HUU-AY-AHT FIRST NATIONS
Economic Development Structuring

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Agenda

- Introduction
- Liability Protection
- Avoiding Tax & OSR
- Corporate Structure
- Governance Structure
- Governance Structure Models
- Recommendations

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Introduction

Why we're here…

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Introduction

- Governments getting out of business
- Except aboriginal governments
- Considerations
  - Reduce liability
  - Maximize profits
    - Minimizing taxes
    - Avoid OSR claw backs
  - Separate politics from business

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Introduction

- How best should First Nations structure their economic development?
- Two components for economic development structuring for First Nations
  - Corporate Structure
  - Governance Structure
- Considerations determine corporate and governance structure

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Liability Protection

How we reduce the risk…

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Liability Protection

- Carry out economic development through a separate legal entity
- Corporations provide the best liability protection for economic development
- Creates limited liability protection
  - Shareholders only liable for what they have
    - invested in the company
    - loaned to the company

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Liability Protection

- The ability to isolate liability in the corporation is its primary advantage for First Nations economic development
- Disadvantages of a corporation
  - Corporations are taxable
  - Corporations separate from Treaty Nation
  - Loss of tax advantage
- Profits not maximized because of taxes

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Liability Protection

- Loss of liability protection – "piercing the corporate veil"
- Not using proper legal name
  - Distinctive element
  - Descriptive element
  - Corporate designation
  - Limited partnership for LPs
- Confusion over who is doing business

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Avoiding Tax & OSR

How we don't lose advantage…

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Avoiding Tax & OSR

- Maximize profits by minimizing taxes
  - Huu-ay-aht tax exemption ITA s.149(1)(c)
  - "Public body performing the function of government"
  - Subsidiaries for business on treaty lands
    - ITA s.149(1)(d.5)
    - 90% owned 90% income from on treaty lands
- Not for multiple owners or off treaty lands

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Avoiding Tax & OSR

- Using corporations off of treaty lands
  - Provides limited liability protection
  - Does not provide tax advantage
- Other structure required
- Limited partnerships can be utilized to avoid or reduce tax and maintain tax advantage

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Avoiding Tax & OSR

- OSR reduces Canada's funding contribution as a First Nation develops its own sources of revenue
- Intended to emulate provincial transfer payments from Canada
- OSR Agreement
  - 5 year exemption; +3.3%/year; maximum 50%
- Claw back time lag (claw back for year 6 calculated year 7 deducted year 8)

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Avoiding Tax & OSR

- OSR rate applied to defined own source revenues to determine annual reduction
- Variable base amount exemption
- Own source revenue subject to claw back
  - Property taxes
  - Fees and other listed revenue
  - Income from "business and property"

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Avoiding Tax & OSR

- Business and property income
  - Businesses owned directly (not through corporation, trust or partnership)
  - Dividends received from a corporation (regardless of percentage of ownership or location where corporate income earned)
  - Distributions from a trust or partnership (excluding return of capital)
  - Capital gains on the disposition of capital property owned directly and used for commercial purposes

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Avoiding Tax & OSR

OSR Revenue	$500,000
Basic Exemption	- $124,000 +/-
Net OSR Revenue	$376,000
Inclusion Rate (y10)	X 16.5%
Claw back	**$ 62,040**

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Avoiding Tax & OSR

- Dividends/distributions not subject to OSR until actually paid
- Unpaid dividends/distributions not subject to OSR
- Possibility of change in future OSR agreements

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Avoiding Tax & OSR

- Direct ownership of commercial enterprises should be discouraged
- Percentage of ownership and location where income earned not relevant to OSR (unlike ITA 149(1)(d.5) & (d.6))
- Anti-avoidance provision prevents using business and property funds for Public Services without flowing through Huu-ay-aht government

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Corporate Structure

How we achieved the results…

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Corporate Structure

- Partnership: relationship between two or more legal entities
- Governed by the Partnership Act and partnership agreement
- Limited partnership must have one general partner and one or more limited partners
- General partner: assets and liability
- Limited partner: liability protection

