grant bonuses in aid of any manufacturing business or other industrial or commercial enterprise.10*

Roughly a decade later, this outright prohibition was tempered by enabling legislation dealing expressly with a general power to make grants, the authority being made subject to the prohibition against bonusing. Section 3 of the *Municipal Amendment Act, 1974 (No. 3)* added the following provision[11]:

> *248a. Notwithstanding any special provision in this Act, the council of every municipality may, subject to section 248 [of the Municipal Act, 19701, make grants to any person, institution, association, group or body of any kind, including a fund, within or outside the boundaries of the municipality for any purpose that, in the opinion of the council, is in the interests of the municipality*.

This is obviously the precursor of the general power to make grants found in Section 107 of the Act, today.

The current language of Section 106 of the Act was largely settled in the *Municipal Amendment Act, 1986 (No. 2)*.[12]

PART 2: CURRENT LEGISLATION RELATED TO BONUSING

Economic Development

- Municipalities are generally able to promote themselves for economic development purposes, including by providing sites for industrial and commercial uses.

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9 *An Act respecting the Granting of Bonuses by Municipal Corporations*, O.Prov. 1924 (14 Geo. V.), c.56 at s. 2).

10 *An Act to amend the Municipal Act*, S.O. 1962, c.86, s.36.

11 S.O. 1974, c.136, s.3.

12 S.O. 1986, c.24, s.l.

- The relevant provisions do not include an express statutory exception to the bonusing rule (see the definition in section 1 of the *Municipal Act, 2001;* S. 11 - #10 in table; s. 111).

- Economic development services is defined as follows:

  1(1) "economic development services" means, in respect of a municipality, the promotion of the municipality for any purpose by the collection and dissemination of information and the acquisition, development and disposal of sites by the municipality for industrial, commercial and institutional uses ...

Existing Legislative exceptions to Bonusing

S. 107 *Municipal Act*, 2001 - Grants to non-commercial enterprises

- Grants may be made for any purpose "... council considers to be in the interests of the municipality...", subject to s. 106.

- "Guarantee" expressly listed in s. 107 as possible - a contingent liability - potential application of debt limit (See O.R. 403/02 - Debt and Financial Obligation Limit - recognition by treasurer of contingent liability – paragraph 4(2)4.)

S. 109 *Municipal Act. 2001* - Community development corporation (CDC)

- Note limited objects for a CDC - "... promoting community economic development ... by ... community strategic planning...".

S. 108 *Municipal Act, 2001* - Small business counselling

- A municipality can establish a local board or corporation in relation to an economic development program.

- Approvals that may be needed include: 1. LGIC (Cabinet) to establish a program; 2. Minister of Municipal Affairs and Housing approval of objects and powers of corporation; 3. participation in a provincial program.

- Of note is the limitation on the bonusing exception for assistance to a small business - three years from date premises occupied.

S. 110 *Municipal Act, 2001* - Municipal capital facilities

- With respect to the bonusing exemption, in addition to other financial assistance, a property tax and development charge exemption is available for municipalities. If an exemption is used, notice is required to the assessment corporation, to any other municipality that otherwise might be able levy taxes on the relevant property, to the Minister of Education and to any school board with jurisdiction over the relevant property.

- S. 110 and the bonusing exemption is limited to the types facilities listed in regulation (O.R. 46/94 as amended - Municipal and School Capital Facilities). These include, for example: facilities used by the council or for the general administration of the municipality; water, sewer and drainage facilities; policing facilities; and cultural, recreation and tourist facilities.

- The capital facilities that can be provided through a s.110 agreement are municipal, and the parties to the agreement can only be bonused in relation to the facilities (see 110(4)). This may be contrasted with the traditional idea of economic development bonusing of commercial or industrial enterprises.

S. 203 *Municipal Act, 2001* - Corporations

- Bonusing options are listed in the regulation (O.R 168/03, section 19), including bonusing of: s. 203 corporations in respect of public transportation and public access to cultural or recreation facilities; and of s. 203 corporations providing services to municipalities where the corporations are wholly owned by municipalities.

- Another provision in s. 19 allows for bonusing of a City of Brampton economic development corporation, through the *Planning Act* community improvement plan provisions.

