The Role of Non-Share Capital Corporations in Providing Essential Public Services in Canada

MICHAEL GOUGH
Partner, Osler, Hoskin & Harcourt LLP, Toronto, Ontario

Introduction

Canadians rely on their government to provide a wide range of goods and services. Sometimes governments provide such services directly, and in other instances, governments use Crown corporations to act as their agents. Many Crown corporations have been mandated to achieve important public policy aims in a commercial setting. As a result, Crown corporations have come be important sponsors of economic development, providing key goods and services and otherwise strengthening the cultural fabric of the country.

In the last ten years, determined to reduce or eliminate budgetary deficits, governments in Canada have sought to devolve the provision of some services either to a lower level of government or away from government itself. At the same time, governments have sought to reduce, or at least not increase, taxation levels. These two drives have left governments with fewer funds to spend on the provisions of some essential services. Where the government has redefined policy priorities or the penury of the public purse has forestalled action, public interests previously met by the government are increasingly being met through private initiatives.

The privatization of services, particularly essential public services, long provided by the government or the transition of those services to public-private partnerships is not, however, a change that has been universally welcomed. Goods and services provided through for-profit business corporations may be more expensive since, for example, financing may be more costly in the private sector. In particular, business corporations with equity financing require profit margins to ensure return on equity to shareholders. The issue of full or partial privatization of essential public services remains contentious precisely because some believe that public interests may not always be best served by those not motivated principally by return on equity.

With this in mind, policy makers are now more often turning to another mechanism that has been successfully used in Canada and in Britain but with little recognition or public examination. Community-based non-share capital not-for-profit corporations ("NSCCs"), which in Canada are incorporated under Part II of the *Canada Corporations Act*[1] or the equivalent provincial legislation,[2] have proven to be efficient vehicles through which essential public services can be provided. Few have taken note of or otherwise studied the increased role of NSCCs in Canada, perhaps because their success has been so quiet and the transition so relatively seamless.

Despite their relative anonymity before the Canadian public, community-based NSCCs have been used with considerable success for NAV Canada, various airport authorities across Canada (such as the Greater Toronto Airport Authority), and with a variety of safety and consumer authorities in Ontario. British equivalents to NSCCs, public interest corporations ("PICs"), have been used successfully in situations where previous privatizations have failed: in managing water and sewage treatment facilities and in building, maintaining, and operating the national rail infrastructure. Ultimately, NSCCs may not be appropriate in all contexts, but governments at all levels in Canada should consider greater utilization of NSCCs for the provision of some essential public services.

Crown Enterprise in Canada

In the 18th and 19th centuries, the role of government in Canada consisted principally of raising and supporting a militia for defence. As Peter Hogg notes, this quickly changed:

> . . . even in the 19th century in the colonies, the range of governmental activity was acknowledged to be much wider, as only the state could assemble the resources needed to build the canals, railways and other public works needed for the economic development of pioneer communities. And, in the 20th century, collectivist political ideals have everywhere turned the state into a regulator of much economic and social activity and a supplier of many goods and services. The province of government is no longer clearly bounded but is, on the contrary, capable of indefinite expansion.[3]

This form of "public enterprise," whether carried out through Crown corporations or directly by the Canadian government, has been counted as one of the features distinguishing Canada from the United States. Hershel Hardin, in *A Nation Unaware*, states:

> Canada, in its essentials, is a public enterprise country, always has been, and probably always will be. Americans have, or at least had, a genius for private enterprise; Canadians have a genius for public enterprise.[4]

So pronounced is public enterprise in Canada that Crown corporations have come to be viewed as "characteristically Canadian institutions"[5] that have "strengthened the cultural fabric of the country."[6]

The 1973 Report of Ontario's *Committee on Government Productivity* noted a "significant rise" in the number of Crown corporations and agencies in Ontario since the end of the Second World War. In 1973, at the time of the Report, there were some 300 Crown corporations or agencies in Ontario alone. They accounted for 40% of all individuals employed by the public sector in Ontario.

Seventy-five percent (75%) of those Crown corporations or agencies had been created since 1960. The Committee asked itself why governments had found this structure, one outside the traditional departments or ministerial forms of organization, so attractive. The reasons included: (i) administrative advantage through reduced regulatory rigidity; (ii) greater freedom in personnel and financial administration; (iii) independence from partisan politics; (iv) greater flexibility in responding to public requirements; and (v) more flexibility in raising revenues through premiums, fees, and charges. Last but not least, Crown agencies allowed an outlet "for the sheer volume of government business, which appeared to be on the increase."[7]

Community-based NSCCs enjoy virtually all of the same benefits and attributes. Moreover, NSCCs shift the capital and operating costs away from government to entities that can as efficiently finance them and, in many circumstances, more effectively deliver those services. To determine whether community-based NSCCs merit greater use in Canada and identify the circumstances in which their use is appropriate, it is instructive to examine their current use in Britain and Canada.

