



Cornerstone Hydro Electric Concepts Association Inc.

April 27, 2018

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, Suite 2700
Toronto, ON M4P 1E4

Re: Draft Report of the Board: Corporate Governance Guidance for OEB rate-regulated Utilities (Board File No.: EB- 2014-0255)

Dear Ms. Walli:

Attached please find Cornerstone Hydro Electric Concepts Association's (CHEC) comments with respect to the Board's invitation to comment on the Draft Report on OEB Guidance on Utility Governance. This submission addresses the several issues outlined in the Draft Report dated March 28, 2018 and follows the same format (Attachment A).

CHEC is an association of seventeen (17) local distribution companies (LDC's) that have been working collaboratively since 2000. The comments over the following pages express the views of the CHEC members.

We trust these comments and views are beneficial to the Board's initiative. CHEC looks forward to continuing to work with the Board in this matter.

Yours truly,

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ATTACHMENT A

Director Independence:

Independence: Utilities should have a board of directors at the utility level and a majority of those directors should be independent of the shareholder and any affiliate.

CHEC is supportive of having a Board at the utility level. CHEC is also supportive of ensuring the majority of Board Directors are independent of the shareholder. However, independence from affiliates is another matter. Independence from affiliates should depend on the relative size and purpose of the affiliate. For example, if the affiliate is small and largely inactive, or active but in a different business than the utility, then maintaining independence does not add much value to the governance equation.

In addition to the above, there needs to be a clear and concise definition for the term “Independent” considering the shareholder is accountable for the utility and it is the duty of the shareholder to appoint the Board of Directors. While the Draft Report of the Board does provide a definition (A director is considered independent if she or he is neither an employee nor Director of an affiliate (including the parent or holding company) nor an employee or Director of the majority or controlling shareholder.), the Affiliate Relationship Code (ARC) currently does not. Furthermore, the definition provided in the Draft Report of the Board may not be appropriate considering the comments noted in the previous paragraph. A clear and concise definition of what is considered “independent” will aid in avoiding confusion and serve to eliminate interpretation issues as utilities prepare to restructure their Boards.

In addition to independence, CHEC would also recommend that Directors be appointed based on their interest in the community, who are engaged, and who can bring different perspectives to Board discussions.

Board Size: The board should comprise no less than five directors.

CHEC members are amendable to a minimum number of Directors on a Board, however, specifying a minimum of five Directors may be excessive depending on the size and structure of the utility. For smaller utilities that are not located nearby major urban centres, it may be difficult to attract and retain proficient and independent Directors. Directors should also be compensated for their responsibilities, which means having five or more “paid” Directors could result in increased operating costs for a small utility. This in turn, increases the burden on the end ratepayer.

For these reasons, CHEC would suggest a minimum of three Directors is more appropriate for the smaller utilities Board. Board Staff may want to consider a range of minimum Directors based on the size and requirements of the utility. Larger utilities who adopt a more risk-based approach and have a diverse strategy may require more Board Directors due to the scale and scope of their organization. Smaller utilities should be able to adopt a more simplistic approach. CHEC would also suggest keeping the odd

number configuration on utility Boards to ensure a majority of independent Directors can be maintained, and to aid in eliminating a deadlock on Board decisions

Scope of Oversight: Shareholder agreements or directions that limit the board of directors from exercising its independent judgment should be avoided.

CHEC agrees that shareholder agreements or directions that limit the Board of Directors from exercising its independent judgement should be avoided. However, this does not mean that shareholder agreements should be avoided altogether.

Shareholder agreements can be valuable and are often standard practice when you have a Board that is separate from the shareholders. Best practices would suggest that shareholder agreements that limit Boards in areas that directly impact the value of the shareholders investments (e.g.: corporation name changes, amalgamations, windups, issue/redeem shares, debt issuance, sale of business, etc.), but have no limits on operational or personnel matters, will not impact a Director's ability to exercise his or her independent judgement. Hence, a properly drafted and executed shareholder agreement can promote good corporate governance and can be a valuable tool for promoting goal congruence between management and their shareholders.