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Corporate Structure

- When limited liability protection lost
  - – Piercing the corporate veil and LPs
    - Not aware dealing with limited liability entity
    - Unclear on who is carrying out the business
    - Limited partner engages in day-to-day operations of the LP
  - – Consequences
    - Cast the net of liability to related entities

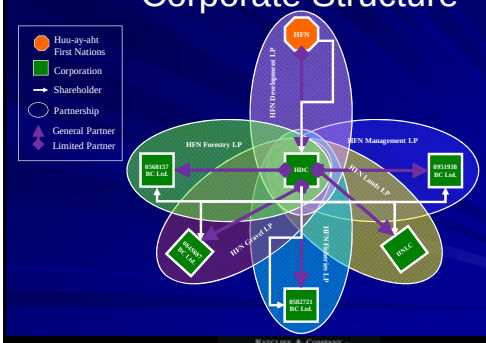
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Corporate Structure

- HFN Development LP
  - HFN as limited partner and HDC general partner
- Operating LPs
  - Forestry, Gravel, Fisheries, Lands, Management
  - HFN Development LP as limited partner and corporate general partner for each Operating LP
- Each active business conducted through its own Operating LP
  - Isolates failed business and protects successful businesses

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Corporate Structure

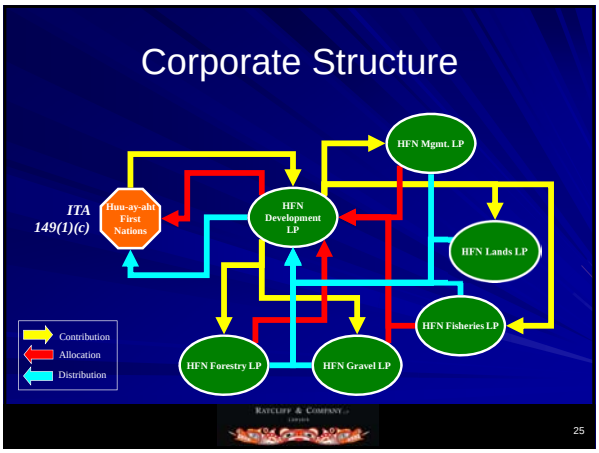


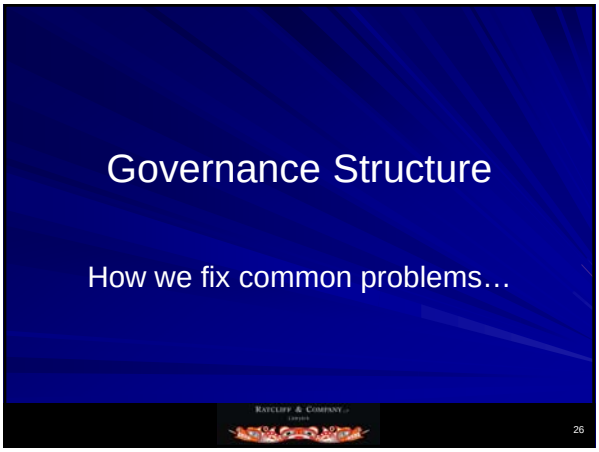
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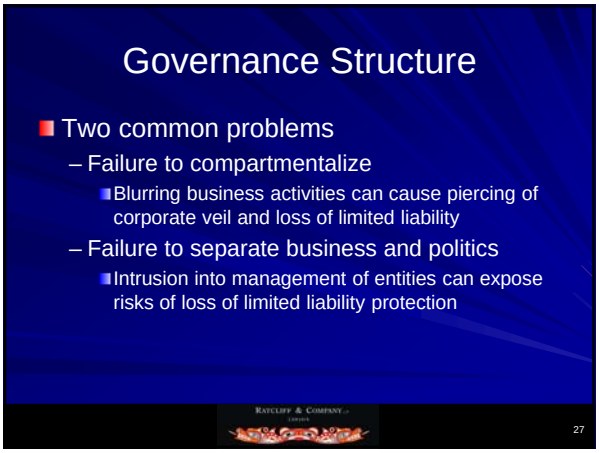
Corporate Structure

- Allocation of 99.99% of profit to limited partner for tax purposes
- Distribution does not affect allocation
- Profit
  - Retained for expansion of current business
  - Retained for investment in new opportunity
  - Distributed

