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# Regulating Utility Governance

AN ANALYSIS OF THE  
ONTARIO ENERGY BOARD'S  
ROLE

BY ROBERT B. WARREN

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# Introduction

By letter dated June 22, 2016, the Ontario Energy Board (OEB) initiated a consultation to develop guidance on corporate governance for OEB rate-regulated utilities<sup>1</sup>. The OEB gave no indication of what it intends to do by way of “guidance.” The Board-commissioned reports – from consultants Elenchus and KPMG<sup>2</sup> – on which the consultation will apparently be based suggest a range of possible “guidance mechanisms”, ranging on a continuum from the issuing of standards for corporate governance, to periodic performance audits of compliance with those standards, to direct OEB engagement with utility boards.

This paper examines the possible role of the OEB in relation to the governance of rate-regulated utilities. It argues that the OEB should have no such role. The reasons for that are:

- + The OEB’s jurisdiction with respect to guidance on governance is, at best, questionable. Prior to recent amendments to the *Ontario Energy Board Act* (OEBA), the OEB had neither explicit nor implicit jurisdiction with regard to governance. As a result of these recent amendments the OEB has, arguably, implicit jurisdiction, but only to a limited extent. Whether it should exercise that jurisdiction is questionable, based on the interpretation and application of similar provisions in other statutes.
- + At the most basic level, playing any role with respect to governance would serve no purpose. What is regarded as good governance practice is well known. It has been the subject of policies issued by securities regulators, rulings by the courts, academic commentary and writings in the business press. The OEB has no expertise in governance which would enable it to add anything useful to what is already well established.

1 Ontario Energy Board, “Consultation on the Development of Corporate Governance Guidance for OEB Rate-Regulated Utilities”, EB- 2014-0255, August 9, 2016. At [http://www.ontarioenergyboard.ca/OEB/Industry/Regulatory+Proceedings/Policy+Initiatives+and+Consultations/Corporate+Governance+Guidance+\(EB-2014-0255\)](http://www.ontarioenergyboard.ca/OEB/Industry/Regulatory+Proceedings/Policy+Initiatives+and+Consultations/Corporate+Governance+Guidance+(EB-2014-0255)); Letter from the OEB to regulated utilities, dated June 22, 2016. At [http://www.ontarioenergyboard.ca/oeb/\\_Documents/EB-2014-0255/ltr\\_Corporate\\_Governance\\_Guidance\\_20160622.pdf](http://www.ontarioenergyboard.ca/oeb/_Documents/EB-2014-0255/ltr_Corporate_Governance_Guidance_20160622.pdf).

2 Elenchus Research Associates, *Corporate Governance for Regulated Natural Gas and Electricity Utilities, Draft Report Prepared for the Ontario Energy Board*, June 22, 2016 (referred to later as the Elenchus Report). At [http://www.ontarioenergyboard.ca/oeb/\\_Documents/EB-2014-0255/Elenchus\\_Draft\\_Report\\_Corp\\_Governance\\_20160622.pdf](http://www.ontarioenergyboard.ca/oeb/_Documents/EB-2014-0255/Elenchus_Draft_Report_Corp_Governance_20160622.pdf); KPMG LLP, *Ontario Energy Board: Review of Corporate Governance of Electricity Distributors, Final Report*, April 19, 2015 (referred to later as the KPMG Report). At [http://www.ontarioenergyboard.ca/oeb/\\_Documents/EB-2014-0255/KPMG\\_Report\\_Corporate\\_Governance\\_20150429.pdf](http://www.ontarioenergyboard.ca/oeb/_Documents/EB-2014-0255/KPMG_Report_Corporate_Governance_20150429.pdf).

+ The OEB already has extensive knowledge of, and control over, certain business practices of rate-regulated utilities through its powers to approve rates, to issue licenses, and to make Codes. It can fulfill its statutory mandate to set just and reasonable rates, and protect the interests of consumers with respect to prices, without playing any role, however limited, in the governance of regulated utilities.

+ That the OEB should play some role in the governance of rate-regulated utilities is not supported by either the Elenchus Report or the KPMG Report. In addition, the recommendations in those reports would, if adopted, represent an inappropriate regulatory over reach.

+ Playing some role in the governance of rate-regulated utilities would serve no public policy goal. On the contrary, playing such a role would be contrary to good public policy.

This paper will begin by examining what is meant by governance. It will then examine the existing regulatory rules and practices of the OEB, showing that those rules and practices affect some of the outcomes of utility governance, but not the governance itself. That is an important distinction, and I will argue one the OEB should respect.

The paper will then examine the question of the jurisdiction of the OEB to engage in the oversight of corporate governance. In discussing jurisdiction, it will contrast the roles of governance as set out in two Ontario statutes, those in the Ontario *Business Corporations Act* (OBCA)<sup>3</sup> and those in the Ontario *Environmental Protection Act* (EPA)<sup>4</sup>. It will also discuss the approach of the courts to interpreting the governance provisions of the OBCA, an approach I will argue should preclude the OEB from trying to play any role in the governance of utilities.

The paper will examine the KPMG and Elenchus Reports with a view to determining first, whether they support the OEB playing a role in the oversight of corporate governance and, second, whether the recommendations they contain are either reasonable or appropriate.

Finally, the paper will discuss whether having the OEB play a role with respect to the governance of rate-regulated utilities represents good public policy.

<sup>3</sup> *Business Corporations Act*, R.S.O. 1990, c. B.16.

<sup>4</sup> *Environmental Protection Act*, R.S.O. 1990, c. E.19.