Canadian NSCCs and British PICs share one key characteristic in common: they do not have shareholders who look to the corporation to earn income, whether in the form of distributions or capital appreciation. According to some, however, NSCCs and PICs are confusingly termed "not-for-profit" corporations. Paul Maltby,[8] for example, notes that a number of PICs (and NSCCs) can and regularly do generate profits. Where profits do accrue, the money is used for furthering the objectives of the corporation rather than funding distributions to shareholders. Thus, where an airport is operated by a not-for-profit corporation, for example, it will use its accumulated profits to fund service improvements and ongoing modernization, assuming costs previously borne by taxpayers. The costs of financing such initiatives fall on the immediate consumers of the NSCC's service through user fees or charges.

The British Experience with NSCCs

While PICs are a relatively new phenomena in Britain, their use in recent years has been increasing. Some commentators have even begun to suggest that the issue is not whether they are a viable alternative to state enterprises or for-profit business corporations; rather the question is how much more pervasive will the use of PICs become in light of their success. Following the successful use of PICs in connection with water and sewage services and national rail infrastructure, serious consideration is being given to their use in delivering services currently provided through the government-run National Health Service.[9] In both water and rail, the PICs operate a monopoly over an essential service. Both acquired their operating assets from unsuccessful business corporations that acquired their original assets through government privatization initiatives.

(i) *Glas Cymru (Welsh Water)*

Welsh Water is a non-share capital not-for-profit company limited by guarantee.[10] Its structure is similar to an NSCC in Canada. Welsh Water is the sixth largest of ten regulated water and sewage companies in England and Wales and serves over 1.3 million customers. It operates 83 impounding reservoirs and 105 water treatment utilities supplying an average of 900 million litres of water each day. Today, Welsh Water has assets of £15 billion (Cdn$37.2 billion).[11]

Welsh Water was originally privatized in 1989. Cashflow for the new owner quickly turned negative. The cost of financing assets in the latter years was absorbing approximately one third of revenues. Shareholder investors had concerns about "regulatory and political risk." Their concerns were shared by lenders, reflected in the high cost of capital. Welsh Water acquired the business in April 2000 from the private-sector operator at a purchase price of £2 billion ($4.98 billion). The purchase price was financed entirely by debt. The debt, in ten traunches, was rated from A/Aaa through BBB/Baa2.[12] The favourable ratings arose in large part from the stable and predictable regulated revenue stream derived from the monopoly water and sewage franchise owned by the corporation.

Welsh Water is a single purpose entity established with a mandate to provide services to its customers at competitive rates. The success of this PIC is related in no small way to its success in cutting the cost of financing assets and investments. Annual water rates, once the highest in England, are now close to the average. In 2003, the company increased its financial reserves to £420 million ($1 billion) and its profit before interest and tax was £187 million ($463 million).[13] Unlike NSCCs in Canada, "companies limited by guarantee" in England and Wales are taxable.

Welsh Water has a board of nine directors, all of whom are members of the company. Six of the nine board members, including the chairman, are non-executive officers.[14] The board of Welsh Water has a nominating committee that is responsible for identifying and nominating candidates for appointment as directors by the board. The committee also makes recommendations on whether to re-appoint directors whose terms are due to expire. Directors, once nominated, are approved by the board for submission to the "members" who elect the directors at their annual meeting.[15]

The "members" of Welsh Water, who are currently 50 in number, serve a function similar to shareholders in an ordinary corporation. Instead of taking an equity position in the company, the members of Welsh Water are appointed by the board using a set procedure.[16] Members are initially sought out by the board placing advertisements in appropriate media and by asking suitably qualified or representative bodies, groups, or organizations to promote awareness of membership amongst individuals associated with them. Membership applications are received and reviewed and then passed on to the chair of the

Membership Selection Panel of the board. Once screened, the panel assesses applicants against the company's published criteria for membership, especially with regard to the qualities and experience of the potential member, his or her independence and personal integrity, and his or her ability to contribute to the affairs of the company. The panel then sends its report to the full board with its membership recommendations. Members receive no compensation, but they are reimbursed for expenses incurred in carrying out their duties. Should it become apparent that the 50-person membership does not adequately represent all significant stakeholders in the community, the company is authorized to appoint up to 200 members.

Members, like shareholders, scrutinize Welsh Water's performance against commercial and other targets as well as against water industry benchmarks for quality of service and cost efficiency. Members play a role in corporate governance by participating in members' conferences and general meetings of the company. In addition, the members approve certain major transactions or changes to the company's constitution, the appointment of directors, and the appointment of the company's auditors.[17]

In a case study of Welsh Water, Maltby identified four ways in which the corporation has successfully managed its business.[18] First, it is operated as a single-purpose company, and its constitution prevents it from diversifying into non-regulatory activities. Second, it embarked on a substantial program of a competitive outsourcing, with over 80% of its annual expenditure carried out by third parties, thereby transferring risk onto external private companies. Third, it rewards good management through bonus schemes that focus on increasing financial reserves, improving customer services, and reducing environmental impact. Finally, the company displays strong corporative governance. A majority of its board consists of non-executive members. Behind them are 50 community-based members who hold the board to account.

Welsh Water is subject to the regulatory authority of the Office of Water Services. Unlike some community- or consumer-based NSCCs in Canada, such as NAV Canada, the fact that the interests of consumers and service providers are aligned through the membership in the corporation has not done away with the need for public regulatory oversight. This may be due primarily to the fact that, where the ultimate consumer of the service is the general public as opposed to a relatively small group of sophisticated consumers (as in the case of NAV Canada), a public regulatory oversight may remain an economic or political necessity.