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Corporate Structure
ITA 149(1)(c)
Huu-ay-aht First Nations
HFN Development LP
HFN Mgmt. LP
HFN Lands LP
HFN Fisheries LP
HFN Gravel LP
HFN Forestry LP
Contribution
Allocation
Distribution
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Governance Structure
How we fix common problems…
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Governance Structure
Two common problems
– Failure to compartmentalize
Blurring business activities can cause piercing of corporate veil and loss of limited liability
– Failure to separate business and politics
Intrusion into management of entities can expose risks of loss of limited liability protection
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Governance Structure

- What is compartmentalization?
  - Separate different business activities and their assets into separate legal entities
- Primary advantage
  - ensure protection of other businesses if one business fails or causes harm
- Secondary advantages
  - accurate and transparent reporting
  - avoids duplication

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Governance Structure

- Consequences of not compartmentalizing
  - Failure of one business may affect another unrelated business
  - Operational efficiencies harder to realize/lost
  - Less accurate financial reporting
    - Inter-company loans, accounts receivable/payable
  - Organizational confusion
  - Risk of "piercing the corporate veil"

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Governance Structure

- Business mandates
  - Specific mandates for each business can aid in compartmentalization
  - Each business should have a specific mandate and operate in that mandate
  - New businesses should be established for new mandates

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Governance Structure

- Business names
  - Business Corporations Act (BC) requirements
    - Distinctive element (i.e. "HFN")
    - Descriptive element (i.e. "Forestry")
    - Corporate designation (i.e. "Ltd.", "Corp." or "LP")
- Name branding
  - "Common branding" for related businesses
  - Importance of keeping activities separate

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Governance Structure

- Business management
  - S. 64 of Partnership Act
    - "engages in the management of the business"
      - Court cases sparse on what this means
    - Risk of loss of limited liability protection if limited partner engaged in day-to-day affairs
  - Political leadership and senior administration should not be seen to be engagement in management of Operating LPs

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Governance Structure

- HFN Management Limited Partnership
  - Eliminates duplication of services by all businesses
  - Assists in separating government administration from business administration
  - Eliminates s. 64 PA risks
  - Each Operating LP has entered into a management services agreement with the HFN Management LP

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Governance Structure

- Management services agreement
  - Covers the following services
    - Management
    - Administrative
    - Financial
    - Record keeping
    - Accounting and advisory
  - Sets out costs of carrying out the services for each Operating LP

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Governance Structure

- Harvard Project – leading research on successful aboriginal businesses
  - Two decades, hundreds of research projects
- Keys to economic development success
  - Sovereignty: asserted right to self-government
  - Capable, ethical and determined leaders
  - Integrated culture and traditions into institutions

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Governance Structure

- Strong institutions
  - Laws and policies that are clear, stable and predictable with conflict of interest rules
  - Dispute resolution processes that are efficient, independent and fair
  - Capable, professional and stable public service free from political interference
  - Competent business management free from political interference but held accountable

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Governance Structure

- Roles and responsibilities clearly defined
  - First Nation government
  - Board of directors for companies
  - Senior management of companies
- Appointments/removals must be fair
  - Directors should not be removed just because a new government is elected

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Governance Structure

- Business must be accountable to First Nation as owner
  - Shareholder common law rights
    - Financial reporting
    - Election and removal of Directors
    - Right to profits
    - Share in assets on wind-up/dissolution

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Governance Structure

- Role of First Nation
  - Vision and mission for economic development
  - Strategic planning/development objectives
  - Citizens involvement with the above
- Role of Board of directors
  - Overseeing senior management
  - Approving major operational decisions
  - Approving operational policies/procedures
  - Reporting to the First Nation

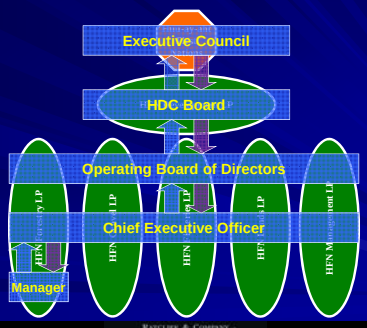
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Governance Structure