# Governance

Virtually all of the literature on corporate governance deals with publicly traded corporations, because of the risks investors in such corporations bear and the resulting obligations those corporations owe to those investors. It is commonly assumed that the standards that apply to publicly traded corporations should apply, automatically, to private, closely held corporations.

There are, of course, fundamental differences between the two. For example, as discussed below, the principal remedies for a breach of the statutory obligations of officers and directors in a publicly traded corporation are the oppression and derivative action remedies, pursued in civil proceedings. In a private, closely held corporation, the principal remedy for a breach by the officers and directors of their statutory obligations would be for the shareholder to remove the officers and directors.

Despite the differences, the principles of good corporate governance developed in the context of publicly traded corporations are generally accepted as a useful guide to good governance practices in private, closely held corporations.

Corporate governance has been defined as follows:

The processes and structure used to direct and manage the business and affairs of the corporation with the objective of enhancing shareholder value, which includes ensuring the financial viability of the business. Process and structure define the division of power and establish mechanisms for achieving accountability among shareholders, the board of directors and management. The direction and management of the business should take into account the impact on other stakeholders, such as employees, customers, suppliers and communities.<sup>5</sup>

<sup>5</sup> Toronto Stock Exchange Committee, Report of the Toronto Stock Exchange Commission on Corporate Governance in Canada, 1994, p. 7.

There has been extensive commentary in academic literature and in court decisions on what constitutes good governance practices. In the wake of the financial crisis in 2008, there has been a good deal of commentary on enhancing governance practices in order to identify and avoid risk. Most recently, a group of what have been described as “US corporate titans”, including Warren Buffett and Jamie Dimon, have issued what they call “Commonsense Principles of Corporate Governance”.<sup>6</sup>

From the literature has emerged a set of guidelines broadly accepted as the core of good governance practices. A good example capturing these core guidelines is National Policy 58-201 (NP 58-201), which sets out the governance guidelines developed by the members of the Canadian Securities Administrators. That policy contains the following corporate governance guidelines:

- + maintaining a majority of independent directors on the board of directors
- + appointing a chair of the board or a lead director who is an independent director
- + holding regularly scheduled meetings of independent directors at which non-independent directors and members of management are not in attendance
- + adopting a written board mandate
- + developing position descriptions for the chair of the board, the chair of each board committee and the chief executive officer
- + providing each new director with a comprehensive orientation and providing all directors with continuing education opportunities
- + adopting a written code of business conduct and ethics
- + appointing a nominating committee composed entirely of independent directors
- + adopting a process for determining the competencies and skills the board as a whole should have, and applying this result to the recruitment process for new directors

<sup>6</sup> Governanceprinciples.org, “Commonsense Corporate Governance Principles,” July 21, 2016. At <http://www.governanceprinciples.org/>.

- + appointing a compensation committee composed entirely of independent directors
- + conducting regular assessments of the board's effectiveness, as well as the effectiveness and contribution of each board committee and each individual director.

The guidelines in NP 58-201 have, with minor variations, been broadly accepted as the core of good governance practices.

Municipally owned electricity distribution utilities (known as local distribution companies, LDCs) have particular governance challenges created because of their unique circumstances. Those circumstances include the fact that they are subject to the risk of an inherent conflict of interest arising from the competing obligations of the members of municipal council who may sit as directors. Unlike the vast majority of OBCA corporations, LDCs are obligated to comply with directives from the provincial government, something which at times may be at odds with the financial best interest of the LDC. Finally, the fact of extensive regulatory oversight has an impact on their governance practices.

The particular challenges of governance for municipally owned LDCs have been the subject of separate analysis and commentary.<sup>7</sup> There is no reason to believe that any challenges shareholders, directors and senior managers of municipally owned LDCs experience cannot be resolved by them. It is, frankly, unlikely the OEB could add anything useful on the subject.

In light of the extensive literature on what constitutes good corporate practices, and absent any other consideration, the question arises as to what the OEB can add.

It must also be asked what particular expertise the OEB has with respect to corporate governance. Its expertise lies in the business practices that give rise to just and reasonable rates, that is in a narrow band of the outcomes of corporate governance but not governance itself.

<sup>7</sup> See, for example, Robert B. Warren and Daniel P. Ferguson, "Corporate Governance for Municipally-Owned Local Electricity Distribution Utilities," Weirfoulds blog, April, 2016. At <http://www.weirfoulds.com/LDCs>.

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## OEB Rules and Practices

The OEBA grants the OEB the authority to approve the rates for natural gas and electricity utilities. The power to approve rates involves a periodic review, and effective control, over virtually every aspect of the utilities' operations. I use the words "effective control" advisedly because if what a utility proposes to do is found by the OEB not to be prudent, the utility cannot recover the cost in rates. If the utility nonetheless engages in the impugned activity, the cost of doing so is borne by the shareholder. If the shareholder is unhappy with that, it can remove the officers and directors responsible for the decision.

Pursuant to its authority to approve rates, the OEB has issued detailed rules on what it regards as good utility practice and on the standards utilities must meet to have their rates approved. Whether the OEB has the jurisdiction to do so, because the rules and standards arguably fetter its discretion to approve rates, is another question. What the rules and standards amount to are prescriptions as to what the OEB regards as the acceptable outcomes of corporate decision-making that, if not satisfied, would result in a denial of the requested rates.

