

EPCOR Proposal for Drainage Transfer - Letter of Intent

Recommendation:

That the April 11, 2017, Financial and Corporate Services report CR_4436, be received for information.

Report Summary

This report provides an overview of the Letter of Intent that Administration and EPCOR Utilities Inc. developed for further consideration of Council regarding the transfer of the Drainage Utility assets and liabilities from the City to EPCOR.

Previous Council/Committee Action

At the January 24, 2017, City Council meeting, the following motion was passed:

That the City Manager work with EPCOR Utilities Inc. to develop a Letter of Intent with EPCOR for further consideration of Council regarding the transfer of the Drainage Utility assets and liabilities from the City to EPCOR as outlined in the EPCOR Proposal with due consideration of the following principles:

1. The public's interests must be a top priority.
2. There must be value for the taxpayers and ratepayers.
3. Provide a net advantage to the City and maintain or enhance the City's long-term financial sustainability.
4. EPCOR's existing electricity, water and other business operations will be maintained.
5. City Council will remain as regulator of drainage rates through a Performance Based Regulation, similar to water.
6. Utility customers must not be negatively impacted: EPCOR to maintain no more than the rate increases required to support the service and quality metrics in the current Drainage Services Utility plan.
7. Ensure ongoing effective asset management practices and continued commitment to current Council priorities for flood mitigation.
8. All staff impacted by the proposal will be treated respectfully and their employment statuses will be maintained.
9. Mechanisms to address and include:
 - transparency of operations
 - equivalent public involvement to current environment situation,

- public access to information
- City's right to audit (or audit by City Auditor)
- future divestment of assets requiring public hearing
- an inquiry process to ensure the regulator and public can stay involved outside the Performance Based Rates process

Report

Context

The Letter of Intent, included as Attachment 1, sets out the fundamental terms of the proposed transfer of the City's Drainage Utility assets and liabilities to EPCOR. It outlines the key steps and actions necessary to effect the orderly transfer of the City's Drainage Utility, if the transfer is approved. It also formalizes EPCOR's commitments to satisfy the principles referred to in the January 24, 2017, City Council motion.

Transfer Principles

The balance of this report explains how each of the transfer principles identified by Council is addressed. This is done through a combination of the terms incorporated into the Letter of Intent developed by Administration and EPCOR and through the findings and conclusions of the independent Grant Thornton Report (presented to City Council on November 8, 2016, as Attachment 1 of CR_3800 EPCOR Proposal - Results of the Independent Assessment).

1. *The public's interests must be a top priority.*

- City Council will continue to ensure the public interest remains a top priority following a transfer of the Drainage Utility through (1) Council's ongoing role as regulator of the Drainage Utility, (2) Council's ongoing role as the shareholder of the company that owns and operates the Drainage Utility and (3) the City's contractual rights concerning the provision of the Drainage Utility services under the franchise and other transfer agreements. Attachment 2 provides a matrix outlining the various roles of City Council.

2. *There must be value for the taxpayers and ratepayers.*

- Grant Thornton's independent analysis confirmed that "EPCOR's proposal to transfer Drainage has potential to yield net benefits to the City, taxpayers, and ratepayers."
 - The City and taxpayers will benefit from the increase in the EPCOR Dividend by at least \$20 million in the first full year following a transfer (prorated over the balance of 2017).
 - EPCOR has committed to hold the 3% annual Drainage Utility rate increase through to March 31, 2022, followed by a Performance Based Regulation application for new rates. This is below the rate increase for Drainage Utility currently projected by the City and is accomplished through operating and capital management efficiencies

that were independently reviewed and assessed as reasonable by Grant Thornton.