(ii) *Network Rail*

Like Welsh Water, Network Rail is a non-share capital not-for-profit company limited by guarantee. The board is accountable to its members, who do not receive dividends or share capital. All of Network Rail's profits are reinvested in the maintenance and upgrading of rail infrastructure. Membership in Network Rail is drawn from a wide range of industry partners and interested parties, including members of the public. The board of directors oversees the conduct of the business and affairs of the company and is directly accountable to the members. Network Rail is financed entirely through debt.

Network Rail is the engineering company that was formed to revitalize Britain's railways. It is responsible for maintaining and upgrading all aspects of railway infrastructure including track, signalling systems, bridges, viaducts, tunnels, level crossings, and stations. The company does not operate a train service, but its main customers are the train and freight operating companies that do.[19]

Network Rail was formed in late 2002 to acquire Railtrack, a for-profit publicly traded business corporation that purchased its rail assets on a privatization initiative concluded by U.K. government in 1996. The privatization was much less successful than hoped for. As Maltby notes:

> In the years after the privatization, owners enjoyed a boost in the share price which rose from £3.80 to a high of £17.68 in November 1998. These profits were augmented by management's reluctance to invest resources in the long term health of the network (by May 1997 Railtrack was £700 million behind on its railway investment and maintenance program, [a situation] described by the rail regulator as 'wholly unacceptable'). Instead attention was focused on making the most of Railtrack's significant property portfolio, which offered more lucrative short term potential for profits. Reluctance to invest in rail repairs was compounded by the engineering subcontracting regime which left managers at Railtrack with little knowledge over what work was being carried out, and its quality.[20]

The result of the failure to invest in or upgrade facilities sadly produced a series of train derailments and crashes that claimed a number of lives. During this time, government subsidies to the company had steadily increased even while the share value of Railtrack decreased. In January 2001, the UK Institute for Public Research recommended that a non-share capital public interest company should replace Railtrack. The government acted on this recommendation and Network Rail came into existence in 2002.[21]

The composition of the board of Network Rail and of the membership is intended to ensure that the broadest possible spectrum of interests are served by the company and that good governance practices are maintained. The board of Network Rail comprises 12 directors, seven of whom are non-executive.[22] The board has a nominating committee that is charged with seeking out suitable board candidates, and in pursuit of this, it uses the services of an international search firm to help identify appropriate board candidates.[23] In terms of company membership, two categories exist: industry members and public members. The policy and procedure for appointing members is similar to that used by Welsh Water.[24] Overall, the dual membership structure ensures that company management is held accountable by 40 industry members and 60 "public interest" members, along with the Strategic Rail Authority, the government's arm's-length rail advisor which ensures that public subsidy is appropriately spent.

Given its critical importance to commuters and travellers and given the size of its annual public subsidy, Network Rail is also subject to the authority of the Office of Rail Regulation, the railway industry's economic regulator. Its principal function is to regulate Network Rail's stewardship of the national rail infrastructure. While the limited number of rail operators could be seen to be Network Rail's consumers, the regulatory regime treats passengers as the ultimate consumer.

The Canadian Experience with NSCCs

(i) *NAV Canada*

NAV Canada was incorporated on May 1995 as a non-share capital not-for-profit corporation under Part II of the federal *Canada Corporations Act*. It thereafter purchased the Canadian Civil Air Navigation System from the Government of Canada for $1.5 billion, which money was raised through debt financing.[25] Having acquired these assets, NAV Canada is able to generate income by imposing and collecting consumer service charges for its air navigation system services in accordance with the legislative charging principles. The corporation relies solely on its customer service charges for operating expenses and debt service. To ensure that these activities are properly managed, four members appoint directors to the NAV Canada board: the airlines (four directors); the federal government (three directors); the unions (two directors); and business and general aviation (one director). The board also includes four independent directors in addition to the President and CEO.[26]

Previously air and navigation services in Canada had been provided directly by the federal government through Transport Canada. The service was and remains crucial as almost all aircraft, whether carrying passengers or cargo, depend on the air navigation system for their safe movement. While determining that it would remain responsible for airport policy, regulation, and safety and security matters, the government took the decision to devolve the day-to-day responsibility for air navigation to NAV Canada as part a decision to privatize the operation of Canada's major airports.

On top of $1.5 billion paid to the federal government for the transfer of the air navigation system, the corporation has invested or committed close to $1.0 billion in new systems and technology since 1996.[27] All of this was financed by debt. The strength of NAV Canada's revenue stream has left it with an exceptionally high credit rating. At the same time that this is true, the service charges paid to NAV Canada by its customers, the airlines, are 28% below the level that they were at when collected from passengers using the old air transportation tax. The efficiency of NAV Canada has been such that, in 2001, it won the prestigious Eagle Award as the world's best traffic control system from the international user group IATA.[28]