*Control over certain outcomes of regulated activities is not control over governance and does not provide a basis for such control.*

It is again important to distinguish between control over the outcome of some corporate decisions, control which would be manifest in the approval of rates, and interference in the decision-making process giving rise to those outcomes. The OEB exercises control over the former through the regulatory process, but not over the latter. The latter is what constitutes corporate governance.



In addition to the power to approve rates, the OEB has the authority, under the OEBA, to issue Codes which prescribe, in detail, how regulated utilities are to carry on their businesses and how they are to account for the costs and revenues of doing so. Finally, the OEB has the authority to issue licences which, again, contain detailed requirements as to the nature of the activities that utilities may carry on. Taking all of this together, the OEB now has detailed information about, and control over, all of the regulated activities of regulated utilities. Control over certain outcomes of regulated activities is not control over governance and does not provide a basis for such control.

In one instance the OEB exercised its authority to affect the governance structure of regulated utilities. In its Affiliate Relationships Codes<sup>8</sup> it has required utilities to ensure that at least one-third of the membership of the board of directors is independent from any affiliate. That the OEB has been able to use its existing authority to intervene in the governance structure of the utilities it regulates to the limited extent required by specific circumstances is not an argument in favour of the OEB intervening in some general way in the corporate governance of all regulated utilities. And, as set out below, that limited intervention in the governance structure is pursuant to the OEB's legislative authority to approve just and reasonable rates, and not to some explicit or implicit authority with respect to governance.

8 Ontario Energy Board, "Affiliate Relationships Code for Electricity Distributors and Transmitters", revised March 15, 2010, and Ontario Energy Board, "Affiliate Relationships Code for Gas Utilities", revised November 25, 2010.

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## Jurisdiction

The following examination of the OEB’s jurisdiction, to do anything in relation to the governance of rate-regulated utilities, will be in three parts. In the first, I will examine the OEB’s jurisdiction prior to the recent amendments to the OEBA. In the second, I will examine that jurisdiction in light of those recent amendments. In the third, I will compare whatever jurisdiction may have been granted by the recent amendments to the governance jurisdiction as set out in two other statutes, the OBCA and the EPA.

### THE OEB’S JURISDICTION PRIOR TO THE RECENT AMENDMENTS TO THE OEBA

In discussing the jurisdiction of any regulatory agency, it is useful to begin by repeating certain basic propositions. The Supreme Court of Canada (SCC), in its decision of the case of *ATCO Gas & Pipelines Ltd v Alberta (Energy & Utilities Board)* (ATCO decision), made two observations about the extent of the jurisdiction of an administrative tribunal. In the first, the SCC, quoting David Mullan in his text on *Administrative Law*, stated that:

Administrative tribunals or agencies are statutory creations: they cannot exceed the powers that were granted to them by their enabling statute; they must “adhere to the confines of their statutory authority or ‘jurisdiction’ [; and t]hey cannot trespass in areas where the legislature has not assigned them authority.”<sup>9</sup>

The second observation of the SCC was as follows:

But more specifically in the area of administrative law, tribunals and boards obtain their jurisdiction over matters from two sources: (1) express grants of jurisdiction under various statutes (explicit powers); and (2) the common law, by application of the doctrine of jurisdiction by necessary implication (implicit powers).<sup>10</sup>

Prior to the recent amendments to the OEBA, discussed below, the OEB had no express grant of jurisdiction, that is no explicit power, with respect to the

<sup>9</sup> *ATCO Gas & Pipelines Ltd v Alberta (Energy & Utilities Board)*, 2006 SCC 4, [2006] 1 SCR 140, at para. 35.

<sup>10</sup> *Ibid.*, at para. 38.

governance of rate-regulated utilities. The question of whether the OEB had implicit power, by virtue of the application of the doctrine of jurisdiction by necessary implication, turns on the application of tests set out by the OEB, in a 1987 decision cited by the SCC in the ATCO decision. Those tests are the following:

- + [when] the jurisdiction sought is necessary to accomplish the objectives of the legislative scheme and is essential to the Board fulfilling its mandate;
- + [when] the enabling act fails to explicitly grant the power to accomplish the legislative objective;
- + [when] the mandate of the Board is sufficiently broad to suggest a legislative intention to implicitly confer jurisdiction;
- + [when] the jurisdiction sought must not be one which the Board has dealt with through use of expressly granted powers, thereby showing an absence of necessity; and
- + [when] the Legislature did not address its mind to the issue and decide against conferring the power upon the Board.<sup>11</sup>

Prior to the recent amendments to the OEBA, and arguably even after those amendments, the principal power granted by the Legislature to the OEB was the power to approve rates for the utilities it regulates. As noted above, in the exercise of that power, the OEB has extensive knowledge about, and control over, the business practices of those utilities. Given that, the exercise of some jurisdiction over governance is not necessary to accomplish the objectives of the legislative scheme and is not essential to the OEB fulfilling its mandate.

In making this observation, I am, as I have noted above, aware that the OEB has, in one instance, issued rules with respect to a corporate governance matter. The existence of the Affiliate Relationships Codes is not evidence of some broad jurisdiction with respect to the governance of regulated utilities. On the contrary, it is related to the OEB's statutory authority to ensure that ratepayers pay only just and reasonable rates, that is rates not affected by the actions of gas and electricity distributors arising from their dealings with their affiliates.

<sup>11</sup> Ibid., at para. 73.

If, as I argue, the OEB did not, prior to the recent amendments to the OEBA, have either the explicit or the implicit power to deal generally with issues of corporate governance, the question is whether the explicit or implicit power has been granted by the recent amendments to the OEBA.

