



PUBLIC INTEREST ADVOCACY CENTRE  
LE CENTRE POUR LA DÉFENSE DE L'INTÉRÊT PUBLIC

April 29, 2018

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board

Dear Ms. Walli:

**VIA E-MAIL**

**Re: EB-2014-0255  
Draft Report of the Board: Corporate Governance Guidance for OEB Rate  
Regulated Utilities  
Comments of the Vulnerable Energy Consumers Coalition (VECC)**

1. VECC has reviewed the Board's draft report and the reports prepared by KPMG and Elenchus which inform the Board's report.
2. VECC supports the Board's general intention to work towards promoting better governance of rate-regulated utilities. VECC also supports the Board's specific proposals to encourage every utility to adopt a board of directors which:
  1. Has at least five directors
  2. Is not restricted by shareholder agreements,
  3. Has the skills necessary to execute its functions effectively,
  4. Is structured to provide oversight of key functions of the utility business,
  5. Has effective committees with members who have the requisite skills, and
  6. Develops the skills of all directors.
3. VECC supports the Board's initial reporting requirements. The Board should monitor the adoption of its recommendations and utility performance in order to determine whether or not it is necessary and appropriate to require utilities to adopt certain governance principles.
4. However, VECC is concerned by suggestions that governance regulation is a substitute for rigorous review of rate applications.<sup>1</sup> It is not.
5. Measures to promote better governance of rate regulated utilities only ensure that utilities are managed in an ethical and competent manner. Governance measures do not ensure that the utility

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<sup>1</sup> Elenchus Research Associates Inc, Corporate Governance for Regulated Natural Gas and Electricity Utilities (Final Report 19 December 2016) at 9, 51.

will act in the best interests of its ratepayers and for that reason, governance alone cannot substitute for rate regulation.

6. Directors are legally responsible for acting in the best interests of the corporation:

*Business Corporations Act, R.S.O. 1990, c. B.16*

134 (1) Every director and officer of a corporation in exercising his or her powers and discharging his or her duties to the corporation shall,

- (a) act honestly and in good faith with a view to the best interests of the corporation; and
- (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

7. Under *BCE Inc. v. 1976 Debentureholders*, the Supreme Court of Canada reaffirmed that “although directors must consider the best interests of the corporation, it may also be appropriate, although not mandatory, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders [like consumers].”<sup>2</sup>
8. In the context of a regulated utility, the utility “must operate in a manner that balances the interests of the utility’s shareholders against the interests of its ratepayers” and if a utility fails to balance those interests, “it is incumbent on the OEB to intervene in order to strike this balance and protect the interests of ratepayers.”<sup>3</sup> This means that the directors of rate-regulated utilities have a duty to consider the interests of ratepayers, but not necessarily to act in the interests of ratepayers, and the OEB is responsible for determining whether an appropriate balance between the utility’s shareholders and its ratepayers has been struck.
9. Furthermore, directors are nominated, elected, re-elected, and removed by shareholders. While directors may have theoretical legal obligations towards other stakeholders, directors will generally serve the interests of the shareholders to whom directors are held accountable. No other stakeholder has any effective mechanism to ensure that directors act in their interests, aside from a review of the utility’s rate application before the Board.
10. Even when a Board competently advances the corporation’s interests, it may not necessarily act in the best interests of consumers or the public. For example, consider a board of directors who are deciding the levels of capital investments to propose for the purpose of a rate application. The directors may propose a greater level of capital investments than what would be in the best interests of consumers. The directors may decide that a larger capital base will generate larger returns for shareholders. The directors may, arguably, be required to consider the impact of this decision on ratepayers, but the directors can ultimately decide to proceed with their decision in spite of any impact on ratepayers. Ratepayers would have no effective mechanism to challenge the directors’ decision to overlook their interests other than the OEB rate review process. A competent and ethical board of directors acting in the best interests of the corporation may still not act in the best interests of ratepayers.

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<sup>2</sup> 2008 SCC 69 at para 39.

<sup>3</sup> *Toronto Hydro-Electric System Limited v. Ontario Energy Board*, 2010 ONCA 284 (CanLII), <<http://canlii.ca/t/29c86>> at para 9.

11. Elenchus acknowledges the need for continuing regulation given that directors have no duty to act in the best interests of consumers:

Although directors have the duty to consider the interests of stakeholders, including customers, the OEB cannot rely solely on the board of directors to ensure the OEB's mandate is fulfilled. Although directors have a duty to consider the interests of customers, they do not have duty to act in their best interest; they must remain loyal to the best interests of the corporation. The OEB, on the other hand, has a broad public interest mandate and an explicit objective to protect the interests of consumers.<sup>4</sup>

12. Neither the KPMG report nor the Elenchus report provide any evidence that good governance improves performance, never mind evidence that good governance is sufficient to protect the interests of users in the absence of detailed rate regulation. Even the KPMG report, which appears to narrowly understand performance as the financial performance of the corporation rather than acting in the best interests of corporations, explicitly acknowledges that it is merely describing best practices without any evidentiary basis that such practices improve performance:

Conclusions about the overall effectiveness of an LDC's performance cannot be necessarily derived from its corporate governance makeup or the degree of Director independence.<sup>5</sup>

13. The Board has a detailed scorecard for electricity distributor performance.<sup>6</sup> While systemic analysis is difficult due to reporting inconsistencies, there is no obvious relationship between good governance structures and any of the Board's main performance metrics.
14. The Toronto Hydro-Electric System Limited provides an example of the need for continuing regulation despite good governance. It has 14 directors, just three of whom are municipal councilors.<sup>7</sup> It also has the second highest costs per customer, an unusually low number of telephone calls answered on-time, and actual costs that are more than 25% above predicted costs.<sup>8</sup> In EB-2010-0142, the Board accepted a settlement agreement on Toronto Hydro-Electric System Limited's rate application which reduced the revenue requirement by \$53.6 million.<sup>9</sup> Even ratepayers of large well-governed utilities benefit from rigorous OEB oversight.
15. KPMG found that the Alberta Utilities Commission, Nova Scotia Utility and Review Board, and Québec Régie de l'énergie focused on regulation of dealings with customers rather than regulation

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<sup>4</sup> Elenchus Research Associates Inc, Corporate Governance for Regulated Natural Gas and Electricity Utilities (Final Report 19 December 2016) at 31.