- Role of Senior management
  - Responsible for day-to-day operations
  - Human resources for businesses
  - Expenditures within approved budget
  - Accuracy of financial and accounting records
  - Advising and reporting to board of directors
- Liability protection and success requires separation of politics and business

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Governance Structure



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Governance Model 1

How we currently make decisions…

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Governance Model 1

- Financial Administration Act
  - Economic Development Committee (s.8)
    - Chair appointed by Chief Councillor
    - 3 to 5 other members
  - EDC mandate (s.9)
    - Advise Exec. Council on economic development
    - Give direction to administration and consultants
    - Identify and research opportunities
    - Monitor and review performance

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Governance Model 1

- Financial Administration Act (continued)
  - Huu-ay-aht Development Corporation (s.57)
    - Note: not HFN Development LP
    - EDC board of HDC
    - Hold HFN business interests
  - Economic development policy regulation required (s.71)

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Governance Model 1

- Economic Development Policy Regulation (EDPR)
  - Principles (s.4)
    - Business plans
    - Business case analyses
    - Reasonable expected return on investment
    - Capable management for day-to-day operations
    - Strategic direction from HFN

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Governance Model 1

- EDPR (continued)
  - Principles (s.4) (continued)
    - Partnerships considered if increased return, warranted risk shared and sustainable
    - Risks must be understood and mitigated
    - Accountability through financial disclosure and performance reports
    - Decisions must take into account limited resources and competing opportunities
  - Emphasis on strategic planning (R&D)

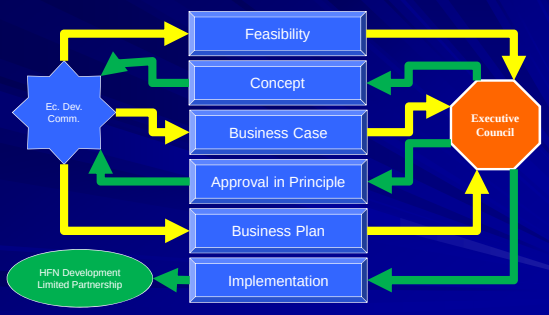
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Governance Model 1

- EDPR (continued)
  - Project stages (s.6(1))
    - Feasibility study by EDC (ss.2)
    - Concept list approved by Exec. Council (ss.3)
    - Business case by EDC – HDC resources (ss.4,5)
    - Approval in principle by Exec. Council (ss.6)
    - Comprehensive business plan by EDC (ss.7,8)
    - Approval to proceed by Exec. Council (ss.9)
    - Implementation by HDC (ss.10,11)

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Governance Model 1



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Governance Model 1

- EDPR (cont.)
  - CEO of HDC responsibilities (s.7)
    - CEO hired/contracted by HDC
    - Manage HFN businesses [PA s.64 concern]
    - Represent HFN in partnerships
    - Monitor performance of businesses
    - Report to EDC
  - Distribution (return on investment)
    - 15% for 5 years
    - 20% thereafter

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Governance Model 1

- Purchasing Policy Regulation
  - Applies to HFN businesses (s.2(c))
  - Purchases over $1,000 require 3 quotes
  - Purchases over $25,000 require open competition with an evaluation committee
- Risk Management Policy Regulation
  - Applies to HFN businesses (s.1(c))
  - Annual risk assessment and mitigation

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Governance Model 1

- EDPR (cont.)
  - Profits of HDC
    - Required dividends on shares or under shareholder agreement [OSR concerns]
    - Retained for sustainability
    - Businesses approved by Exec. Council for implementation
    - Extraordinary dividend (distribution?) – OSR concern?