## THE RECENT AMENDMENTS TO THE OEBA

Section 125.2 of the OEBA, introduced in Bill 112, provides:

125.2 Where a transmitter, distributor, retailer of electricity, gas marketer or unit sub-meter provider is a corporation, every director and officer of the corporation shall,

(a) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances; and

(b) take such measures as necessary to ensure that the corporation complies with all applicable requirements under this Act, the Electricity Act, 1998 and the Energy Consumer Protection Act, 2010. 2015, c. 29, s. 19.

Section 126.1(d) makes a person guilty of an offence who “contravenes this Act, the regulations or a rule made under Section 44.”

Section 125.2 of the OEBA repeats the wording of Subsection 134(1)(b) of the OBCA. That Section, as will be discussed further below, has been taken to be a kind of distillation of the governance obligations of officers and directors. It would appear on the surface that the Legislature, in enacting Section 125.2 and Section 126(1)(d) of the OEBA, has given the OEB the explicit power to enforce certain governance obligations and, by application of the doctrine jurisdiction by necessary implication, the implicit power to issue guidelines with respect to the corporate governance of rate-regulated utilities.

*The power to do so is to protect the public interest from the abuse of monopoly power. It is not a power to protect the interests of the shareholders of the utilities.*

However, before reaching that conclusion it is important to consider two matters. The first is the extent of any governance authority the OEB might exercise under the new sections. The second is whether similar powers, granted in other statutes, have been used to exercise authority with respect to the governance practices of corporations.

Dealing with the first matter, as noted above, that the OEB has extensive powers, through the authority to approve rates, to make Codes and to issue licenses, to supervise and control some of the activities of regulated utilities. The power to do so is to protect the public interest from the abuse of monopoly power. It is not a power to protect the interests of the shareholders of the utilities.

Given that the OEB already has the power to protect the public from the abuse of monopoly power, Section 125.2 must be directed to something else. To determine what that something else is, it is necessary to look at two other recent amendments to the OEBA.

The first of those amendments authorizes the OEB to permit, if special circumstances warrant, distribution utilities to engage in other lines of business.<sup>12</sup> What those other lines of business might consist of is an open question. For the sake of argument, if we assume that the other lines of businesses might include those entailing greater business risk, the authority granted to the OEB to approve engaging in that other business is one which, by necessary implication, allows the OEB to protect ratepayers from harm. No intervention in matters of governance is required to allow the OEB to fulfill its statutory mandate.

The other relevant amendment to the OEBA eliminates any restrictions on the businesses the affiliates of a regulated utility may engage in.<sup>13</sup> The Legislature has, thus, permitted the affiliates of regulated utilities to engage in any form of business, however risky it might be. It might be argued that Sections 125.2 when combined with 126(1)(d) are intended to give the authority to the OEB to exercise some form of control over the decisions of regulated utilities to permit their affiliates to engage in risky businesses.

To adopt that interpretation, however, would be to argue that the Legislature has taken away with one hand what it has granted with the other. That makes no sense. The OEB has no jurisdiction with respect to the activities of the

<sup>12</sup> Subsection 71(4) of the OEBA.

<sup>13</sup> Section 73 of the OEBA was deleted.

unregulated affiliates of regulated utilities, other than to the extent that those activities may harm the ratepayers of the regulated utility. And the OEB has already exercised its jurisdiction to protect ratepayers from that harm through the Affiliate Relationships Codes. Given that the OEB has no jurisdiction over the activities of the unregulated affiliates of rate-regulated utilities, any attempt to do so indirectly by exercising control over the governance activities of the regulated utilities would take the OEB beyond its jurisdiction.

## THE OBCA AND THE EPA

The second matter I wish to consider is whether provisions similar to Section 125.2 and 126(1)(d) in other statutes have authorized the exercise of control over corporate governance.

### (i) OBCA

In common law, the officers and directors of a corporation owe duties of loyalty and care to a corporation. Those duties have now been set out in corporate statutes, in the case of Ontario LDCs in the OBCA. Regulated utilities in Ontario, it should be remembered, are corporations subject to the OBCA.

Subsection 115(1) of the OBCA provides that “Subject to any unanimous shareholder agreement, the directors shall manage or supervise the management of the business and affairs of a corporation.”

Subsection 134(1) of the OBCA provides:

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.

Point (a) above is commonly referred to as the duty of loyalty. That duty includes the duty to avoid conflicts of interest, not to use a director’s position for personal gain, to serve a corporation selflessly, honestly and loyally, and to exercise independent judgment.

The SCC, in its decision in *Re People's Department Stores Ltd (1992) Inc (People's)*, described the content of the directors' fiduciary duty in the following words:

The statutory fiduciary duty requires directors and officers to act honestly and in good faith *vis-à-vis* the corporation. They must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation. They must avoid conflicts of interest with the corporation. They must avoid abusing their position to gain personal benefit. They must maintain the confidentiality of information they acquire by virtue of their position. Directors and officers must serve the corporation selflessly, honestly and loyally.<sup>14</sup>

As a general proposition, the courts will defer to the decisions of directors if they can be seen as reasonable business decisions based on a consideration of reasonable alternatives and if they reflect the application of an "appropriate degree of prudence and diligence."<sup>15</sup>

The decisions by officers and directors must be based on an assessment of the best interests of the corporation. At its most basic, the best interests of the corporation are economic interests, particularly the interests of the shareholders. But they may also include the interests of employees, suppliers and consumers. They may also include broader societal concerns, for example, the impact of the corporation's activities on the environment.