Duncan McCallum, in writing about Consumer Service Corporations, ascribes NAV Canada's success to six factors: (i) The concentration of consumer-appointed directors ensures that management is motivated to seek new efficiencies and better ways to serve its customers. (ii) The objects of NAV Canada are narrow and simple – to deliver effective and efficient air traffic controlling in Canada and in the international air space delegated to Canada. It is a single purpose corporation. (iii) At the regulatory level, NAV Canada's governing legislation trusts users to take care of themselves; there is no direct rate regulation. (iv) The Government of Canada can veto any material changes to NAV Canada's corporate structure and can direct NAV Canada in several key areas, specifically safety, service to remote regions, and compliance with Canada's international obligations. If NAV Canada is wound up, all remaining assets revert to the Government of Canada. (v) The board is structured so as to minimize conflicts of interest: NAV Canada's directors may not be politicians, civil servants, union officials, or officers or employees of a major consumer or supplier. (vi) NAV Canada has direct control over its operations, and it has a strong internal management team for both operating and capital activities.[29]

(ii) *Greater Toronto Airports Authority (GTAA)*

The GTAA was incorporated in March 1993 as a non-share capital not-for-profit corporation under Part II of the *Canada Corporations Act* to operate and develop a regional network of airports in the Greater Toronto Area. The GTAA acquired Pearson International Airport from the Government of Canada under a 60-year ground lease with an option to renew the lease for a further period of 20 years. The ground lease includes all airport land, buildings, structures, roads, and bridges. In a subsequent transaction, the GTAA also acquired Terminal 3 of the airport from Terminal 3 Development Corporation and Terminal 3 Limited Partnership for a purchase price totalling $855 million.[30]

As part of its agreement with the federal government, the GTAA has undertaken a substantial airport development program involving new runways, the replacement of Terminals 1 and 2 with a new single terminal building, as well as maintenance and repair of existing airside terminal and groundside facilities. To fund the improvements and the acquisition of Terminal 3, the corporation went to the capital markets and borrowed the requisite funds. The GTAA utilizes revenues obtained from airline rates and charges, terminal concessions, rental revenues, parking revenues, and commercial vehicle fees to operate and to service the debt. The GTAA also has the power to levy per passenger facility charges. Currently, these charges are set at $12.00 per departing passenger and $8.00 per connecting passenger.[31] The GTAA sets its annual aeronautical rates and charges to cover projected operating costs on a break-even basis for each year after taking into account projections for traffic levels and non-aeronautical revenue.[32]

The business operated by the GTAA is a natural monopoly in the region as entry by competitors is unlikely owing the amount of space required, airspace concerns, and environmental impact issues. In return for the airport concession, the GTAA pays the federal government rent. The largest component of this is base rent, which reflects the money that Transport Canada would have received had it continued to operate the airport prior to improvements.

Ensuring accountability within the context of this monopoly is achieved through the composition of the GTAA's membership, which is drawn from the community. The 15 members also serve as the corporation's board of directors. All directors are non-executives of the GTAA. Each of the Regional Municipalities of York, Halton, Peel, Durham, and the City of Toronto are entitled to nominate a director. The federal government and the government of Ontario are entitled to appoint two directors and one director respectively. In addition, four directors are appointed by the board from a list of candidates nominated by a pool of nominators composed of the Law Society of Upper Canada, the Association of Professional Engineers of Ontario, the Institute of Chartered Accountants of Ontario, the Toronto Board of Trade, and the Boards of Trade and Chambers of Commerce in the Regional Municipalities of York, Halton, Durham, and Peel. The board itself is entitled to appoint three additional directors.[33]

The method of selecting directors is somewhat similar to the method used in the selection of new members by Welsh Water and National Rail. At the GTAA, the corporate secretary, at least 90 days prior to expiry of the term of a member, requests the Corporate Governance Committee of the board to assess the requirements of the board. Those entitled to nominate members to the GTAA are solicited for the names of candidates who meet the description of the knowledge, skills, and expertise then required by the board as determined by the Corporate Governance Committee. If the committee determines that some or all of the candidates proposed by the nominator do not have the knowledge, skills, and expertise required by the board or receives the names of less than three candidates, then the nominator and the Corporate Governance Committee are required to cooperate to identify other candidates who are resident or employed within the jurisdiction and who meet the skills needs of the board. Once the Corporate Governance Committee has identified an appropriate candidate, it recommends him or her to the board.[34]

In recommending a candidate for appointment or reappointment by the board as a member, the Corporate Governance Committee is required to have regard to the knowledge, skill, and experience specified by the board. This may include experience in the fields of law, engineering, accounting, management, and air transportation industry management. The committee is required to ensure that at least one financial expert is a member of the board. This process of selecting members, who then are elected directors, ensures that the board of directors of the GTAA is representative of the community and that the individuals nominated to the board have the appropriate skills needed by the GTAA at the time of nomination.[35]

All of the airport authorities designated by the federal government to operate Canada's major airports are required to meet certain public accountability principles, which are reflected in an airport authority's by-laws and ground lease. These public accountability principles include the requirement that an airport authority be a not-for-profit corporation incorporated under the *Canada Corporations Act* with prescribed objects.[36] The principles also deal with the composition of the board and qualification of directors. The corporation is required to set out a procedure for dealing with conflicts of interest, a code of conduct, and a policy on non-arm's-length transactions. The annual general meeting of the corporation at which audited financial statements and the annual report are presented must be open to the general public. The principles also mandate the creation of a community consultative committee to provide for effective dialogue with the community on airport matters and plans and the consideration of municipal concerns.[37]