- The Letter of Intent provides for the orderly transfer of the Drainage Utility assets, liabilities and operations from the City to EPCOR without negative impacts on utility ratepayers or taxpayers.
 - EPCOR will pay the City \$75 million of Transition Cost Compensation over a period of time, to be determined by the City, to ensure that the City and taxpayers are fully compensated for any costs incurred by the City as a result of the transfer.
3. *Provide a net advantage to the City and maintain or enhance the City's long-term financial sustainability.*
- As noted above, the independent Grant Thornton analysis concluded that EPCOR's proposal to transfer the Drainage Utility has potential to yield net benefits to the City, taxpayers, and utility ratepayers. The net benefits were summarized by Grant Thornton starting on page 103 of Attachment 1 of CR_3800 and are quoted below:
 - **Capital Savings:** Drainage is forecast to have large \$1.9 billion capital program over the next 10 years (which can potentially increase further with additional flood mitigation investment). EPCOR's 10% capital efficiency appears to be reasonable, and can result in \$193 million in savings over the 10 year forecast period. This is a significant factor, and one which would also benefit ratepayers since EPCOR would have a lower rate base on which it would be able to generate a regulated Return on Equity (ROE) compared to other ownership alternatives.
 - **Operational Savings:** EPCOR meets the mandatory criteria of not proposing any Drainage staff layoffs. Rather it poses a number of incremental cost savings opportunities which appear reasonable. It was agreed that EPCOR would be able to introduce cost saving measures, while minimizing the impact of lost synergies, where possible.
 - **Organizational Focus:** EPCOR has matured as an organization, and has fully transitioned from the sale of its power generation business in 2009. It has shifted much of its focus on water utilities since that time. This is a fundamental change since its last Proposal to transfer Drainage in 2005.
 - **Incremental Dividend:** EPCOR proposes to use the health of its strong balance sheet to provide the City with at least a \$20 million additional dividend the first year following the transfer. We find this to be advantageous to the City and taxpayers since Drainage currently does not pay a dividend to the City, and the future state of the Drainage Utility appears to require a significant amount of investment.

- **Commitment to Hold Rate Increase:** Our quantitative analysis revealed that any owner (i.e. City, EPCOR, notional third-party) of Drainage Utility will need to increase utility rates to fund the forecast capital program. The Utility does not appear to be financially self-sufficient over the long-term with a 3% annual increase of monthly Drainage rates. However, EPCOR has committed to hold these rate increases in spite of earning a low Return on Equity (ROE) between forecast years 2017 to 2021. In addition, it is forecast to have the lowest total rate revenue increase of the scenarios analyzed when a 10.5% ROE on the equity component of the rate base is introduced in 2022.
- **Proven Regulatory Regime:** EPCOR proposes to use a Performance Based Regulation for Drainage as it does for EPCOR Water and Wastewater. Given that both EPCOR and the City (in its capacity as regulator) are familiar with this regime for Water, it is reasonable to assume that similar regulatory regime can be adopted for Drainage.
- **Transfer of Liability:** A transfer of the Drainage Utility would result in a transfer of associated environmental and property damage liabilities. EPCOR would be eligible for municipal protection offered by the Municipal Government Act through a bylaw in the same manner as those protections have been extended to EPCOR's Water Services and Wastewater Treatment businesses.
- **Control over Municipal Development:** The proposed division of Drainage Planning responsibilities means that the two areas responsible for area and detailed engineering drawing review would remain with the City. This ensures the City would have direct control over the direction of municipal development.
- **Expansion of EPCOR's Business:** In-house expertise in the full water-wastewater cycle could be leveraged by EPCOR to qualify for new full-cycle or drainage related business development opportunities. This could have a direct financial benefit for the City through further increases in EPCOR's dividend.
- **Retained Control:** The City would retain control over the Drainage Utility assets, operations, and planning through its roles as regulator and shareholder, and through Council's position as elected officials representing citizens.

4. *EPCOR's existing electricity, water and other business operations will be maintained.*

- The transfer of the Drainage Utility to EPCOR is not expected to negatively affect EPCOR's existing business operations.
- As part of the 2017-2021 Water and Wastewater Performance Based Regulation approval, EPCOR has committed to reflect economies of scale

savings in shared service costs in water and wastewater rates.

5. *City Council will remain as regulator of drainage rates through a Performance Based Regulation, similar to water.*

- Utility Committee (and Council) will continue to regulate the same key aspects of the Drainage Utility as they currently do today with rates, terms and conditions of service and major capital initiatives such as the development and implementation of a Stormwater Integrated Resource Plan.
- EPCOR will operate in accordance with the existing Drainage Bylaw until such time as a new EPCOR Drainage Bylaw is approved. This will include a mechanism whereby rates, fees and charges will be adjusted on January 1 of each year in accordance with EPCOR's commitment to limit annual rate increases to 3% (blended between the Sanitary and Stormwater Utilities) through to the end of March 2022. (Further details of the model for the proposed EPCOR Drainage Bylaw are included in Schedule B of the Letter of Intent (Attachment 1).