Recent decisions of the SCC have extended the obligations of officers and directors to also include the duty to treat stakeholders affected by corporate actions equitably and fairly.<sup>16</sup> Establishing mechanisms to ensure that the interests of stakeholders are considered would form part of good governance practices. What is important in this context is that the OEB, through the exercise of its rate-approval power, already performs the function of ensuring that the interests of stakeholders affected by the decisions of regulated utilities are protected.

It is important at this point to reiterate that the courts consistently defer to the decisions of officers and directors if they can be seen as reasonable business ones. For example, the Ontario Court of Appeal, in the case of

<sup>14</sup> *Re People's Department Stores Ltd (1992) Inc*, 2004 SCC 68, [2004] 3 SCR 461, at para 35.

<sup>15</sup> *Ibid.*, at para 67.

<sup>16</sup> See, for example, *People's* at para 42.

*Re Stelco Inc.*,<sup>17</sup> addressed the role of the court in considering the role of the directors as described in Subsection 102(1) of the *Canada Business Corporations Act*, which is identical in its wording to Section 115 of the OBCA. The Ontario Court of Appeal made the following observation:

I do not see the distinction between the directors' role in "the management of the business and affairs of the corporation" (CBCA, s. 102) – which describes the directors' overall responsibilities – and their role with respect to a "quasi-constitutional aspect of the corporation" (i.e., in filling out the composition of the board of directors in the event of a vacancy). The "affairs" of the corporation are defined in s. 2 of the CBCA as meaning "the relationships among a corporation, its affiliates and the shareholders, directors and officers of such bodies corporate but does not include the business carried on by such bodies corporate". Corporate governance decisions relate directly to such relationships and are at the heart of the Board's business decision-making role regarding the corporation's business and affairs. The dynamics of such decisions, and the intricate balancing of competing interests and other corporate-related factors that goes into making them, are no more within the purview of the court's knowledge and expertise than other business decisions, and they deserve the same deferential approach. Respectfully, the motion judge erred in declining to give effect to the business judgment rule in the circumstances of this case.

In the same decision, the Court of Appeal cited the observation of the SCC in the *People's* decision that:

Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making.<sup>18</sup>

The Court also cited its own decision in *Brant Investments Ltd v KeepRite Inc.*<sup>19</sup> for the following observation:

Business decisions, honestly made, should not be subjected to microscopic examination. There should be no interference simply because a decision is unpopular with the minority.

The deference shown by the courts to the decisions of officers and directors, reflected in these decisions, should be kept in mind when the OEB decides whether it should play any role with respect to the governance of regulated

<sup>17</sup> *Stelco Inc, Re*, 196 OAC 142, 75 OR (3d) 5 at para 70.

<sup>18</sup> *Ibid.*, at para 65.

<sup>19</sup> *Ibid.*, at para 66.



utilities. It should also be kept in mind that the OBCA contains no regulatory oversight over compliance with the obligations set out in Sections 115 and 134. Instead, the remedies for breaches of those sections are ones pursued by, principally, shareholders or other stakeholders of the corporation in civil proceedings.

It is also important to remember in this context that regulated utilities are OBCA corporations and that, as such, they are entitled to the freedom afforded such corporations. The SCC, in the *ATCO* decision, made this point in the following way:

At the risk of repeating myself, a public utility is first and foremost a private business venture which has as its goal the making of profits. This is not contrary to the legislative scheme, even though the regulatory compact modifies the normal principles of economics with various restrictions explicitly provided for in the various enabling statutes.<sup>20</sup>

In exercising its power with respect to the approval of rates the OEB is, in the words of the SCC in the foundational case of *Northwestern Utilities Ltd. v. The City of Edmonton*:

Fixing rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested.<sup>21</sup>

Doing those things does not require the regulator to exercise any form of involvement in the governance of the regulated utility. To the extent that the shareholder of that utility must protect its own interests, for example in the face of inadequate governance by the officers and directors, it has the remedies available to it under the OBCA or, in the case of a closely held private corporation, the shareholder can replace the offices and directors.

Subsection 258(1)(j) of the OBCA makes it an offence for a person who “otherwise without reasonable cause commits an act contrary to or fails or neglects to comply with any provisions of this Act or the regulations.” That Subsection would, in theory, permit prosecution for failure to comply with the obligations in Section 134. I have been unable to find any case where such a prosecution took place. Where Section 134 is referred to is in civil proceedings, typically those involving oppression or derivative action remedies, where the wording of the section is used as a standard against which to measure the actions of officers and directors.

<sup>20</sup> *ATCO*, supra, at para 78.

<sup>21</sup> *Northwestern Utilities Ltd v Edmonton (City)*, [1929] SCR 186, at 192.

The point of this analysis is this: while Sections 125.2 and 126(1)(d) of the OEBA appear to give the OEB some measure of control over the governance of regulated utilities, though not their unregulated affiliates, the interpretation and application of similar provisions in the OBCA strongly militates against the OEB exercising any jurisdiction with respect to the governance of regulated utilities.

## (ii) EPA

The EPA imposes obligations on officers and directors which may be, and are, enforced by prosecution.