S. 28 *Planning Act* - Community improvement plan (CIP)

- Two general steps are involved: 1) general planning process applies to approval of a CIP; 2) approval by Minister of Municipal Affairs and Housing of bonusing (see ss. 28(8).)

- "Grants and loans" are possible to owners and tenants of land in the community improvement project area, and their assignees (see ss. 28(7)). These can be flexible in design. There is no direct mention of a tax consequence in s. 28, but the use of a tax increment financing equivalent could be explored.

- The total costs of assistance under s. 28 and under s. 365.1 of the *Municipal Act, 2001* are limited generally to "rehabilitation" costs for lands and buildings. (See subsection 28(7.1) of the *Planning Act*.)

S. 365.1 *Municipal Act. 2001* - Cancellation of taxes

- Environmental remediation action is necessary before tax assistance is available (i.e. actions taken to reduce contaminants, obtaining of *Environmental Protection Act* certificates) for a property using this section, which is often associated with "brownfields" rehabilitation.

- Bonusing under 365.1 is through a CIP (Minister's approval - see ss. 28(8) of the *Planning Act*).

- Fixed assessment and tax cancellation options are available for the "development period" or "rehabilitation period" for a property. The provincial portion of property taxes (school taxes) may be part of the assistance.

- Not limited to municipal facilities (contrast to s. 110 of the *Municipal Act, 2001).*

- Notice to Minister of Finance is required for a proposed 365.1 bylaw. Approval of that Minister is needed with respect to application of a bylaw under this section to the school purpose taxes.

Tax Incentive Zones Act (Pilot Projects), 2002

Not used to author's knowledge.

What's New - Recent Developments

Bill 51 - Proposed amendments to the *Planning Act*

- See excerpts attached to paper - proposed ss. 28(7.l), (7.2) and (7.3).

- The new "community improvement" definition would include construction and energy efficiency.

- The existing limit on CIP bonusing would be revised. The legislation would no longer state that the total of s. 28 grants, loans and s. 365.1 tax assistance cannot exceed costs of rehabilitation. Instead, in the bill, "eligible costs" is defined in a more detailed manner, and expressly includes costs related to "... development ... of lands and buildings for rehabilitation purposes ...", as well as for the provision on energy efficient uses, buildings etc.

- See proposed ss. 28(7.1) (eligible costs) *"... the eligible costs of a community improvement plan may include costs related to environmental site assessment, environmental remediation, development, redevelopment, construction and reconstruction of lands and buildings for rehabilitation purposes or for the provision of energy efficient uses, buildings, structures, works, improvements or facilities."*

Bill 53 - Proposed new City of Toronto Act. 2005

- City council (instead of the Minister of Municipal Affairs and Housing) would be able to approve bonusing in two cases:

    - Small business counselling (would replace s. 108 of the *Municipal Act, 2001*) - see proposed ss. 112(3) - reproduced at end of paper.

    - S. 28 of the *Planning Act* - CIP - See proposed s. 84 - reproduced at end of paper.

Bill 190 - Proposed "Good Government" bill

- Amendments to s. 110 of the *Municipal Act, 2001* (municipal capital facilities).

- An amendment to the above section is proposed in Bill 190 ("Good Government" bill - Schedule O - reproduced at end of paper). It provides proposed legislative wording that a tax or development charge exemption for municipal capital facilities can be all or part of the taxes or development charges.

Questions and Considerations

The following is a list of considerations that may be of interest or relevant to the legal issue of bonusing, or to related practical matters:

- Market value transaction?

- Is a good faith contract or bargain part of the transaction?

- A commercial or industrial enterprise? (may be unclear - for example, sports teams)

- A municipal undertaking? Something done often by municipalities, such as providing certain kinds of services (sewer, water, roads) or unique?

- Is the service provided to the general public?

- Are any fees charged on like conditions for all users?

- Financial impact and risk credit rating/debt limit

- Legal risk, including application of other possibly unfamiliar areas of law - e.g. law of guarantee; corporate commercial law; powers of a Part III *Corporations Act* corporation

- If there is an issue whether or not a proposed action would constitute bonusing, can review the list of exceptions as there is a range of potentially useful options.

