

December 2, 2015

To: Members,
Executive Committee

Re: Buffalo Pound Water Treatment Plant – Governance Review and Restructuring

RECOMMENDATION

1. That the City of Regina and City of Moose cause their respective interests in the Buffalo Pound Water Administration Board (the “Board”) to be incorporated as a non-profit corporation under *The Non-Profit Corporations Act, 1995* (Saskatchewan) with the following attributes:
 - (i) four classes of memberships (Class A-voting, Class B- voting, Class C- non-voting and Class D – non-voting);
 - (ii) the City of Regina be issued 74 Class A voting memberships in the corporation; and
 - (iii) the City of Moose Jaw be issued 26 Class A voting memberships in the corporation; and
 - (iv) the corporation be named the “Buffalo Pound Water Treatment Corporation”
2. That the City Solicitor be authorized to finalize and file the Articles of Incorporation at the Saskatchewan Corporate Registry to bring effect to the incorporation as outlined in recommendation #1.
3. That the Chief Financial Officer be designated as the City’s proxy for the purposes of exercising the City’s voting rights in Buffalo Pound in accordance with such direction as may be provided by City Council from time to time.
4. That City Council authorize the Chief Financial Officer to finalize and approve the unanimous membership agreement setting forth the governance principles for Buffalo Pound (the “Unanimous Member’s Agreement”) pending the issuance of the Articles of Incorporation by the Saskatchewan Corporate Registry.
5. That City Council authorize the Chief Financial Officer to finalize and approve the terms of a long term water access agreement between the City and the Plant to ensure secured long term permanent water access for the City (the “Water Access Agreement”)
6. That the City Clerk be authorized to execute the Unanimous Member’s Agreement and Water Access Agreement after review and approval by the City Solicitor.
7. That this report be forwarded to the December 21, 2015 meeting of City Council for approval.

CONCLUSION

Since 1951, the Cities of Moose Jaw and Regina have jointly owned and operated the Buffalo Pound Water Treatment Plant (the “Plant”), which is located at Buffalo Pound Lake. Pursuant to joint venture agreement, the Plant overseen by the Buffalo Pound Water Administration Board (the “Board”) on behalf of the Cities and is owned by the Cities in approximately the following proportions (the exact ratio is subject to annual year-end adjustments and is reviewed as part of the financial statement audit):

Regina = 74%

Moose Jaw = 26%

As a result of recent concerns about the need for enhanced governance at the Plant, the Board, with the support and involvement of the Cities, undertook a detailed governance review. The objective of the review was to identify opportunities to improve governance of the Plant and to provide a foundation for potential revisions to the Plant’s structure, ownership and business model. Based on the review completed, each of the Cities and the Board have indicated general support for the conversion of the Board into a non-profit corporation proportionately owned by the City of Regina and City of Moose Jaw as this structure will ensure a modern, transparent and accountable arrangement.

In addition to the creation of a non-profit corporate structure, each of the Cities has worked collaboratively to establish a mutually acceptable governance model. Some of the principles considered were (1) the size and make-up of the Board of Directors, (2) appointment process for Board of Directors, (3) relationship of the newly formed corporation and its Board of Directors to each respective City Council, (4) the decision making authority of the newly formed corporation, and (5) dispute resolution between Cities and dealing with membership interests. Once the incorporation has been completed, the Cities will work collaboratively to bring effect to a revised governance structure as is set in the Unanimous Membership Agreement attached as Appendix “A” to this report.

BACKGROUND

The basis for the ongoing joint ownership and operation of the Plant was the 1951 agreement that established the following:

- The Plant would be built for the purpose of developing and providing a satisfactory water supply for the Cities of Regina and Moose Jaw.
- Regina would proceed with construction.
- For five years, Moose Jaw retained the right to become a participating partner to the extent of one quarter share (25% ownership).
- The Plant would be managed, controlled and operated by a Board (two members from Regina and one member from Moose Jaw).
- Each city would be able to source its entire supply of water from the Plant.
- Each city would purchase, install and maintain its own equipment (subject to the approval of the Board) to transmit water from the Plant.

- The Board shall allocate costs of any proposed improvements or extensions at the Plant to the cities “in proportion to their actual or anticipated requirements”. Each city will pay the cost allocated and the ownership shall be adjusted accordingly.
- The Board shall establish an operating budget that establishes a unit price for water sales including a premium for a capital reserve to cover the cost of replacements, improvements, and extensions to the Plant.
- If demand exceeds Plant capacity, the Board will allocate water sales to each city on the basis of their respective ownership share.
- The Board has full authority to engage services (e.g. staff) in the operation of the Plant.
- The Board would annually submit operations reports to each city and periodically make recommendations about the Plant.