Finally, at least once every five years, the airport authority must cause a review to be made of its management, operations, and financial performance to be conducted by a qualified independent person. The terms of reference of the review include the extent to which the airport authority is operating a safe and efficient service to the public and an efficiently run undertaking in accordance with its business plans. The review must also examine the extent to which financial and management control and information systems and management practices have been maintained.[38]

Safety and Consumer Protection NSCCs

Beginning in 1996, the Province of Ontario devolved responsibility for administering safety and consumer regulations that had previously been carried out by government to several non-share capital not-for-profit corporations incorporated under the Ontario *Corporations Act*. This undertaking was implemented through the *Safety and Consumer Statutes Administration Act, 1996* (the "CSA Act").[39] This initiative was not the first time that the Government of Ontario had devolved responsibility for the administration of a consumer statute to an NSCC.

In March 1976, under the *Ontario New Home Warranties Plan Act*,[40] the Minister of Consumer and Commercial Relations designated the Ontario New Home Warranty Corporation, a non-share capital not for profit corporation incorporated under the Ontario *Corporations Act*, to be the entity responsible for administering the *Ontario New Home Warranties Plan Act*. In almost all other jurisdictions of Canada, home warranties are administered by a government department. The Ontario New Home Warranty Corporation, now called Tarion, is governed by a board of 17 directors who, with one exception, are non-executive appointees. The directors are the members of the corporation.

A majority of the members of the board are drawn from the home-building and development industry. Also represented on the board are representatives from the Ministry of Consumer and Business Services, financial institutions, the Canada Mortgage and Housing Corporation, and municipalities.

In light of the 20 years of success enjoyed by the NSCC charged with running Ontario's New Home Warranty Program, the Ministry of Consumer and Commercial Relations (as it then was) in 1996 delegated powers and duties under 11 consumer safety statutes to designated NSCCs, referred to as "administrative authorities,"[41] to administer those statutes. In speaking to the legislation during committee consideration, the Minister stated that the boards of directors would include representatives from industry, government, consumer groups, and the general public, to ensure an appropriate balance. The government would retain ultimate oversight, maintaining its role in the areas of standards setting, defining policy and monitoring industry performance. The new regime would enable "self-management and self-regulation but certainly not de-regulation." The Minister stressed that the government would continue to safeguard the public interest by retaining full responsibility for safety standards through legislation and regulations.[42]

Under the CSA Act, the Lieutenant Governor in Council may, by regulation, designate one or more administrative authorities for the purposes of administering designated legislation.[43] The CSA Act further specifies that an "administrative authority … is to be a not-for-profit corporation without share capital incorporated under the laws of Ontario or Canada." Amongst the administrative authorities established as NSCCs were the Technical Standards and Safety Authority, the Travel Industry Council of Ontario, the Ontario Motor Vehicle Industry Council, and the Real Estate Council of Ontario. The Lieutenant Governor in Council has designated the *Technical Standards and Safety Act*, the *Motor Vehicle Dealers Act*, the *Real Estate and Business Brokers Act*, and the *Travel Industry Act* as legislation to be administered by the appropriate NSCC.[44] However, before the Minister could designate an administrative authority to administer any one of these statutes, an Administrative Agreement first had to be negotiated between the NSCC and the Minister.

The Administrative Agreements between the Minister and the various authorities are lengthy and comprehensive. Among other things, they set requirements with respect to business plans and annual reports and their contents; the composition of the board and its responsibilities; financial terms (including the development of administrative fees for services to be provided by the authority) and the transfer of Crown employees to the new authority. The administrative authority is required to indemnify and save harmless the Crown from and against all claims and demands against the Crown attributable to anything done or omitted to be done by the administrative authority. The Crown gives a similar cross indemnity. Finally, the administrative authority is required to maintain comprehensive general liability insurance acceptable to the Minister in a minimum amount not to be less than $10 million inclusive per occurrence.[45]

Consumer safety NSCCs finance their operations through the fees charged for services, as well as fees charged in connection with training programs and advertisements placed in consumer safety publications. As no significant assets were transferred to them, none of these NSCC's had to go to market for debt financing.

Financing Public Interest Corporations

It is no coincidence that, in the early to mid 1990s, the federal government moved to devolve responsibility for operating Canada's major airports and its air navigation system to NSCCs at the same time that it became apparent that large expenditures of money would be required to modernize both airport facilities and Canada's air navigation system. Nevertheless, in the case of Canada's major airports, the federal government structured the devolution process so that it retained the revenue streams generated by those airports at the same levels earned before transfer. Amongst the various airport authorities in Canada, the federal government receives approximately $250 million in base rent – with almost $150 million of this coming from the GTAA alone.

It is valid to ask whether NSCCs can operate efficiently where governments seek to preserve for themselves a portion of the revenue stream from the devolved enterprises. NAV Canada, the various Canadian airport authorities, along with Welsh Water and National Rail, are all capital intensive enterprises. Can NSCCs adequately finance their capital needs on a continuing basis?