PART 3: BONUSING IN A MODERN MUNICIPAL CONTEXT

Given the less than clear understanding of what, precisely, constitutes unlawful bonusing, it is not surprising that many municipalities undertake activities which are arguably in contravention of that general prohibition. Municipalities in the 21st century are engaged in an intense competition to attract and retain business. Just as the "City Above Toronto" trumpets the advantages of locating within its borders (as do most of the cities and towns "beside", "close to" and even "nowhere near" Toronto), Toronto itself has a very organized and proactive economic development program that is designed to assist and encourage specific industries and commercial operations generally. In this competitive climate, it can be hard to draw the line between where the promotion of the legitimate economic interests of a municipality ends and the conferring of illegitimate advantage begins.

Despite their increasing responsibilities, municipalities continue to rely on property taxes as their principal source of revenue. Business assessment is the high-yield segment of the property tax base, and if a one-time municipal investment can encourage the establishment or retention of a long-term source of that tax revenue, conferring the necessary advantage can be viewed as a sound business decision. Similarly, if municipal participation in or contribution to a project can produce larger or more immediate benefits for a municipality's residents, it is a rare politician who first wants to endure a legal lecture on the pitfalls of the somewhat arcane anti-bonusing provisions. Municipalities are being urged by their tax-weary residents to "do more with less" and public-private partnerships, where benefits and risks are apportioned in ways unimagined in an earlier municipal context, are seen as one way of attempting to achieve that goal.

It is therefore not surprising that, notwithstanding the legislative tendency to restrict permitted forms of municipal bonusing as described earlier in this paper, most municipal councils are not averse to doing whatever is required to promote what they perceive to be the economic or social interests of their communities, even if that means flirting with breaches of the anti-bonusing provisions. These measures often go unchallenged, which tends to support the impression that bonusing has become an acceptable way of doing municipal business. However, the anti-bonusing provisions that currently appear in the *Municipal Act, 2001* have remained unchanged for close to a half century and, as a result, many modern municipal initiatives are vulnerable to judicial scrutiny.

A RECENT BONUSING DECISION

The most recent instance where a municipality was found to have lost sight of the line between progressive governance and prohibited bonusing was examined in the decision of the Ontario Superior Court of Justice in *1085459 Ontario Ltd. v. Prince Edward (County)*.[13] The County had sought to establish a broad band network capable of supporting a variety of applications, including high-speed internet service. The initial impetus for the project was the County's inability to transmit large data files between its numerous administrative offices, which were located in its various pre-amalgamation municipalities. In pursuing a solution to that problem, the County saw an opportunity to deliver a concurrent benefit to its residents.

The County was not capable of delivering a network service itself, so in order to encourage its timely development it conducted a request for proposals and selected a private sector proponent with which it entered into a contract. The contract required the contractor to construct the network at its own expense, but included a provision that the municipality would contribute an initial $115,000 towards the construction and provide financing guarantees or minimum service contracts in order to permit the contractor to secure financing for the project on reasonable commercial terms. The financial contribution was identified in the agreement as a prepayment by the County for future network services to be provided to it, and was recoverable by the County over five years through special discounted rates for its future use of the service.

After the contract had been entered into, a commercial competitor who had not participated in the RFP process sought a judicial declaration that the prepayment for network services was an

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[13] (2005) 14 M.P.L.R (4th) 1 (Ont. S.C.J.).

unauthorized municipal bonus and therefore violated Section 106 of the *Municipal Act, 2001*. In approaching the issue, Hackland J. noted that "bonus" was not a defined term and that there had been little recent caselaw dealing with the subject. Given this interpretive leeway, His Honour was of the opinion that what constituted a bonus should be strictly construed so as not to unduly limit the potential parameters of such public/private joint ventures, which the court recognized as being increasingly important in the establishment of municipal facilities.

Despite this restrictive and deferential approach, the court determined that it could not avoid the finding that the payment by the municipality conferred an "obvious advantage" on the developer and was therefore a bonus within the meaning of Section 106 of the *Municipal Act, 2001***.** The court found as a fact that the contract in issue was entered into in good faith and for a valid municipal purpose, but noted that Section 106 does not simply aim to prohibit activities carried out in bad faith, nor does it exempt all bona fide attempts to advance the interests of the citizens of a municipality.