Director Skills:

The board as a whole must possess the complete range of skills necessary to execute its governance function and discharge its responsibilities effectively.

CHEC does not fully agree that a Board should possess a “complete” range of skills. While the skill set possessed by a Board is an important consideration, compiling this skill set will be difficult and challenging when it comes to a small Board of Directors. Factors for consideration are as follows:

- It could be costly to maintain a Board with a “complete” range of skills as this could mandate an increase in Directors to satisfy the definition of “complete”;
- A recognized professional may bring bias to Board discussions rather than an independent viewpoint;
- It may be difficult to locate and retain a suitable professional individual for a Board that is outside of a major urban centre;
- Finding suitable individuals with current energy sector regulatory knowledge can be problematic; and
- An experienced executive may have appropriate skills in certain functions (i.e. finance, IT, etc.) without having formal training in this area.

As an alternative, CHEC would suggest a more cost-effective approach would be to maintain a Board with a requisite core skill set, and to augment that skill set with external expertise as needed (e.g. if a legal opinion on a matter is required, then a lawyer could be hired).

A matrix approach should be used to compile an inventory of director skills.

CHEC has no issue with using a skills matrix approach to compile an inventory of Director skills. To ensure the matrix contains acceptable content, matrix specifics could be derived through a utilities self-developed process, or the OEB could provide a recommended skills matrix in the form of a template. Either approach would aid utilities in ensuring compliance in this area.

Board and Committee Structures and Functions:

Boards should ensure that they are structured to provide oversight of key functions of the utility business.

CHEC is supportive of ensuring Boards and Committees are adequately structured to provide oversight of key functions of a utility, providing the OEB is willing to afford some flexibility in this regard. A Board/Committee structure that works for a large utility may not be practical or necessary for a smaller utility. Challenged with limited resources, a Director's skill set may need to be more diverse, and Committees may need to be less specific, in order for a smaller Board to adequately govern all the key functions of the business. As such, flexibility will be key to ensuring the governance structure is well suited to the size of the utility.

That said, there are also cost implications to Board and Committee structures. Suffice it to say, a small and appropriately designed Board/Committee structure will be more cost-effective and efficient than a poorly designed larger structure.

Committees of the board are an effective means of achieving appropriate oversight of key functions

CHEC recognizes the fact that Committees are an effective means of achieving appropriate oversight of key functions. However, as noted above, for smaller utilities Committees are not always practical or necessary. Utilities should have the flexibility to determine the optimal Board/Committee structure for their business. For example, one approach that has worked in the past is the formation of Committees on an ad hoc basis. With this approach, Board resources are utilized more efficiently and effectively. It is important that a small utility Board not be regarded negatively if it can adequately justify an ad hoc or non-Committee format.

Committee members should possess the requisite skills to effectively discharge their responsibilities.

If a Committee is deemed to be required, it would only make sense that the committee members have the requisite skills to effectively discharge their responsibilities. Again, it has been noted that smaller utilities often do not have access to the same resources as larger utilities. Therefore, Committee members for a smaller utility may require a

broader skill set or more diverse background than those found on larger utility Committees. Alternatively, in some cases, it may be more practical to hire subject matter experts on an as needed basis to advise on specific Committee matters.

Supporting documentation and Practices:

Utility boards should have a written mandate and any committees of the board should have a written charter.

CHEC is supportive of a written charter and mandate for both the utility Board and any Committees assigned therein. This is recognized as an industry best practice. CHEC also agrees that the utility Board should be responsible for creating and maintaining the written charter.

The mandates of boards and any committees should be documented.

As noted above, CHEC is supportive of documenting the mandate of a utility Board and any Committees subsequently appointed by the utility Board. Mandates for the Board and any Committees should be contained within the charter noted above.

Boards should have a written code of conduct.