It is unlikely that NSCCs can borrow at rates that are quite as advantageous as those available to government. The most successful NSCC debt offering in Canada was that of NAV Canada, which had a AAA rating from Dominion Bond Rating Service, Standard & Poor's, and Moody's. It has, as McCallum notes, practically unlimited access to debt capital at a cost close to the lowest of any Canadian corporate issuer.[46] McCallum suggests that entities such as NAV Canada have a significant advantage because they are 100% debt financed and debt is cheaper than equity.[47]

The concept of financing without equity is now reasonably well accepted in Canada. A variety of NSCCs have raised several billion dollars and have earned strong credit ratings in doing so. Moody's Investors Services recently published a paper on NSCCs entitled *Canadian Non-Share Capital Corporations and Infrastructure Finance: High Credit Quality Despite the Lack of Equity*.[48] The paper examines debt issued by four different airport authorities and NAV Canada. Each financing has been highly successful and enjoyed high ratings. None of the entities examined benefited from a government guarantee of their debt. All of them operated without balance sheet equity and at relatively low coverage ratios. In the opinion of Moody's, there were four key structural characteristics to these NSCCs:

- effective monopoly of an essential service and high demand elasticity;
- an ability to levy and collect tariffs for fees;
- regulatory, legislative, and political framework that supports financial stability through ability to adjust tariffs and fees; and
- governing boards and management that support the execution of pricing and cost control strategies.[49]

Perhaps the most important factor for Moody's is that an NSCC must operate as an effective monopoly provider within its service area. However, NSCCs not having a monopoly can still be a high-credit quality if their debt is sized appropriately to the revenue base, or they hold a virtual monopoly over a particularly large geographic or market niche (for example, regional airports). NSCCs can also support high credit ratings if they provide an essential service that cannot be easily duplicated and one that fulfills a proven, or regulatory required, need.

The essential nature of the service is reflected in relative demand inelasticity to pricing or service charges. Moody's notes that the relative insensitivity to pricing charges must be sustainable when viewed from two perspectives: economics and politics.[50] An NSCC's considerable flexibility for raising rates is potentially limited by political and social opposition. Moody's observes that "opposition to revenue enhancement would be far greater if there was any perception that higher rates benefited equity holders rather than service users."[51] Since NSCCs are structured to operate at break-even plus a modest coverage factor, unlike for-profit entities, rate increases can be more clearly perceived as being necessary to support the continued provision of the NSCC's essential service.

Where an NSCC has assumed a responsibility that had previously been carried out by government, enabling legislating is generally required to give effect to the transfer of responsibility. Typically, Moody's notes, such legislation mandates some degree of government representation on the board of directors.[52] It notes further, however, that it is crucial that the legislative and regulatory framework ultimately operates to isolate the NSCC from undue government influence.

Moody's also observes that, to date, Canadian NSCC debt has typically included characteristics that are commonly seen in structured and project finance transactions, such as financial tests for future debt issuance, minimum continuing ratios, and reserve funds. They note that, in sizing reserve funds and coverage ratios, the nature of the NSCC's revenue stream is important. The revenue stream that can be actively changed by the issuer, such as landing fees with airport authorities, allows more flexibility than when the revenue stream is a passive one – one composed, for example, of a single dedicated fee that cannot be readily changed by the NSCC and on which volume is entirely dependant on consumer demand.[53]

Conclusion

Before considering some categories of essential public services that might be fruitfully devolved to community-based NSCCs, it is worthwhile to summarize the indicia of success where community-based NSCCs (or PICs in Britain) have assumed responsibility for the delivery of such services.

(i) The service provided must be a monopoly or "near and functional monopoly."

(ii) Demand for the service must be inelastic.

(iii) An NSCC should have its objects restricted to a single purpose.

(iv) The legislative and regulatory framework authorizing the devolution of authority to deliver a public service should be as unobtrusive as possible. If consumer and producer interests are aligned, there should be minimal need for additional regulatory supervision.

(v) The assets to be transferred by the government to the NSCC should be at current carrying value. This lowers the cost of capital to the NSCC and, in turn, leads to lower rates or fees, producing a direct consumer benefit. If consumer charges are held constant, then the assets may be transferred to the NSCC at a premium to their current carrying value.

(vi) The service to be provided should be operated on a user-pay basis, and the income derived should cover substantially all of the costs involved in delivering the service. Hospitals may be inappropriate for this model: while they are community-based NSCCs, they rely heavily on transfer payments from the province to fund their services. Toll highways or airports and aviation systems are more appropriate examples.

(vii) Greater board accountability is more likely when members are recruited from the community. When membership is composed of both users and the general public, the majority of members should be drawn from ultimate users or consumers of the service to be delivered.

(viii) NSCCs should adhere to a number of public accountability principles similar to those negotiated with the airport authorities. Of these, perhaps the most important is mandating a review, at least once every five years, of the NSCCs management, operations, and financial performance by a qualified independent person. Where inefficiencies are found, members should be given the right to convene a meeting of the board of directors and the reviewer to determine the course of action best suited to resolving the problems disclosed.

(ix) A regulatory authority that oversees delivery of an essential service monopoly may be necessary when the NSCC serves a large number of consumers directly or where the service provided is politically sensitive from a health or public safety and security perspective. However, where regulatory supervision or approval of rates and fees is imposed, this tends to introduce uncertainty over whether the NSCC will be able to increase rates or fees to the appropriate level to service debt. This negatively impacts the cost of borrowing, increasing the overall debt load.

