

Corporate Governance for Municipally-Owned Local Electricity Distribution Utilities

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Local distribution electricity utilities (“LDCs”) have been a source of stable and predictable income for their municipal owners. That is in large measure a result of the fact that LDCs are providing a monopoly service overseen by a regulator charged with the obligation, among other things, to ensure the stability of the LDCs.

One result of these circumstances is that municipalities have in many cases played a limited role in the governance of their LDCs. In addition, the directors of LDCs, including in some cases members of municipal councils, have likewise played a limited role in governance. They have elected, instead, to rely largely, if not entirely on the expertise of management. This is in part because of the complexity of the electricity distribution business, in part because the fact of regulatory oversight, and in part because the range of business decisions was limited by the absence of competitive pressures.

Several new factors are combining to make the focus on the governance of LDCs more important. Technological changes pose a potentially significant challenge to the traditional distribution model, creating the prospect of having to develop new business models with an attendant increase in business risk. At the same time, legislative changes expose LDC governance to regulatory oversight. Finally, the prospect of mergers and consolidations creates a new set of governance obligations and challenges, particularly in circumstances where municipalities, as a result of a merger or consolidation, hold only a minority interest in the LDC.

The governance obligations of directors are based, in the first instance, on compliance with the statutory obligations to act honestly and in good faith, with a view to the best interests of the corporation and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Directors are obligated to serve a corporation selflessly, honestly and loyally, and to exercise independent judgment.

Directors are obligated to avoid conflicts of interest, which in most cases will involve circumstances where a director obtains, directly or indirectly, a monetary gain as a result of his or her decisions. However, municipal councillors may encounter circumstances where monetary gain is not at issue, but where there may be a conflict between his or her obligations to the municipal owner and his or her obligations to the LDC.

In the circumstances of a merger or consolidation, a municipality may go from being a majority, or sole, owner of the LDC to holding only a minority interest. To protect its interests in those circumstances, the municipality must first ensure that the transaction processes, including the transaction documents, are designed and structured in ways which protect its interests. Once the transaction is completed, the resulting governance structure must include mechanisms, whether in the form of a unanimous shareholder’s agreement or a shareholder declaration, that provide, to the extent possible, the municipality holding a minority interest with the appropriate degree of control or influence over, and awareness of, the operations of the LDC.

The governance challenges for directors, and for municipalities, most often arise in the following circumstances:

1. Resolving conflicts in the respective roles of a director as a member of the municipal council and of the board of directors of the LDC;
2. Determining whether, or to what extent, regulatory oversight relieves directors, and indeed municipalities, of their governance obligations;
3. Ensuring that the board of directors, and the governance structure, are properly equipped to deal with the challenges of an evolving distribution sector; and
4. Ensuring that the proper transaction governance mechanisms are in place in circumstances where, as a result of a merger or consolidation, a municipality holds only a minority interest in the LDC.

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