Based upon the governance review completed, the Plant has operated well over the last 60 years primarily due to strong relationships on the Board and due to strong operational management. As is typical with joint ventures, the Cities provided minimal guidance to the Board as to its role and the Board therefore provided managerial oversight into Plant operations. The review identified the following issues as rationale to support strengthening the Plant’s governance and organizational structure:

- 1) A need for clarity around the roles and responsibilities of the Cities in relation to Plant governance outside of appointing members to the Board;
- 2) A need for the Cities to meet regularly to review Plant related issues and a set process to give direction to the Board on Plant oversight;
- 3) A need to structure a Board based upon relevant skill sets and qualifications;
- 4) A need to incorporate long term planning process for the Plant into the Cities’ respective planning processes;
- 5) A need to ensure that risks at the Plant level are incorporated into each Cities’ risk management program;
- 6) A need to establish formal performance management and succession planning at the Plant;
- 7) A need to establish formal reporting and accountability to the Cities other than the provision of a written annual report; and
- 8) A need to create a formal communications protocol between the Plant and the Cities.

The Administration from each of the Cities has worked collaboratively to develop a revised corporate governance structure that adequately addresses these issues. The end result will be an appropriate corporate governance structure that will modernize the Plant into a more efficient, transparent and accountable arrangement for each of the Cities.

DISCUSSION

Working collaboratively, the Cities and the Board have established the following objectives for the revised governance structure for the Plant:

- 1) To ensure that the Plant moves to a financial model that is sustainable and eliminates the cash-call to the Cities for capital renovations, replacement and expansion (currently, the Cities receive and deal with requests for capital projects on a one-off basis).

- 2) To establish a model that protects the Plant's ability to operate in a business-like manner, with a particular focus on satisfying the stewardship responsibilities of the Cities and its end-user customers.
- 3) To establish ownership rights of the Cities into the future and to confirm the relationship between ownership and consumption.
- 4) To provide the Plant with the ability to expand its services beyond the current services for the purpose of advancing the economic interests of the Cities and to contribute additional revenue (and profit).

Creation of New Non-Profit Corporation

The first step of the governance process is for the City of Regina and City of Moose Jaw to work together to create a new corporate entity under *The Non-Profit Corporations Act, 1995* (Saskatchewan). This entity will be structured to ensure there is flexibility moving forward to accommodate any governance modifications or larger changes that may be required. The attributes of the new corporation required to facilitate the desired governance structure are:

- (i) four classes of memberships (Class A-voting, Class B- voting, Class C- non-voting and Class D – non-voting);
- (ii) the City of Regina be issued 74 Class A voting memberships in the corporation; and
- (iii) the City of Moose Jaw be issued 26 Class A voting memberships in the corporation; and
- (iv) the corporation be named the “Buffalo Pound Water Treatment Corporation

The newly created corporation will be a “municipal corporation” and a separate legal entity that operates much like a subsidiary corporation with the following characteristics:

- a) operates through the governance structure that is set by the Cities;
- b) the Cities would be the controlling shareholders;
- c) the Cities (through the respective City Councils) would have control over the election and make-up of the Board of Directors;
- d) it would prepare separate financial statements that would be consolidated into each Cities' respective financial statements;
- e) unless alternative sources of funding are available, would be provided grants or loans by the Cities to operate; and
- f) although a separate legal entity with separate financial statements, the debts of the municipal corporation will be calculated against the Cities' debt limits in proportion to each .

The conversion of the Plant to a municipal corporation allows each of the Cities and the Board to obtain more transparency and certainty going forward as opposed to the current contractual joint venture arrangement which is based upon outdated and unclear agreements from the early

1950's. A municipal corporation model has been implemented effectively in a number of Canadian municipalities for similar entities with EPCOR, ENMAX and several power utility corporations in Ontario being examples. Further, the conversion of the Plant to a municipal corporation would be consistent with the recent governance and structural changes completed with The Regina Exhibition Association Limited.

Creation of Unanimous Membership Agreement

The Administration has worked with its counterparts at the City of Moose Jaw and the Board to create a mutually acceptable governance structure for the Plant. A tool that is typically used to establish governance structures for municipal corporations is a Unanimous Membership Agreement. A draft of the Unanimous Membership Agreement that has been discussed and agree to by each respective Administration is attached as Appendix "A".

The Unanimous Membership Agreement contains the following principles:

1) Corporate Mandate

The corporate mandate for the Plant has been clarified to require the Plant to reliably and efficiently provide safe, high-quality and affordable drinking water to each of the Cities.