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Governance Model 1

- Cash Management Policy Regulation
  - Applies to HFN businesses (s.2(d))
  - Annual cash forecast and cash management plan adjusted monthly
  - HDC responsible for all HFN businesses (s.4(3))
  - Required internal short term borrowing

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Governance Model 2

How we could make decisions…

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Governance Model 2

- Alternate governance structure model
- Based on
  - Harvard Project
  - Experience
- Designed for Treaty First Nations
  - Law making authority
  - Economic Development Act
  - Governance and Fiscal Agreement

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Governance Model 2

- Why have an Economic Development Act and Governance and Fiscal Agreement?
  - First Nation policies and procedures can be changed without Business involvement
  - Policies and procedures not enforceable
  - Policies and procedures can diverge
  - Act has force of law
  - Agreement is legally enforceable and change requires agreement of all parties

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Governance Model 2

- First Nation government responsible for strategic planning, research and development – EDA
  - Economic Development Office, Economic Development Committee, Executive Council and Council
- Business operations responsible for implementing approved business – GFA
  - HFN Development LP and Operating LPs

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Governance Model 2

- Economic Development Act
  - Mission & values for economic development
    - Operate independent of Nation's financial resources
    - Provide a reasonable return on investment
    - Operate free from political interference but be held accountable to the Nation
    - Operate in accordance with all applicable laws and plans

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Governance Model 2

- Economic Development Act (cont.)
  - Mission & values for economic development
    - Engage in economic development that is socially, economically and environmentally sustainable and respectful of the Nation's history, culture, traditions and environment
    - Maximize employment, contracting and training opportunities for Huu-ay-aht citizens and businesses
    - Institute/maintain a preferential hiring policy

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Governance Model 2

- Economic Development Act (cont.)
  - Research and development requirements
    - Feasibility studies identify new business opportunities to be approved in principle
    - Five year economic development plan
      - Sets out opportunities approved in principle
      - Updated annually
    - Business plans to implement new businesses

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Governance Model 2

- Economic Development Act (cont.)
  - Responsibilities of Nation performed by
    - Legislature
    - Executive Council
    - Economic Development Committee
    - Economic Development Officer

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Governance Model 2

- Economic Development Act (cont.)
  - Role of Legislature
    - Approve Economic Development Plan
    - Approve in principle new business opportunities
    - Coordinating citizen's input
  - Role of Executive Council
    - Recommend economic development plan
    - Recommend feasibility studies
    - Determine which opportunities in economic development plan are implemented

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Governance Model 2

- Economic Development Act (cont.)
  - Role of Economic Development Committee
    - Oversight of economic development
    - Serve as HDC board
    - Recommend economic development plan, feasibility studies and business plans to Executive Council
    - Provide information to Huu-ay-aht government
    - Provide direction to economic development officer

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Governance Model 2

- Economic Development Act (cont.)
  - Role of Economic Development Officer
    - Manage economic development office
    - Supports Economic Development Committee
    - Help prepare Economic Development Plan
    - Prepare feasibility studies and business plans
    - Provide entrepreneurial information to members
    - Negotiate new business relationships, as directed

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Governance Model 2

- Economic Development Act (cont.)
  - Business Planning
    - Economic Development Plan
      - Strategic statements and communications
      - Reports on Operating LPs and new opportunities
    - Feasibility Studies
      - Assessment of viability
      - Less detailed and costly than Business Plan
    - Business Plans
      - Comprehensive including market analysis, capital requirements, structure and return on investment

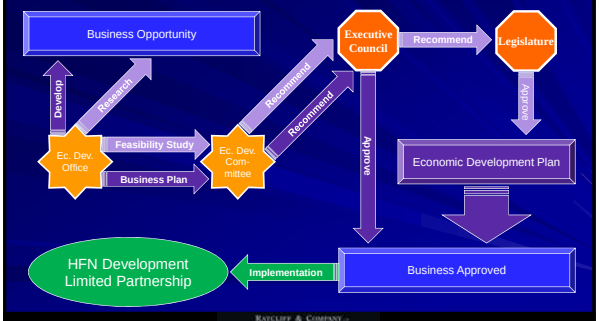
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Governance Model 2

- Economic Development Act (cont.)
  - Business Planning (cont.):
    - Process for approving and implementing new business opportunities
    - Adherence to business mandates
    - No interference by politicians or senior administration in business operations

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Governance Model 2



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Governance Model 2

- Governance and Fiscal Agreement
  - Role of Executive Council in operations
    - Appoint HDC board (EDC)
    - Approve structural changes in HFN Development Limited Partnership
    - Approve operational anomalies in HFN Development Limited Partnership
    - Approve annual plan and financial statements of HFN Development Limited Partnership

