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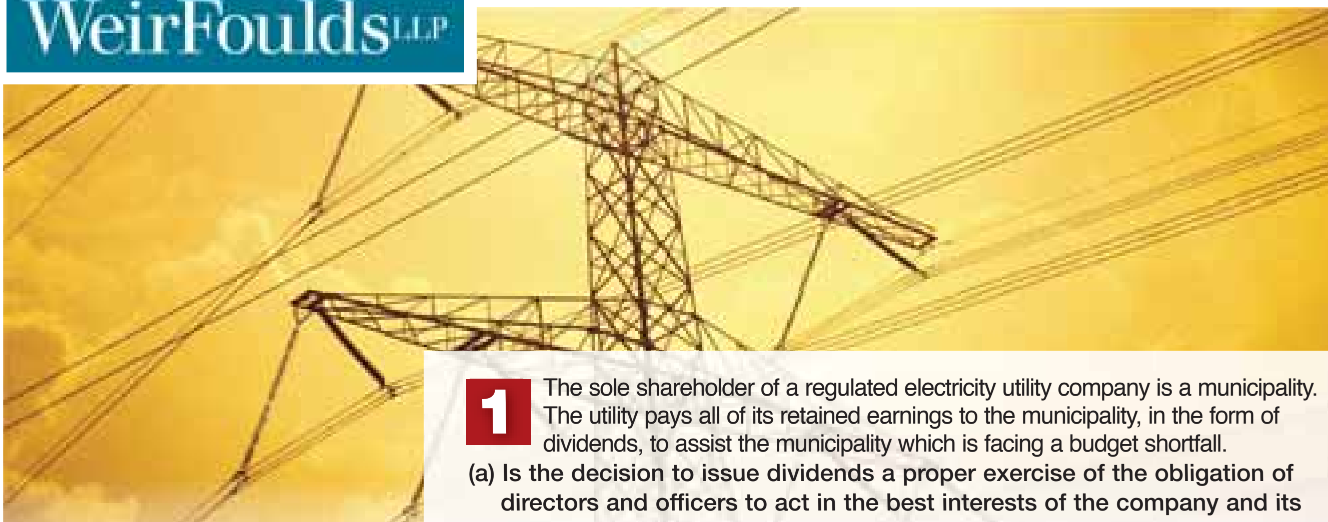

## Corporate governance in the energy sector

For in-house counsel working within the energy sector, the challenges are many, whether you're working on behalf of a public sector company serving the public purse or a publicly traded private sector entity. If you're working for the municipally owned utility, how do you reconcile the needs of the city with those of the ratepayer when both are important stakeholders? And how do politicians factor into the equation when they become directors on the board but also still represent taxpayers who vote for them? Then there is the case of the publicly traded utility that ushers in an industry veteran who takes care of himself first with a tidy compensation package that is later rejected by a new majority shareholder. What should have been done to avoid such a situation?

**1** The sole shareholder of a regulated electricity utility company is a municipality. The utility pays all of its retained earnings to the municipality, in the form of dividends, to assist the municipality which is facing a budget shortfall.

**(a) Is the decision to issue dividends a proper exercise of the obligation of directors and officers to act in the best interests of the company and its shareholder?**
**Yes or No**

**(b) Do the officers and directors of a regulated utility company also have an obligation to the utility's ratepayers?**
**Yes or No**

**2** The same municipality appoints three members of council to the seven-member board of directors. The utility proposes to increase its rates. Doing so will impose a burden on local residents and businesses. Do the municipal councillors have a conflict of interest?
**Yes or No**

**3** The electricity utility has an oil spill from one of its transformers in a remote area. The spill is contained, with apparently minimal damage to a nearby lake. The local managers of the company decide not to report the spill to the officers and directors of the company. Are the officers and directors still obligated to order a cleanup?
**Yes or No**

**4** In January, in the wake of the death of its founding chair, New Utilities Inc., a TSX-listed electric utility holding company, recruited John Sparks to serve as its new chair. Sparks was a recently retired senior executive, who had spent his entire career in the utilities industry.

NUI's shares were depressed at the time, largely due to subpar decision-making by its board and senior officers. Sparks accepted the position subject to settling his compensation package. He arranged for Venture Co. to buy out NUI's largest shareholder in February. The board consisted of nine directors, including Sparks. Four resigned and were replaced by new directors, nominated by Venture Co.

Sparks proposed a generous compensation package for himself: a signing bonus of $10 million and an option at current market value for a significant number of NUI shares. Rather than face a struggle with Sparks, the chair of the compensation committee resigned and was replaced by a new director.