Having determined that there had been a bonusing, the court went on to decide whether or not that bonus could be justified on the basis that the broad band network was a municipal capital facility in accordance with Section 110 of the *Municipal Act, 2001***.**[14] On this point, the court found that:

- the project qualified as a municipal capital facility both because it was a facility related to telecommunications and because it was used for the general administration of the municipality.

- the fact that the facility would be available for the use of the community as a whole and not simply the municipal government did not disqualify it as a municipal capital facility.

- the County had breached the technical requirements of Section 110 by not providing written notice of the passing of the by-law to the Minister of Education as required by Subsection 110(5) of the Act and by not restricting the use of the up-front payment as required by Subsection 110(4).[15]

- although pursuing a valid municipal purpose in good faith, the County had thereby inadvertently failed to comply with section 110 of the *Municipal Act, 2001* and was in technical violation of the Act.

Fortunately for the County, for a number of reasons unrelated to the legislation the Court exercised its discretion not to grant the declaratory relief that was sought and the application was

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[14] The prescribed categories of municipal capital facilities are set out in 0. Reg. 46/94, as amended.

[15] S. 110(4) of the *Municipal Act, 2001* provides that assistance shall only be in respect of the provision, lease, operation or maintenance of the facilities that are the subject of the agreement.

dismissed.[16] The municipality was nevertheless put to the financial and (presumably) political expense of having to defend its actions in court and, given the divided result, no costs were awarded to either party.

The British Columbia Approach

The Court in *Prince Edward County (supra)* referred favourably to the decision of the British Columbia Supreme Court in *Kendrick v. Nelson (City)*[17], which considered a very similar section of B.C.'s *Municipal Act*[18] prohibiting municipal bonusing. In that decision, McEwan J. commented on the difficulty of attempting to parse a complex set of covenants and obligations as follows:

> Unless there were an obvious aspect of "something for nothing" I see no basis on which this court can "pick the bones" of this agreement for signs of a s. 292 breach. ... This Court is in no position to ascertain the point at which the City's demands would have been unacceptable and [the developer] would have abandoned the project, or to weigh that possibility against the interests of the City in the project proceeding. These judgments are all over matters of public interest within Council's mandate and discretion.[19]

The Court concluded that the agreement was a complex attempt to coordinate public and private objectives, that there was no evidence that the private party got a "break" with respect to the servicing aspects of the arrangement, and that the anti-bonusing provisions of B.C.'s *Municipal Act* were not intended to be a mechanism for determining whether a municipality made a good deal or not, which was effectively what the petitioners were seeking. The petition was dismissed with costs to the municipality.

Summary

Both the Ontario and British Columbia decisions reviewed above reflect a judicial reluctance to substitute the courts' opinions for that of democratically elected municipal councils. This is in keeping with the modern, deferential approach to the construction of municipal authority. Both courts recognized that the anti-bonusing provisions must be applied to municipal activity and were potentially restrictive, but for different reasons declined to make findings that would undo the municipal initiatives. The reasoning of both courts illustrated the difficulty of applying old prohibitions to new methods of doing business.

In Ontario, the decision in *Prince Edward County* should serve as a reminder to municipalities that the general prohibition against bonusing is alive and well, notwithstanding other recent

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[16] The court declined to grant the remedy sought because the rights of a third party not before the court would be affected, the applicant was denied standing and the municipality had acted in good faith notwithstanding its technical violation of S. 110 of the Act.

[17] (1997), 31 B.C.L.R (3d) 134; 38 M.P.L.R. (2d) 175 (B.C.S.C.)

[18] R.S.B.C. 1979, c. 290, s. 292

[19] *supra*, note 17 at p. 193 M.P.L.R

legislative initiatives to give municipalities more authority and flexibility to conduct their business. While it is possible to work within the existing statutory framework to target benefits or incentives to a private business in a legally acceptable manner, such arrangements must be carefully structured to fit within one of the exemptions to the bonusing prohibition and care must be taken to comply with all technical requirements. Municipalities must also recognize that, even with careful planning, there will always be some risk of an adverse judicial finding if there is a party interested enough to challenge the municipal action.