2) Board of Directors

Currently, the make-up of the Board is 3 members, who are appointed as follows:

- 1 – appointed by the City of Moose Jaw
- 2 – appointed by the City of Regina

In order to ensure a proper variety of skill sets and experience, an increase from 3 to 5 directors is being proposed, which will be phased in over the first year of the new structure. Also it is recommended that the terms for directors be set at 3 years to ensure consistency.

3) Appointment Process for Board of Directors

Currently, each City appoints its candidates for the Board. It is recommended that the appointment process be changed to become merit-based, based upon the skills and experience that may be required by the Board to ensure that the Plant is operating in accordance with its mandate and the direction from the Cities.

The process being contemplated is consistent with the processes used by most other municipal corporations and would use of a strong Nominations Committee to recommend a list of candidates to the Cities for approval. This would be consistent with the practice used currently by EPCOR and REAL which has been highly successful in obtaining an effective Board of Directors.

Initially, the Cities will appoint an inaugural Board that will consist of the current 3 board members. During the 2016 year, the Board and the Cities will work together to establish a formal process to expand the Board to the desired 5 members through a Nominations Committee made up of 2 Board members and the City Manager from each City who will lead the recruitment process.

During 2016, the Nominations Committee will consider the needs of the Board, recruit and evaluate candidates and recommend all candidates to the Cities for appointment starting in 2017. The current Board members will be evaluated and either re-appointed or replaced as part of this process. If the Cities do not approve of the slate of candidates, then the Nominations Committee will repeat the process until a slate of candidates is approved. If a slate cannot be approved after 2 attempts through each Council, the Board will then be appointed the City of Regina, as majority membership holder rather than through a unanimous motion. This approach is consistent with the approach developed for EPCOR and REAL which is highly effective and in line with current standards.

4) Water Rates Charged on Full Cost Recovery Model

The Cities have each agreed that going forward, water rates charged should be set using a full cost recovery model that will generate sufficient revenues to cover:

- (i) operations;
- (ii) maintenance;
- (iii) indirect costs for administration, research and development, or other costs deemed by the Board and included in its budget as required for fulfilling the mandate;
- (iv) financing costs;
- (v) capital investments, including renovation and expansion to sustain existing infrastructure and capacity to meet the requirements of each of the Cities;
- (vi) other costs that are utility related; and
- (vii) a reasonable rate of return as may be approved by each of the Cities from time to time.

The Plant, under the direction of the Board would be responsible to set water rates and to manage the infrastructure at the Plant, which will ensure that the Plant can be maintained as a going concern without the requirement for one-time cash infusions. This will permit the Plant to be more proactive in business planning and facilities maintenance, which is consistent with current best practices in the industry.

Where an emergency situation exists and the Plant requires additional funds to maintain the desirable level of operations, the Cities have each agreed that they will advance such funds as may be required in an amount which is proportional to their holdings of memberships of the Plant through either (i) the advance of loans to the Plant or (ii) the provision of additional equity to the Plant.

5) Provision of Funding for Capital Renewal

A capital renewal program which was commenced pursuant to an agreement between the Cities dated May 1, 2010 for the initial \$34.2 million worth of work is ongoing but requires additional funding to be completed.

The Plant and the Board have examined all options and have recommended a combination approach using (1) “pay as you go” for 2016, 2017 and 2018 works and (2) financing by way of borrowed funds to fund 2019, 2020 and 2021 works.

The projected capital payment and borrowing requirements are:

2016 - \$1,603,788 capital contribution
2017 - \$3,392,039 capital contribution
2018 - \$5,654,252 capital contribution
2019 - \$38,205,762 borrowed and repaid over 25 years with interest
2020 - \$55,051,190 borrowed and repaid over 25 years with interest
2021 - \$36,320,512 borrowed and repaid over 25 years with interest

The Administration has included these figures within the City of Regina’s utility modelling and has concluded that the capital contributions and borrowing contemplated would be achievable within the City’s current financial and rate structures.

6) Decision Making Limits and Reporting to City Council

The conversion of the Plant into a municipal corporation means that BPWTP would be a separate legal entity from the Cities. As a result, a key part of the governance structure will be finding the appropriate balance between delegating the Board the authority to manage the business and the affairs of the Plant and the ability of the Cities to ensure that their goals are met by establishing certain boundaries.