CHEC is also supportive of having a written code of conduct to promote the integrity, professionalism, and ethical behaviour of a utility Board and its Committees. CHEC would suggest that the OEB may want to specify the minimum requirements expected in such a document to ensure consistency and to ensure appropriate conditions and/or criteria are met.

Boards should provide orientation for new appointees and continuing education and/or other methods of broadening the skills of all directors.

CHEC is supportive of providing orientation for new appointees and/or continuing education for all Directors. Again, CHEC would suggest that the OEB may want to specify the minimum requirements expected in this regard, in order to ensure appropriate expectations are met.

Reporting and Record Keeping Requirements: Any comments on the proposed changes to the RRR designed to obtain information about utility governance.

The Draft Report of the Board does not provide any specifics for the Reporting and Record Keeping requirements at this time. As a result, CHEC can only suggest that the new requirements be as clear and concise as possible. This will ensure there are minimal grey areas for interpretation. CHEC would also suggest that any information

required for reporting and record keeping purposes should be kept in a format that is conducive towards confidentiality (see confidentiality question/response below).

Limited Partnership: How can the proposed requirements best be adapted to suit a utility that is a limited partnership?

CHEC members do not have a limited partnership structure within its group, therefore, CHEC has no comment on this issue.

Confidentiality: Of all the information that is to be reported, what information should be treated as confidential?

Utilities are currently bound by the confidentiality requirements specified in the “Personal Information Protection and Electronic Documents Act” (PIPEDA), the “Municipal Freedom of Information and Protection of Privacy Act” (MFIPPA), and various OEB codes and licensing requirements. Therefore, any information to be reported should, at a minimum, be consistent with these regulations.

In addition to the above, CHEC would recommend that utility Boards be permitted to create a “Confidentiality” policy or agreement that lists specific items that are considered to be confidential in nature (e.g.: personnel documents, human resource information, legal information, labour negotiations, items discussed during “in camera” sessions, etc.). It is expected that Directors would adhere to such a policy to ensure that sensitive information is not at risk of unwanted exposure.

Furthermore, CHEC is of the view that Board and Committee structures and functions can be reported in such a way as to ensure anonymity. Personal information regarding individual Board members (e.g.: skills, gender, age, term, etc.), should be kept confidential and only reported in an aggregated format. CHEC would also suggest that shareholder agreements, directives and other such documents also be kept confidential as these documents may contain utility specific strategic information

Other Comments:

In addition to the above, please note the following additional comments:

1. CHEC recognizes the critical importance of independence from the ultimate shareholder. Beyond that, guidance is about best practices and not specifics. For example, and as noted above, Committees may be necessary for some utilities, but not others. Independence from affiliates may be beneficial in some instances, but not others. As such, it is anticipated that the OEB will put more weight on actual performance (rates most of all, capital investments, community

involvement, etc.) rather than on detailed compliance with the proposed guidelines.

2. There will likely be a cost impact to implement the changes associated with the OEB's guidelines, which could be material for some utilities. There should be a cost recovery mechanism in place to capture and recover these costs.
3. The proposed guidelines should recognize that utilities have adopted different corporate governance practices depending on their size, ownership structure, nature of operations, scope of work, complexity of activities, corporate strategy, and risk profile. Any guidelines issued by the OEB should be flexible enough to accommodate these differences, providing they are in alignment with industry best practices.
4. CHEC would like to see further information on how the OEB intends to evaluate a utility's performance and rates in the context of its governance practices. For instance, the OEB's governance architecture and function is "guidance", therefore would the OEB look unfavourably towards those utilities who have not implemented some or all of the guidelines?
5. The OEB needs to ensure its framework for corporate governance remain focused on best practices, rather than just mandating regulatory standards. This is because regulatory standards are restrictive while best practices are key towards balancing the unique qualities of an organization with the practices it has in common with others.
6. On a final note, CHEC would like to suggest the OEB contemplate the use of a transition period for utilities to migrate toward an independent Board of Directors. It will take time for a utility to migrate to the OEB's guidelines and proposed best practices, thus a transition period would seem appropriate to ensure a smooth migration towards compliance.