Section 194(1) of the EPA provides:

194(1) Every director or officer of a corporation has a duty to take all reasonable care to prevent the corporation from,

(a) discharging or causing or permitting the discharge of a contaminant, in contravention of,

(i) this Act or the regulations, or

(ii) an environmental compliance approval, certificate of property use, renewable energy approval, licence or permit under this Act;

(b) failing to notify the Ministry of a discharge of a contaminant, in contravention of,

(i) this Act or the regulations, or

(ii) an environmental compliance approval, certificate of property use, renewable energy approval, licence or permit under this Act;

(c) contravening Section 27, 40, 41 or 47.3 in respect of hauled liquid industrial waste or hazardous waste as designated in the regulations relating to Part V;

(d) contravening Section 93 or 184;

(e) failing to install, maintain, operate, replace or alter any equipment or other thing, in contravention of an environmental compliance approval, certificate of property use, renewable energy approval, licence or permit under this Act; or

(f) contravening an order under this Act, other than an order under Section 99.1, 100.1, 150 or 182.1.

(1.1) Clause (1) (a) does not apply to a contravention of Section 14 unless the contravention causes or is likely to cause an adverse effect. 2005, c. 12, s. 1 (65).

Section 194(2) of the EPA provides that every person who has a duty under Subsection 1 and who fails to carry out that duty is guilty of an offence. The requirements of Section 194 of the EPA are requirements of good governance, a point which has been made, repeatedly, by the courts when discussing the content of the defence of due diligence to charges laid under that section. The courts have emphasized the importance of the existence of an environmental management system, created and enforced by the officers and directors, as a key component of that defence.

*The deference shown by the courts to the decisions of officers and directors, reflected in these decisions, should be kept in mind when the OEB decides whether it should play any role with respect to the governance of regulated utilities.*

The reason that a breach of the requirements in Section 194 is subject to prosecution, while the OBCA requirements in Sections 115 and 134 have, to my knowledge, not been, is that a breach of the governance requirements in the EPA may result in harm to the public. By contrast, a breach of Section 134 of the OBCA would result in harm to security holders of the corporation, its shareholder or to the corporation but not to the public. As noted above, the courts have repeatedly said that the remedies for such harm lie in civil actions.

## KPMG and Elenchus Reports

The point of the comparison is this: Section 194 of the EPA authorizes the prosecution of officers and directors for failing to adhere to the governance standards because there is no other way to protect the public from harm. That is not the case with Section 125.2 and 126(1)(d) of the OEBA.

The OEB's June 22, 2016 letter was accompanied by two reports:

- + a report entitled *Review of Corporate Governance of Electricity Distributors* dated April 29, 2015 and prepared by KPMG (the "KPMG Report")
- + a report entitled *Corporate Governance for Regulated Natural Gas and Electricity Utilities* dated June 22, 2016 and prepared by Elenchus Research Associates Inc. (the "Elenchus Report").

A close reading of the reports leads to the conclusion that they do not support even a minimal role of the OEB in governance, let alone the extensive role which those reports recommend.

The first observation to be made is that the KPMG Report deals only with corporate governance of LDCs while the Elenchus Report deals with corporate governance for both regulated natural gas and electricity utilities. There are material differences between the ownership of LDCs and natural gas utilities and, correspondingly, their governance circumstances.

The two largest regulated natural gas utilities are publicly traded corporations. Publicly traded corporations are subject to more extensive governance oversight, by their shareholders and by financial regulators, than are privately-held corporations. To treat municipally owned LDCs and natural gas utilities as the same, for purposes of a governance analysis and recommendations for governance oversight, portrays a lack of basic understanding of the important differences between the two.

The KPMG Report notes that "the OEB, *not unlike other energy regulators*, does not publish a code or guideline specifying requirements for corporate governance for LDCs" (emphasis added).<sup>22</sup> Regrettably, KPMG does not

<sup>22</sup> KPMG Report, p. 6.

explore why it is that those other energy regulators do not have a code or guideline specifying requirements for corporate governance. The reason, I suggest, is obvious. No such code or guideline is required in light of the extensive regulatory powers exercised by those energy regulators.

Both KPMG and Elenchus point to the corporate governance requirements of regulatory bodies in the financial services and securities industries. In that context, KPMG makes the following observation:

Regulatory bodies in the financial services and securities industries have more robust frameworks which reinforce corporate governance values and principles. Stronger approaches are also in place to evaluate corporate governance effectiveness.<sup>23</sup>

Again regrettably, KPMG does not examine the differences between circumstances in the financial services and securities industries and those for regulated utilities. The powers exercised by regulators in the financial services and securities industries are not as extensive as the powers exercised by the OEB, or other energy regulators, with respect to the control over aspects of the operation of businesses.

As noted above, the OEB has extensive information about, and control over, some of the operations of regulated utilities. As a result of that control – which I again stress is not the same thing as control over governance – the OEB is able to protect the people affected by some governance decisions of the regulated utilities.

Regulatory bodies in the financial services and securities industries impose governance requirements precisely because they do not have the same level of control over the businesses they regulate. It is an important distinction, the implications of which KPMG did not, but should have, examined.

The Elenchus Report examines what it describes as “some key court cases involving corporate governance which are particularly relevant for regulated utilities.”<sup>24</sup> Elenchus asserts that “this caselaw establishes the foundation for some of the key principles for corporate governance and for the OEB’s jurisdiction.”<sup>25</sup> It is right about the first point, and utterly wrong about the second.

23 KPMG Report, p. 28.

24 Elenchus Report, p. 19.

25 Elenchus Report, p. 19.

The court cases on which Elenchus relies<sup>26</sup> are relevant only to the extent that they expose the weaknesses in Elenchus' analysis. Two of the cases are oppression remedy claims. One involves a bankruptcy. Another involves a plan of arrangement. One deals with the dissolution of a partnership. In each case, the affected parties were able to seek a remedy in the courts. Regulatory oversight of governance was not an issue. Since relief was available in the courts, the logic of the decisions is that no regulatory oversight of governance is required to protect the interests of shareholders or other corporate stakeholders.