6. *Utility customers must not be negatively impacted: EPCOR to maintain no more than the rate increases required to support the service and quality metrics in the current Drainage Services Utility plan.*

- EPCOR has committed to hold the 3% annual rate increase (blended between the Sanitary and Stormwater Utilities) through to March 31, 2022.
- The new EPCOR Drainage Bylaw will include service quality metrics currently approved by Council for the Drainage Utility.

7. *Ensure ongoing effective asset management practices and continued commitment to current Council priorities for flood mitigation.*

- As regulator, Utility Committee and Council will be able to continue to monitor the effectiveness of the asset management practices.
 - EPCOR has committed to provide Utility Committee with annual and periodic performance reporting including progress on capital programs and audit reports as may be requested by the Committee.
- EPCOR has committed to the development of a Stormwater Integrated Resource Plan, a long-term road map that sets stormwater capital investment strategies and priorities. Development of the Stormwater Integrated Resource Plan would be overseen by Utility Committee and would be reviewed annually and updated periodically. EPCOR has agreed to be adaptable to meet the City's needs should Council or Utility Committee desire to have a different type or level of reporting with respect to the Stormwater Integrated Resource Plan and its implementation.

8. *All staff impacted by the proposal will be treated respectfully and their employment statuses will be maintained.*

The Letter of Intent reflects EPCOR's commitments to City employees concerning their transfer to EPCOR. These include EPCOR's commitment to no layoffs and honouring all existing collective agreements until such time as new agreements are negotiated.

9. *Mechanisms to address and include:*

- *Transparency of operations,*

- EPCOR's regulated utility operations are operated in a highly transparent environment.
- The rate renewal process includes extensive information provision concerning rate applications, expert reports and information request responses. It is expected that the Utility Committee will receive the same or more information concerning the Drainage Utility than it currently does.
- EPCOR will provide an annual performance report, periodic reports and audit reports as determined in consultation with Utility Committee. If Utility Committee desires to receive more information, Utility Committee can direct EPCOR to provide the required information.

- *Equivalent public involvement to current environment situation,*

- The public has the right to attend Utility Committee and Council meetings and participate in public hearings for certain bylaw amendments concerning EPCOR utility matters including rate setting. This is the same right that the public currently has as it relates to Drainage matters including rate setting.
- For significant initiatives such as the development of a Stormwater Integrated Resource Plan, EPCOR will conduct extensive community consultation and will adopt consultation and engagement principles and guidelines established through the "Council Initiative on Public Engagement" initiative. The initiative will be developed under the direction of Utility Committee with regular reporting on progress. The public will have the same right to participate in the community consultation process and any subsequent bylaw approval process that they have currently.

- *Public access to information,*

- EPCOR will participate in the City's Open Data initiative for Drainage as it currently does for Water and Wastewater.
- To preserve the public's access to Drainage information, specific information access protocols will be included in the EPCOR Drainage Bylaw that are consistent with the requirements of the *Freedom of*

Information and Protection of Privacy Act— as outlined in Schedule C of the Letter of Intent.

- In this way, the public has similar rights to access such information under EPCOR operation of the Drainage Utility as they do currently under City operation.
- *City's right to audit (or audit by City Auditor),*
- As part of the Franchise Agreement for Drainage, the City will have the right to audit the records and accounts of EPCOR relating to the Drainage Franchise Agreement.
 - The proposed EPCOR Drainage Bylaw will require an annual filing that includes an auditor's report concerning the accuracy of rate calculations.
 - The City's right to request an audit of Utility matters will be included for Council consideration in proposed amendments to Bylaw 12294 - EPCOR Rates Procedures Bylaw.
- *Future divestment of assets requiring public hearing,*
- The Asset and Liability Transfer Agreement will require City Council approval of any proposal to sell all or substantially all of the Drainage Utility assets. Council meetings must be in public unless justification exists for the meeting to be held in private pursuant to the *Freedom of Information and Protection of Privacy Act*.
 - It is in the discretion of Council to determine whether to provide for a public hearing at the time that any divestment is proposed in order to make its decision with respect to divestment. Council will also need to consider any confidentiality requirements of any proposed divestment as part of this determination.
 - In addition, the Unanimous Shareholder Agreement requires Shareholder (represented by City Council) approval of any sale or disposition of the property of EPCOR where any such sale or disposition represents a material amount of the assets or equity base of EPCOR. The Drainage assets would constitute a material amount of EPCOR and could not be sold without Shareholder approval.
- *An inquiry process to ensure the regulator and public can stay involved outside the Performance Based Regulation process.*
- EPCOR has an established process for responding to inquiries from members of Council. The dedicated single point of contact for City Council responds to inquiries within 24 hours and works with the executive assistants to provide updates to more complex inquiries. Drainage will be incorporated into this process following a transfer of

Drainage to EPCOR.