(x) Public accountability principles or an administration agreement between the government and the NSCC should provide clear direction as to the recruitment of both members and directors. The board should have a nominating committee that establishes the needs of the board and the knowledge, skills, and expertise required. If NSCCs are to be community-based, the search should be supplemented with a request to the members for the names of nominees who possess the knowledge, skills, and expertise required by the board.

In a monopoly context, it is valid to ask whether a community-based NSCC is being run efficiently. After all, by definition, no meaningful local comparables exist. Some of the NSCCs examined would respond that efficiency is measured through the quality of the board of directors, the performance of which can be confirmed through scrutiny of the enterprise's operations and financial statements. However, such evaluation criteria may not be effective where the directors are exclusively drawn from among the members of the corporation. Recruiting the best qualified candidates for senior management and compensating them accordingly has also been shown to be critical.

The question of whether a natural monopoly can achieve all of the efficiencies desired may be little different whether the corporation is a for-profit business corporation or an NSCC. Certainly five-year performance reviews of the management, operations, and financial results of the NSCC by a qualified independent examiner is important in examining efficiencies. Distributing these reports to the corporation, the members, government, and the general public can bring inefficiencies and poor management to light, and provide members from the community or government with an opportunity to bring these issues to the board of directors for resolution.

Have existing NSCCs been cost efficient and effective in carrying out their mandates? McCallum notes that, since 1996, NAV Canada resolved problems around its troubling computer system, reduced user charge rates by 28% compared to the passenger tax formerly used from the system, and substantially improved safety levels.[54] Both Welsh Water and National Rail have enjoyed similar success. McCallum also observes that NSCCs have two key advantages: first, through improved alignment of interest, they can deliver services more efficiently; and second, with no equity, they can deliver dramatically lower financing costs.[55]

What additional opportunities for community-based NSCC's exist? There are a number of federal and provincial Crown corporations that do not rely on transfer payments from government or that have significant assets that could be purchased by an NSCC through the use of debt financing, which could thereafter be serviced through user charges. At the federal level, several port corporations might qualify. Many of these are already NSCCs established under the *Canada Marine* Act.[56] Canada Post Corporation might also be a candidate.[57]

Provincially, new highways financed through user toll fees would seem to be ideal candidates. Perhaps as an alternative to privatizing Highway 407, the government might have sold this significant asset to a community-based NSCC that could have financed the acquisition through debt and serviced it through tolls. As noted earlier, the economic and political ramifications of rate increases appear considerably less when the revenue is used to service debt in an NSCC rather than pay dividends on equity.

Canada's municipalities need to spend billions of dollars to maintain water and sewage services. Currently, some municipalities borrow from the Ontario Finance Authority, an agency of the Province of Ontario, to finance water and sewage infrastructure, maintenance, and renewal. This may be more efficient from a financing and administrative point of view for smaller municipalities. However, for larger municipalities, it is possible that a community-based NSCC would be able to borrow funds at rates substantially similar to those available to municipalities or slightly above those rates at which the Ontario Financing Authority can provide funds. Since the Walkerton Inquiry, the regulatory regime around water and sewage has become much more defined. If properly structured, it is unlikely that a regulatory authority over water would be needed to ensure greater public confidence in either quality or safety. Existing regulations, if enforced, should adequately ensure this.

Hospitals are already community-based NSCCs. Almost all Ontario hospitals are non-share capital not-for-profit corporations incorporated under Ontario's *Corporations Act*. They have membership and boards drawn from the communities that they serve. However, they are unlikely candidates for significant growth through debt financing given that such a large portion of their capital and operating income comes by way of transfer payments from the Province of Ontario. Many of them currently operate in deficit. Having said this, the Toronto General Hospital several years ago undertook a highly successful (and highly rated) debt financing in connection with a major expansion of facilities.

Some institutions that might be devolved to the community-based NSCC are those that the government has previously or is currently considering for privatization. The Liquor Control Board of Ontario (LCBO) might be a case in point. While the Province could realize significant proceeds on a sale of the LCBO to an NSCC that would use debt financing to acquire those assets, the amount might not be as much as could be generated by converting the LCBO to a income trust. While an NSCC might be able to finance a purchase price yielding a premium to the Province approaching the proceeds that an income trust might generate, product price increases would likely result. What makes the LCBO a problematic candidate for conversation to a community-based NSCC is the very diverse community values that would come into play in the marketing and sale of alcohol.

The use of community-based NSCCs represents an attractive alternative to privatization. The track record for NSCCs in virtually all contexts examined has been remarkably good. Many of the advantages found by Ontario's *Committee on Government Productivity* for the growth of Crown corporations hold true for community-based NSCCs. They have fewer regulatory rigidities; there is greater freedom in personnel and financial administration; they are independent from partisan politics if properly structured; there is greater flexibility in responding to public needs; and there is much greater flexibility in raising revenues through premiums, fees, and charges. In at least the case of NAV Canada, fees and charges actually decreased. Lastly, use of NSCCs continue to remain an attractive outlet for the sheer volume of government business. Herschel Hardin[58] may well have been thinking of community-based NSCCs when he observed that Canadians have a genius for public enterprise.