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Role of HDC board
    - Exercise common law shareholder rights
    - Appoint Operating boards
    - Approve structural changes in Operating LPs
    - Approve operational anomalies in Operating LPs
    - Approve annual plans and financial statements of Operating LPs

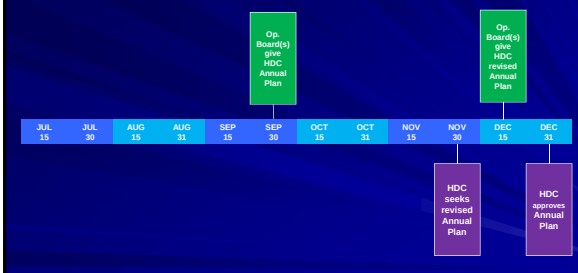
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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Annual Planning
    - HFN Development LP Annual Plan
      - Approved by HDC Board by December 31st
      - Includes budget, expected contributions to Operating LPs and expected distributions from Operating LPs
    - Operating LPs Annual Plans
      - Approved by HDC board by December 31st
      - Includes budget and summary of major projects

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Governance Model 2



Annual Planning – Budget Timelines

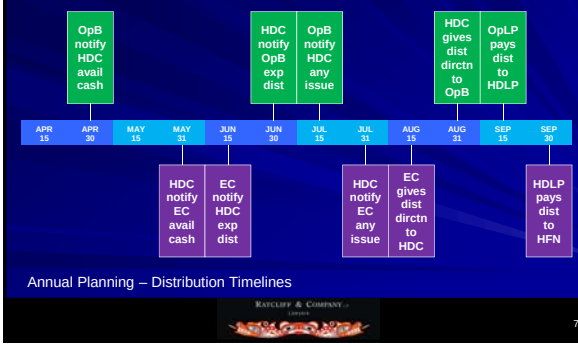
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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Process for distributing profits from operations
    - Available Cash = cash available from operations less
      - amount necessary to cover current liabilities
      - amount necessary to cover budget for next fiscal year
      - Reserve equal to 25% of the balance
    - Each year Operating LPs notify HDC board
    - HDC board notifies Executive Council
    - Concerns and requirements communicated

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Governance Model 2



Annual Planning – Distribution Timelines

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Reporting
    - Quarterly reporting by HDC board to Executive Council
    - Monthly reporting by Operating boards to HDC board
    - Reporting by Chief Executive Officer
      - to People's Assembly or Executive Council – upon request of Economic Development Committee Chair
      - to HDC board – upon request of HDC board Chair

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Role of Operating board(s)
    - Overseeing senior management
    - Approving major operational decisions
    - Approving operational policies/procedures
    - Reporting to First Nation
  - Role of Senior management
    - Responsible for day-to-day operations
    - Human resources for businesses
    - Advising and reporting to board of directors

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Appointments to HDC board
    - Appointed by Executive Council
    - Comprised of the Economic Development Committee
    - A majority must not be Executive Council members (s. 64 PA)
    - Term of office corresponds to that as Economic Development Committee member

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Appointments to Operating boards
    - Appointed by the HDC board
    - Comprised of 5 individuals
    - A majority must not be HDC board members (s. 64 PA)
    - A least 1 must be a non-citizen
    - Term of office is 4 years
    - Can be removed by HDC board in specified circumstances

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Board Appointments - Grounds for removal
    - Persistently absent
    - Undue influence
    - Impropriety or malfeasance
    - Conflicts of interest
    - Grossly incompetent
    - Acting outside authority
    - Not acting in best interests of Nation
  - Right of appeal to Tribunal

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Major Decisions
    - Decisions of HFN Development LP requiring Executive Council approval
      - Structural changes to HFN Development LP
      - Material transactions

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Major Decisions (cont.)
    - Decisions of Operating LPs requiring Executive Council approval
      - Structural changes to Operating LPs
    - Decisions of Operating LPs requiring HDC board approval
      - Operational anomalies of Operating LPs

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Operational Services
    - Each Operating LP has entered into agreement with HFN Management LP for the provision of management services
    - HFN Management LP hires and oversees Chief Executive Officer
      - Salary must be comparable to individuals with similar skill and experience