In addition to misunderstanding the significance of the cases, Elenchus fails to note the observations, for example, in the *People's* and *KeepRite* cases cited above, about the importance of the courts deferring to the business decisions of officers and directors. Rather than supporting some form of enhanced role for the OEB in supervising the governance of regulated utilities, the cases support the proposition that no such enhanced role is required.

Elenchus cites the decision of the Ontario Court of Appeal in the case of *Toronto Hydro-Electric System Ltd v Ontario Energy Board*.<sup>27</sup> In that case, the Court ruled that, where a regulated utility fails in its obligation to protect the public interest, the OEB must intervene to do so. The case stands for the proposition, in other words, that the OEB's existing power to protect the public interest is already sufficient without the need for some enhanced supervision over the governance of regulated utilities.

The court cases cited by Elenchus therefore provide no foundation for the OEB's jurisdiction with respect to governance. On the contrary, they underscore the reality that any OEB involvement in matters of governance would be unnecessary.

The evident failure of Elenchus to understand and apply the conclusions to be drawn from the court cases it cites points to a larger weakness in its Report and in the KPMG Report. Neither report accounts for the significance of the fact that the utilities are OBCA corporations and, as such, are entitled

26 *People's Department Stores Ltd (1992) Inc, Re*, 2004 SCC 68.  
*BCE Inc, Re*, 2008 SCC 69, [2008] 3 SCR 560.

*Toronto Hydro-Electric System Ltd v Ontario (Energy Board)*, 2010 ONCA 284, 99 OR (3d) 481.  
*820099 Ontario Inc v Harold E Ballard Ltd*, 3 BLR (2) 113 (ON Gen Div); affirmed by 3 BLR (2d) 113 (ON Div Ct).  
*PWA Corp v Gemini Group Automated Distribution Systems Inc*, 103 DLR (4th) 609, 64 OAC 274.  
*Brant Investments Ltd v KeepRite Inc*, 1 BLR (2d) 225, 45 OAC 320.

27 *Toronto Hydro-Electric System Ltd v Ontario (Energy Board)*, 2010 ONCA 284, 99 OR (3d) 481.

to a measure of freedom in their actions. This freedom is limited only to the extent necessary to protect the public from the abuse of monopoly power. Neither KPMG nor Elenchus account for the limited nature of the jurisdiction granted to the OEB. Instead, they wrongly assume that the existence of that limited power is a sufficient basis for the exercise of a quite different power, namely one in relation to the governance of regulated utilities.

Notwithstanding what I regard as the material deficiencies in the analyses of KPMG and Elenchus, they recommend that the OEB intervene in the governance of regulated utilities in what I regard as an inappropriate way. The following examples illustrate this point:

+ KPMG recommends that the OEB establish guidelines for effective corporate governance for LDCs, guidelines which should address, among other things, “Risk governance and enterprise risk management – including Board oversight responsibilities of the enterprise risk management framework and supporting assessment, mitigation, monitoring and reporting requirements of management to the Board.”<sup>28</sup>

That is a recommendation that the OEB, without any evident expertise for doing so, oversee the governance of LDCs with respect to decisions made about the businesses of their affiliates. KPMG makes that recommendation without considering whether the OEB has jurisdiction to do that and whether what it proposes is consistent with the approach the courts have taken to the governance provisions in the OBCA.

+ KPMG recommends that the OEB should “monitor the leading behavioural indicators which may also be reflective of the effectiveness of overall corporate governance and decision-making effectiveness of an LDC. These indicators may include: significant changes in business strategy; acquisitions or major investments; increased risk-taking behaviour; increased operational, health, safety or environmental incidents or; major changes to the Board composition.”<sup>29</sup>

Again, that is a recommendation for OEB oversight over governance decisions, not with respect to the LDCs themselves, but with respect to the operations of unregulated affiliates. It is a recommendation made without a supporting analysis of, among other things, the limits to the OEB’s jurisdiction.

28 KPMG Report, pp. 44 and 45.

29 KPMG Report, p. 46.

- + Elenchus recommends that “each utility would disclose whether it is acting in accordance with the OEB guidance, and in any area where it is not, the utility would explain whether and how its approach accomplishes the same objectives as the approach set out in the OEB guidance.”<sup>30</sup>

Again keeping in mind that the OEB already exercises extensive control over regulated utilities, that recommendation can only be meaningful in the context of decisions affecting unregulated affiliates. Again, the recommendation that has a bearing on the operations of unregulated affiliates must take account of the limits to the OEB’s jurisdiction.

- + Elenchus recommends that regulated utilities be required to “disclose all Unanimous Shareholder Agreements or Sole Shareholder Declarations.”<sup>31</sup>

Elenchus does not elaborate on what the OEB would do with the information so disclosed. The disclosure of the information would only be meaningful if the OEB were, in some way, to do something about it. The logic of Elenchus’ recommendation on that point is that the OEB should involve itself in shareholder decisions.

- + Elenchus recommends that the OEB have what it describes as “direct interaction with utility boards through an open process”.<sup>32</sup> It suggests that the LDC’s CEO and the Chair of the Board of Directors participate in a utility’s rate proceeding and, presumably, answer questions about the utility’s governance practices.<sup>33</sup> Doing so would result in an extraordinary degree of public scrutiny over the governance decisions of privately-held corporations. It goes without saying that this would be a radical departure from the treatment of corporations in this province.