NOTES

1. R.S.C. 1970 c. 32.
2. Reference in this paper is to *Ontario Corporations Act*, R.S.O. 1990, c. C38.
3. Peter W. Hogg and Patrick J. Monahan, *Liability of the Crown* (3rd ed.), (Toronto: Carswell, 2000), 333.
4. Herschel Hardin, *A Nation Unaware* (Vancouver: J. J. Douglas Ltd., 1974, 140.
5. Statement by The Hon. Herb Gray, President of Treasury Board, New Legislative Proposals for the Control and Accountability of Crown Corporations, March 1984, 2.
6. Treasury Board of Canada Secretariat: Directors of Crown Corporations, *An Introductory Guide to Their Roles and Responsibilities*, 1, < www.tbs.sct.gc.ca/ccpi-pese/iq/2_e.asp>.
7. *Committee on Government Productivity*, Report Number Nine, Queen's Printer, Ontario, 1973, 37–38.
8. Paul Maltby, *In the Public Interest? Assessing the Potential for Public Interest Companies*, (London, England: The Institute for Public Policy Research, 2003).
9. Prof. David J. Hender, *Notes on Seminar*, June 16, 2004, The Nuffield Trust: Lessons for Others: The Experience of Glas Cymru.
10. Companies "limited by guarantee" are incorporated under the *UK Companies Act, 1985* as non-share capital not-for-profit corporations. The members guarantee or undertake to contribute a stated sum to the company (usually £1) in the event liabilities exceed assets when the company is wound-up.
11. *Supra* note 9.

12. Glas Cymru “Not for Profit” business model, June 16, 2004, The Neffield Trust.
13. Glas Cymru, Annual Report and Accounts 2003/04, 20.
14. <www.dwr.cymru.com> Board of Directors, 2004.
15. Corporate Governance Reference File, Glas Cymru: *Terms of Reference for the Nominating Committee of the Board* (2001).
16. *Ibid*: *Terms of Reference for the Membership Selection Panel*, March 2001.
17. *Ibid: Policy and Procedure for the Selection and Appointment of the Members of Glas Cymru Cyfyngedis*.
18. *Supra* note 8 at 76–77.
19. <www.networkrail.co.uk.> home.
20. *Supra* note 8 at 76–77.
21. *Ibid*. at 76.
22. Network Rail Limited Annual Report and accounts 2004, 13 and 21.
23. *Ibid*. at 21–23.
24. *Policy and Procedure for the Selection and Appointment of the Members of Network Rail* (October 22, 2003), <www.networkrail.co.uk>.
25. NAV Canada Annual Information Form, 2003, 3.
26. <www.navcanada.ca>. Newsroom Backgrounder, Corporate Governance, 1.
27. *Ibid*., *NAV Canada at a Glance*, 1–2.
28. Duncan McCallum, *Ownership, Rate Regulation and Governance In Essential Service Monopolies* (Toronto), 2003, 2.
29. *Ibid*. at 2–3.
30. <www.gtaa.com>, Corporate, About Us.
31. GTAA Annual Information Form, October 31, 203 issued April 8, 2004, 4.
32. *Management’s Discussion and Analysis and Consolidated Financial Statements of the Greater Toronto Transit Authority*, March 31, 2004, 2.
33. *Supra* note 31 at 31.
34. Greater Toronto Airport Authority By-laws, Article 4: and Membership.
35. *Ibid*., Article 4.5.
36. Public Accountability Principles for Canadian Airport Authorities, Victoria Airport Authority Policy and Procedures Manual, Schedule B, Principle 2.
37. *Ibid*., Principles 4, 9, 12 and 13 at 167.
38. *Ibid*., Principle 17 at 5–8.
39. S.O. 1996, c. 19.
40. R.S.O. 1990, c. 0.31.
41. S.O. 1996, c. 19, s. 2 and 4(1).
42. Ontario Legislative Assembly Debates, June 24, 1996, Statement by the Hon. Norman Sterling to the Standing Committee on administration of Justice.
43. S.O. 1996, c. 19, s. 2 and 4(1).
44. O. Reg. 159/97 as amended by O. Reg. 24/03.

45. The Administrative Agreement between the Minister of Consumer and Commercial Relations and the Technical Standards and Safety Authority, January 13, 1997 is used for purposes of discussion in this article.

46. *Supra* note 28 at 2.

47. *Ibid*. at 4.

48. Adam Whiteman and Andrew Kriegler, *Canadian Non-Share Capital Corporations In Infrastructure Finance: High Credit Quality Despite the Lack of Equity*, Moody's Investors Services, March, 2003.

49. *Ibid*. at 1.

50. *Ibid*. at 2

51. *Ibid*. at 2.

52. *Ibid*. at 3.

53. *Ibid*. at 4.

54. *Supra* note 28 at 2.

55. *Ibid*. at 4.

56. S.C. 1998, c. 10.

57. There may be questions in the longer term as to whether Canada Post can maintain a functional monopoly over addressed letters, the only product over which they are granted an exclusive franchise.

58. *Supra* note 4.