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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - Operational Services
    - Policies and Procedures
      - Adopted by Operating boards for the better or more efficient operation of Operating LPs
      - Certain policies and procedures must be adopted within 6 months (already adopted in principle)
      - HDC board may require additional policies and procedures

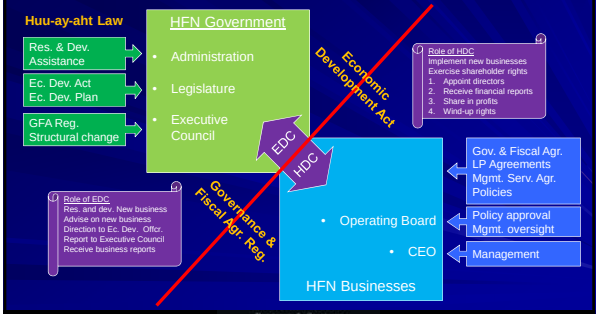
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Governance Model 2

- Governance and Fiscal Agreement (cont.)
  - New Operating LPs
    - Requirement to enter into Governance and Fiscal Agreement and Management Services Agreement
  - General
    - Dispute resolution process
    - Other "boiler plate" provisions
    - Definitions
    - Interpretation principles

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Governance Model 2



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Recommendations

The changes we have made…

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Recommendation 1

- Section 64 and CEO employment
  - S. 64 PA "engages in the management of the business"
  - Have CEO hired by Operating LP, preferably by HFN Management LP (see Recommendation 7)
- Benefits
  - Avoid loss of liability protection for HFN Development LP
- Status: fully implemented

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Recommendation 2

- Section 64 and the Operating Boards
  - Was complete overlap between HDC board and Operating boards
  - Separate HDC board from Operating boards
  - Only 1 or 2 common for liaison purposes
- Benefits
  - Avoid loss of liability protection for HFN Development LP because of s.64 PA
- Status: fully implemented

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Recommendation 3

- Separate business administration
  - Separate bank accounts and reporting
  - Separate financial administration
  - Separate signage, invoices, letterhead
- Benefits
  - More accurate reporting and accountability
  - Avoid loss of liability protection for HFN and HFNDLP because of s.64 PA
  - Corporate veil less likely to be pierced
- Status: substantially implemented

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Recommendation 4

- Legislative references to HDC/dividends
  - Change "HDC" to "HFNDLP"
  - Change "dividends" to "distributions"
- Benefits
  - Accurate reflection of corporate structure
  - Clarity so as to avoid tax and OSR (limited partnerships/distributions)
- Status: not yet implemented

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Recommendation 5

- Governance Structure Model
  - Economic Development Act
  - Governance and Fiscal Agreement
- Benefits
  - Clear, detailed roles and responsibilities reduces conflict and success more likely
  - Transparency and accountability provisions
  - Force of law and contract
- Status: partially implemented

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Recommendation 6

- Role of Legislature
  - Mission & vision through Economic Development Act
  - Strategic planning through Economic Development Plan updated annually
- Benefits
  - Ensures Legislature its proper role
- Status: not yet implemented

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Recommendation 7

- Create HFN Management LP
  - HFNDLP and new general partner
  - HDC appoints board of general partner
  - Hires CEO and senior managers
  - Enters into managements services agreement with Operating LPs to provide management, development and financial administration services

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Recommendation 7

- Benefits
  - No s. 64 PA risk
  - Separates business administration from government administration
  - Corporate veil less likely to be pierced
  - Increased efficiencies & no duplication
  - More accurate financial reporting and accountability as fees reflect true cost
- Status: substantially implemented

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Recommendation 8

- Application of laws to businesses
  - Revoke application of *Cash Management Regulation*, *Purchasing Policy Regulation* and Risk *Management Policy Regulation* to business enterprises
  - Require boards to have own policies in consultation with HDC (have been adopted in principle)
- Benefits
  - Separate politics from business
  - Better able to adapt to changing circumstances
- Status: partially implemented

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Conclusion

- Corporate structure
  - Double liability protection
  - 99.98% of operating profits allocated to First Nation which should be tax exempt
  - OSR can be avoided
- Governance structure
  - Separates business from politics
- Easily add other operations
- One operating failure won't affect others

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Questions



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