The recommendations made by KPMG and Elenchus are not supported by their respective underlying analyses. The recommendations are not supported by any need to protect the interests of those affected by the decisions of regulated utilities. Finally, the recommendations would, if adopted, constitute an unwarranted and inappropriate extension of the OEB’s powers.

<sup>30</sup> Elenchus Report, p. 54.

<sup>31</sup> Elenchus Report, p. 56.

<sup>32</sup> Elenchus Report, p. 55.

<sup>33</sup> Elenchus Report, p. 64.



## Public Policy

I discussed, earlier, the limits the courts have imposed on the exercise of jurisdiction by regulatory agencies. Those limits are imposed to ensure those agencies operate only within powers granted to them by the Legislature. That is a legal concern, rooted in considerations of the rule of law.

The courts have long wrestled with the extent to which they should supervise the decisions of regulatory agencies. From the time of the SCC's decision in the *Dunsmuir*<sup>34</sup> case, the issue has been framed as one of deference to the decision of those agencies. Less attention has been paid to a related, and important, issue, namely the nature and extent of control the government, the Legislature and the agencies themselves place on the exercise of their powers. That control, I suggest, should be considered a question of the governance of regulatory agencies.<sup>35</sup>

Maintaining the limits on the powers exercised by regulatory agencies, through effective governance mechanisms, is a matter of good public policy. It is not in the public interest to have regulatory agencies exceed their powers. I suggest that it is not good public policy to have the OEB play any role with respect to the governance of regulated utilities. Natural gas utilities, which are publicly owned, are subject to all of the constraints which publicly owned corporations face. The Legislature made the decision that LDCs, even though they are almost all owned by municipalities, should be OBCA corporations. As such, they are entitled to the freedom that such corporations possess. Their actions are constrained only to the extent required to protect the public from the abuse of monopoly powers. Any constraint beyond that, such as interference in the governance practices of LDCs, would be inappropriate.

34 *New Brunswick (Board of Management) v Dunsmuir*, 2008 SCC 9, [2008] 1 SCR 190.

35 Robert B. Warren, *Governance of Regulatory Agencies: Case Study of the Ontario Energy Board*, January 2015. At <http://www.thinkingpower.ca/CCRECaseStudy/CCRE%20-%20The%20Governance%20of%20Regulatory%20Agencies%20-%20A%20Case%20Study%20of%20the%20Ontario%20Energy%20Board%20by%20Robert%20B.%20Warren%20-%20January%202015.pdf>. In that paper I noted that the OEB itself did not satisfy the governance requirements of the OECD. Though some of the more egregious governance deficiencies noted in the paper have been corrected, a number have not.

Once in place, any form of guidance with respect to corporate governance will amount to an invitation to exercise control for governance decisions. For example, with the prospect of a public review of their governance decisions, something Elenchus recommends, LDCs will almost certainly avoid the kind of detailed, risk-based analyses that their boards of directors should, in the best interests of the corporation, engage in. To use a military metaphor, any form of guidance with respect to corporate governance will be the beginning of “mission creep.” It will become difficult for the OEB, whether on its own or at the behest of some stakeholder, to resist interfering in governance matters which are properly the concern of the corporation and its shareholders.

The public interest expects, and deserves, the exercise of discipline and restraint by regulatory agencies in the exercise of their powers. The issuance of any form of guidance on corporate governance, by the OEB, would violate that expectation.



# Conclusion

What constitutes good corporate governance is well known. Further articulation of the principles of good governance by the OEB is unnecessary.

To the extent that municipally owned electricity distribution utilities have particular governance challenges, the shareholders, officers, and directors can resolve them, and should be allowed to do so.

The OEB already has extensive oversight of, and control over, the outcome of some of the decisions of the utilities it regulates. Therefore, there is no need for any measure of interference, no matter how seemingly benign, with the corporate governance of those regulated utilities.

Arguments in favour of more control by the OEB over corporate governance, as set out in the KPMG and Elenchus Reports, are based on under-examined and flawed analyses, and a misreading of court cases. The recommendations of KPMG and Elenchus do not account for the nature and extent of the OEB's existing regulatory powers. The recommendations, if adopted, would result in an unprecedented, and inappropriate, regulatory intrusion into the activities of OBC corporations.

Recent amendments to the OEBA duplicate existing provisions in the OBCA. Given the Board's extensive powers over the operations of regulated utilities, the power granted to the OEB in the recent amendments is unnecessary. To the extent that the OEB would purport to exercise those powers with respect to the operations of unregulated affiliates, that would be beyond the jurisdiction of the OEB.

It may be asked, what harm is there in the OEB providing guidance on corporate governance, particularly if that guidance consists only in repeating already well-known principles? The harm lies in what I refer to as regulatory over-reach. The rule of law depends, in part, on regulatory agencies doing only what their statutes permit them to do. Doing more, whether they exceed either their jurisdiction or their expertise, creates confusion and is an implicit invitation to the abuse of power.



# Mowat Centre

ONTARIO'S VOICE ON PUBLIC POLICY

The Mowat Centre is an independent public policy think tank located at the School of Public Policy & Governance at the University of Toronto. The Mowat Centre is Ontario's non-partisan, evidence-based voice on public policy. It undertakes collaborative applied policy research, proposes innovative research-driven recommendations, and engages in public dialogue on Canada's most important national issues.

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