- EPCOR will agree to attend Utility Committee meetings with regular reporting on operational matters and progress on capital plans.
- Provisions granting Utility Committee and Council explicit authority to direct the provision of utility information by EPCOR, including audit reports will be included for Council consideration in proposed amendments to Bylaw 12294 - EPCOR Rates Procedures Bylaw.
- The public will have the same access to monitor and participate in Utility Committee meetings as it does currently.

Next Steps

Council will need to decide if it will authorize the transfer of the assets and liabilities of the Drainage Utility to EPCOR and provide the City Manager with delegated authority to execute all the required agreements to effect the Transfer.

If Council's decision is to transfer, then the following actions should be taken:

- Administration will work with EPCOR to complete the transaction and execute all required agreements as outlined in the Letter of Intent.
- Administration will report back to Council once the transaction has been completed.
- Administration will make recommendations to Council for revisions to Bylaw 16200 - Drainage Bylaw in conjunction with EPCOR proposing an EPCOR Drainage Bylaw.
- Administration will make recommendations to Council for revisions to EPCOR Bylaw 12294 – EPCOR Rates Procedure Bylaw.
- In order to effect a seamless transition, EPCOR and the City will begin collaboration immediately on significant operational matters such as flood mitigation and will report to Utility Committee, as required.
- EPCOR will commence reporting to Utility Committee after the Transfer with respect to the Drainage Utility.

If Council's decision is not to transfer, then the City will continue operating the Drainage Utility.

Corporate Outcomes

The City of Edmonton has a resilient financial position.

Legal Implications

As owner and operator of the Drainage Utility, the City may transfer the assets and liabilities of the Drainage Utility to EPCOR as contemplated in the Letter of Intent.

Pursuant to the *Municipal Government Act*, City Council would remain as regulator of the Drainage Utility as outlined in the Letter of Intent.

Revision or replacement of Bylaw 16200 - Drainage Bylaw is recommended to provide for terms of service and rates for the Drainage Utility in a manner more

consistent with how the water services and wastewater treatment services are regulated by City Council through Bylaw 17698 - EPCOR Water Services and Wastewater Treatment Bylaw.

Although EPCOR has agreed to provide additional reporting and respond to inquiries with respect to the Drainage Utility, in order to implement this reporting, it is recommended that City Council consider revisions to Bylaw 12294 - EPCOR Rates Procedures Bylaw.

In terms of public access to drainage information, EPCOR has exemptions within the *Freedom of Information and Protection of Privacy Act* for the parent company and subsidiaries that operate under the *Gas Utilities Act* and the *Electric Utilities Act*. It does not appear that these exemptions would apply to the Drainage Utility.

If the Office of the Information and Privacy Commissioner were to ever determine that the *Freedom of Information and Protection of Privacy Act* would not apply to the Drainage Utility, the transfer agreements will include a contractual commitment from EPCOR that it will implement and operate an access to information program that is identical to the processes prescribed in the *Freedom of Information and Protection of Privacy Act*, as generally described in Schedule C of the Letter of Intent. Using this approach, EPCOR would agree to provide access to information and apply only the exceptions to disclosure permitted by the *Freedom of Information and Protection of Privacy Act*, however applicants would not have a right of appeal to the Office of the Information and Privacy Commissioner or other independent reviewer. The Office of the Information and Privacy Commissioner can only review access to information requests for public bodies that are subject to the *Freedom of Information and Protection of Privacy Act*.

Metrics, Targets and Outcomes

Drainage Utility's 2017-18 business plan measures - which are aligned to the 2015-24 Aspirational Drainage Master Plan - are included in Attachment 3.

Attachments

1. Letter of Intent Between the City of Edmonton and EPCOR
2. Council's Role as Shareholder, Regulator and Contracting Party
3. Drainage Utility Performance Measures from the 2017 Utility Rate Filing – Operational Performance

Others Reviewing this Report

- R. G. Klassen, Deputy City Manager, Sustainable Development
- A. Laughlin, Deputy City Manager, Integrated Infrastructure Services
- C. Campbell, Deputy City Manager, Communications and Engagement
- D. Jones, Deputy City Manager, City Operations