In order to establish the necessary boundaries, the Cities each agreed that the following decision items will require unanimous approval (ie. approval from each City) before proceeding:

- a) changes to the Plant’s mandate;
- b) the Plant’s long term strategic priorities and goals;
- c) appointment and removal of the Plant’s external auditor;
- d) any transaction or series of related transactions that are outside of the normal course of business of the Plant and involve an expenditure of an amount exceeding \$1,000,000.00 (indexed), unless such transaction or series of related transactions have been approved in the annual budget for such fiscal year.

- e) the payment of wages, salaries, management fees or the making of other payments to either of the Cities other than as contemplated by the annual budget of the Plant;
- f) the increasing of annual management salaries over levels contemplated within the management compensation policy approved by each of the Cities;
- g) any sale or disposition of any plans, patents, trademarks, processes, trade secrets, licenses, distribution rights or other intellectual or industrial property of the Plant other than in the ordinary course of business;
- h) entering into any commitments or arrangements to sell or provide access to raw or potable water with any third parties;
- i) entering into, modification, extension or termination of the Water Supply Agreements with either Regina or Moose Jaw;
- j) seeking financial support or legislative changes from any level of government other than the Cities save and except for support or changes relating to operational items, changes to processes, technology or methods being used by the Plant;
- k) appointment and removal of directors and filling vacancies on the Board;
- l) disposition of the Plant's assets other than in the normal course of business;
- m) changes to the Plant ownership interests;
- n) repayment or distribution of capital invested in the Plant;
- o) making representations, warranties or promises of any financial incentives or similar inducements to third parties that may be binding on the Cities; and
- p) anything related to debt or borrowing.

7) Financial Reporting

Another key element to the revised governance structure will see each City receive more regular reporting from the Plant, on a quarterly basis. The recommended approach is for the Plant to provide an annual written report to each City and to hold two (2) meetings with the Cities each year (in April and October) to report on operational and financial performance.

8) Dispute Resolution and Dealing with Membership Interests

As the Plant has two owners, there is the potential for disputes to arise. The Unanimous Membership Agreement provides numerous dispute resolution mechanisms so that the Cities can be confident any disputes will be resolved in a timely fashion and not hold up ongoing operations.

The recommended approach uses an escalating dispute resolution approach, with the respective City Councils acting as the final level who attempt to settle disputes. Where an impasse still exists after a dispute has been escalated, the Cities could then elect to send the dispute to an independent 3rd party (likely an arbiter or Court) for resolution.

Another option that has been built into the Unanimous Membership Agreement is an option to purchase mechanism that would provide either City the ability to purchase the other City's ownership interest in the Plant in the event of an unresolvable dispute or a potential situation where one party wishes to sell their interest in the Plant to a 3rd party and the other does not wish that to occur. In order to ensure these mechanisms are not used lightly, the Unanimous Membership Agreement contemplates very explicit processes and timelines that must be followed. As a protection to both Cities in the highly unlikely event that a buy-out would occur, the Unanimous Membership Agreement contemplates that each City will continue to receive water access as it normally has at commercially reasonable rates and separate long term permanent Water Access Agreements will be entered into concurrently by the Plant and each City as part of the governance revisions.

RECOMMENDATION IMPLICATIONS

Financial Implications

Once created as a non-profit municipal corporation, the Plant will exist as a separate and distinct legal entity from the Cities with all contracts, collective agreements, employees and operations remaining unchanged. The revisions to corporate structure and the governance model will not affect the day to day operations at the Plant.

The conversion of the Plant into a municipal corporation would enable the Cities to have additional funding structures available to more appropriately set water rates and to fund future capital programs with increasing certainty. From a financial perspective, the goal is to have a business that is financially self-sufficient with access, if required, to funding from its shareholders in the form of additional equity, debt covenants or shareholder loans to support capital investment requirements. Further, with opportunities to pursue expanded business ventures, the Plant could generate additional revenue that could be used towards the operation and maintenance of City facilities that could result in decreased operation and maintenance costs for the City.

Environmental Implications

None with respect to this report.

Strategic Implications

The move to a more contemporary governance structure aligns well with the City's strategic priorities, particularly in the area of strengthening infrastructure, budgeting certainty and managing critical service delivery assets.

Other Implications

None with respect to this report.

Accessibility Implications

None with respect to this report.

COMMUNICATIONS

Communications to date have included extensive discussions between the City of Regina, the City of Moose Jaw, the Plant and the Board. Further communication to all parties and to Plant employees will be required once a revised governance model is approved.

DELEGATED AUTHORITY

This report must be forwarded to the December 21, 2015 meeting of City Council for approval.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'Byron Werry'.

Byron Werry, City Solicitor
Legal

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'Ed Archer'.

Ed Archer
Interim City Manager and CAO