Sparks retained a compensation expert to advise NUI on his compensation package. The expert report was delivered to the board and to the compensation committee in March, at the time scheduled for meetings of the committee and the board. Sparks excused himself from the portion of the meeting of the board at which his compensation package was to be considered. After about half an hour of discussion the board approved the compensation package. Subsequently, a third party acquired all of NUI's shares and sought to set aside Sparks' compensation package.

**(a) Do you think the steps taken by NUI were correct with respect to the compensation package?**
**Yes or No**

**(b) Will the court order the setting aside of the compensation package?**
**Yes or No**

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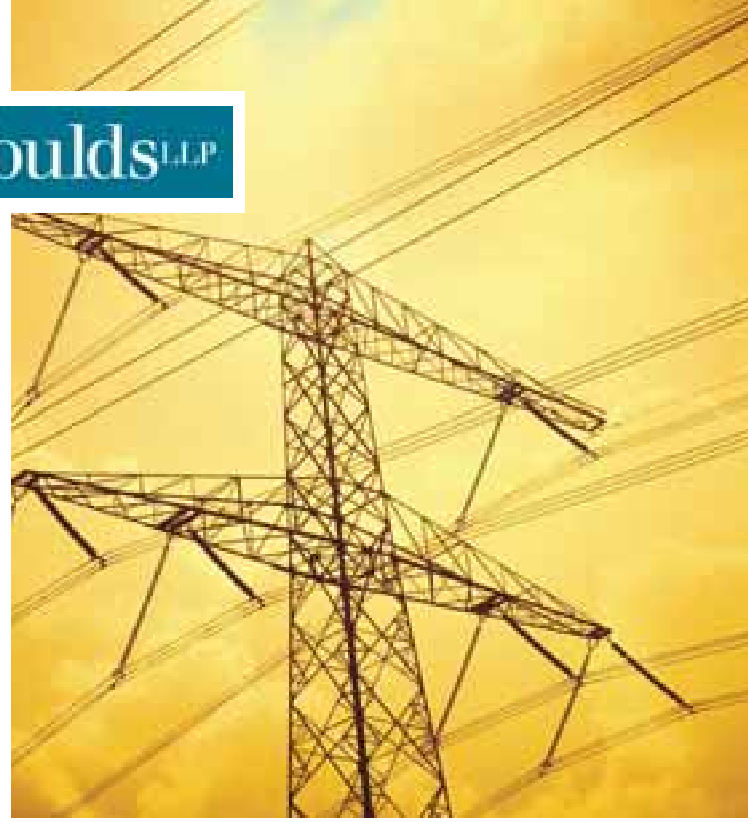

**1** **(A) YES AND (B) YES.**

The Ontario Court of Appeal has held that "the principles that govern a regulated utility that operates as a monopoly differ from those that apply to private sector companies, which operate in a competitive market. The directors and officers of unregulated companies have a fiduciary obligation to act in the best interests of the company, while a regulated utility must operate in a manner that balances the interests of the utility's shareholders against those of its ratepayers. In the circumstances, the independent directors on the utility board should assess whether paying the dividend would have adversely affected the ratepayers.

**2** **YES.**

In circumstances where the decision of the utility will impose a financial burden on residents of a municipality, an independent committee of the board of directors should approve all rate increases.

**3** **YES.**

Provincial and federal environmental protection laws impose a duty of officers and directors to take all reasonable care to prevent the company from breaching those laws. Breaches of that duty can result in the prosecution of officers and directors and, on conviction, the imposition of fines and possibly jail terms. Because of that duty, officers and directors should ensure that, among other things, there is a policy in place requiring that spills be brought to their attention forthwith. Officers and directors must also ensure that the laws governing spills are adhered to, including ensuring that spills are cleaned up and any damage remediated.

**4** **(A) NO.**

The new chair of the Compensation Committee should have consulted with the former chair. The compensation expert should have been retained directly by the Compensation Committee rather than by John Sparks. The expert should have been fully briefed by the Compensation Committee with respect to the issues. The expert report should have been considered by the Compensation Committee and the Committee should have met with the expert. A recommendation of the Compensation Committee should have been made to the board at the board meeting. The expert should have attended the board meeting to answer questions from the board. The board and the Compensation Committee should have taken more time to ensure an informed decision was made.

**(B) YES.**

In light of the flawed decision-making process on this issue, despite the "business judgment" rule, the court would likely set aside the compensation package possibly with particular reference to s.120(7)(c) of the Canada Business Corporations Act on the basis that the contract was not reasonable or fair to the corporation when it was approved.

## YOUR RANKING?

- **One or less correct:** *might be time to brush up*
- **Two correct:** *not bad, but some further work needed*
- **Three correct:** *very well done, but not perfect*
- **Four correct:** *impressive*