<sup>5</sup> KPMG, Review of Corporate Governance of Electricity Distributors (Final Report 29 April 2015) at 42.

<sup>6</sup> Ontario Energy Board, Electricity utility scorecards, online: <<https://www.oeb.ca/utility-performance-and-monitoring/what-are-electricity-utility-scorecards/electricity-utility>>.

<sup>7</sup> Toronto Hydro, Board of Directors (27 April 2018), online: <<https://www.torontohydro.com/sites/corporate/AboutUs/Pages/BoardofDirectors.aspx>>

<sup>8</sup> Ontario Energy Board, 2016 Sector-Wide Consolidated Scorecards of Electricity Distributors, online: <<https://www.oeb.ca/sites/default/files/2016-consolidated-scorecard.pdf>>.

<sup>9</sup> EB-2010-0142, Toronto Hydro-Electric System Limited Partial Decision & Order, online: <<http://www.rds.oeb.ca/HPECMWebDrawer/Record/283982/File/document>>.

of corporate governance as a proxy.<sup>10</sup> Similarly, none of the international regulators reviewed by KPMG had explicit corporate governance requirements or guidelines. Those entities were the Australian Energy Regulator, US Federal Energy Regulatory Commission, and UK Office of Gas and Electricity Markets.<sup>11</sup> Regulating corporate governance is a worthwhile endeavour, but it is far from a proven mechanism for ensuring that utilities act in the best interests of consumers. Neither KPMG nor Elenchus cite any precedent for relying on governance regulation in lieu of rate regulation.

16. Finding no precedent for the regulation of corporate governance in relation to energy, KPMG looks at regulation in the financial services and securities sector. While stricter regulation does exist in these sectors, such regulation is a response to repeated regulatory failures:

It is worth noting that in the financial sector, despite stronger standards for corporate governance and more rigorous required findings, financial institutions regularly find themselves embroiled in financial and operational scandals leading to diminished reputation and regulatory and legal penalties regardless of corporate governance.<sup>12</sup>

17. The financial services sector provides a model for what measures intended to promote good governance might look like, but it also provides many cautionary tales about the limitations of corporate governance:

For example, investigation of the downfall of Lehman Brothers Holdings Inc. demonstrated that the artifacts and filings of corporate governance were present. Yet, gross strategic, operational and risk management lapses ultimately led to the unforeseen downfall of the organization.<sup>13</sup>

18. In the financial sector, good governance initiatives have more often focused on preventing reckless behavior inconsistent with the fiduciary duties of directors to act ethically and in the best interests of the corporation. For example, good governance is concerned with ensuring a fair balance between the interests of shareholders and creditors of a corporation. This is a key difference from rate-regulated utilities, where the OEB engages in regulation to protect the interests of ratepayers, a stakeholder whose interests are outside and different from that of the corporation.
19. VECC notes that one of the key governance proposals that the Board supports involves increasing the number of independent directors. Independent, in this context, refers to directors who are not municipal counselors or employees of the municipal council. Municipal councilors are incentivized to act in ways which help them to be re-elected, irrespective of whether that conduct is in the best interests of the utility or ratepayers. For example, non-independent directors may seek to have a utility pay interest at unreasonable rates to the parent municipality in order to improve the municipality's budget balance. As a result, it is appropriate to require that utilities include some independent directors tasked with putting the interests of the corporation over those of the parent municipal corporation. However, VECC does see value in continuing to allow some directors

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<sup>10</sup> KPMG, Review of Corporate Governance of Electricity Distributors (Final Report 29 April 2015) at 17

<sup>11</sup> KPMG, Review of Corporate Governance of Electricity Distributors (Final Report 29 April 2015) at 18

<sup>12</sup> KPMG, Review of Corporate Governance of Electricity Distributors (Final Report 29 April 2015) at 31.

<sup>13</sup> KPMG, Review of Corporate Governance of Electricity Distributors (Final Report 29 April 2015) at 31.

to be municipal counselors and in exploring other means of making utilities accountable to the ratepayers.

20. Good governance is intended to be just one component of OEB's consumer-centric performance-based approach to regulation. It is a tool that utilities are expected to use to improve their performance.<sup>14</sup>
21. In summary, VECC supports the OEB's initiative to promote better good governance and most of the specific measures proposed. The reporting requirements proposed by the Board are an appropriate first-step. However, good governance will only help to only ensure that directors act competently and in the best interests of the corporation. The rigorous review of rate applications remains essential to ensuring that utilities act in the interests of ratepayers.

Regards,

*Ben Segel-Brown*

Benjamin Dean Segel-Brown Professional Corporation  
Counsel to the Vulnerable Energy Consumers Coalition

Tel: 613-864-6322.

E-mail [bsegel-brown@piac.ca](mailto:bsegel-brown@piac.ca).

1204-ONE Nicholas Street, Ottawa, ON K1N 7B7

Fax: 613-562-0007

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<sup>14</sup> See also Rosemarie T. Leclair, Remarks for the Ontario Energy Association, EnergyConference13, 11 September 2013 at 10.