Utility Governance and Performance

To Own or Not to Own: Ownership and Governance Issues for Municipal Electricity Distribution Utilities

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Professor Guy L. F. Holburn
Suncor Chair in Energy Policy
Director, Ivey Energy Policy and Management Centre
Ivey Business School, University of Western Ontario

Governance and performance

- Academic research finds that political control of utilities tends to impair performance
  - Two channels: regulation and gov’t ownership
  - Political objectives compromise commercial
- Corporate governance can significantly enhance gov’t-owned utility performance
  - Insulates board and management against short-term political intervention
  - Especially critical in absence of competitive market discipline on management

OECD recommendations for governance of gov't-owned utilities

- *Independence* of board and utility senior management from government
- *Clarity* in roles of government, board, senior management
- *Transparency* of performance, *disclosure* of material information

EPCOR case study

- Corporatized in 1996. City of Edmonton sole shareholder. Governance structure overhaul.
- Massive growth in revenue, assets, jobs, dividends and shareholder value since 1996
  - Geographic expansion
    - Edmonton + Alberta + BC + Arizona + New Mexico
  - Business activity reconfiguration
    - Electricity distribution – generation + water
- City has retained 100% ownership of EPCOR

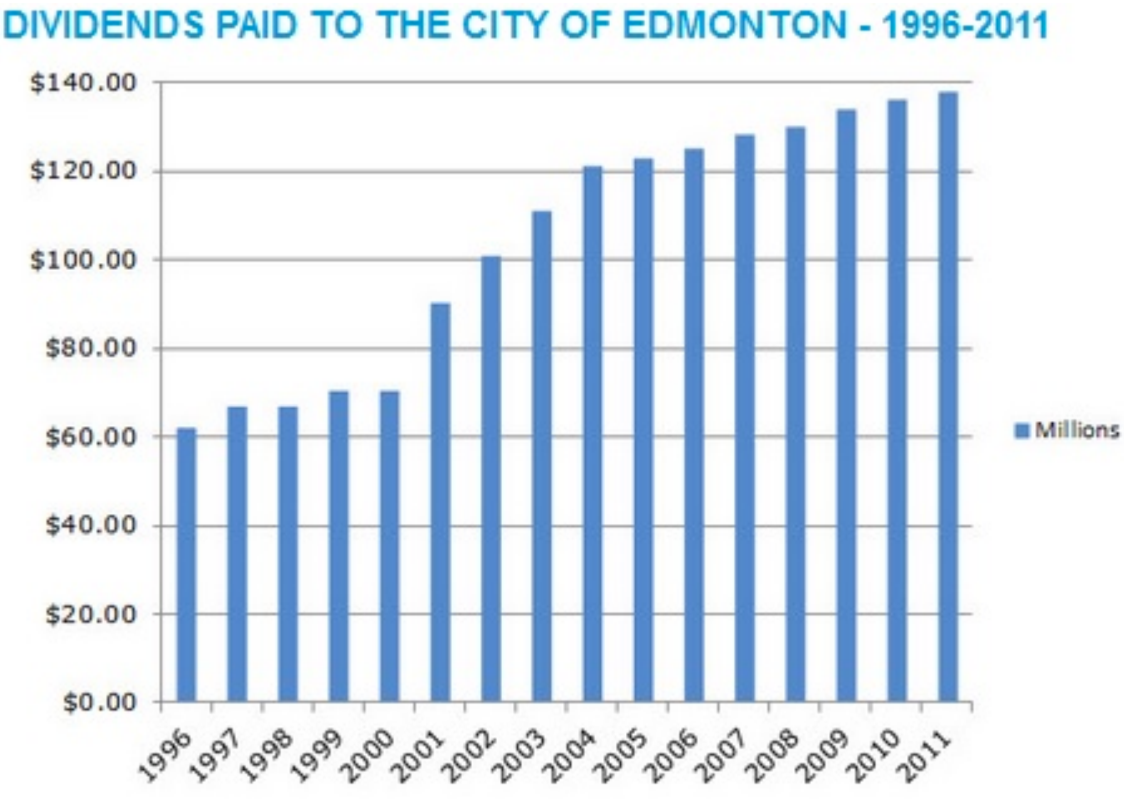
EPCOR growth 1996-2005

	1996	2005	Growth
Edmonton population ('000)	863	1,035	+20%
Revenue ($million)	919	2640	+187%
Dividends ($million)	62	123	+98%
Employees	1200	2600	+117%
Communities served	Edmonton	Alberta, BC, USA	

EPCOR growth: dividends

EPCOR's dividends account for 7% of City revenues.

In Ontario, LDC dividends typically account for <1%.



EPCOR awards

- 42 regional, national and global awards since 2000
  - Corporate governance
    - Conference Board of Canada / Spencer Stuart National Governance Award, 2004
  - Environment
    - Alberta Emerald Foundation, 2008
  - Employment
    - Canada's 50 Best Corporate Citizens, 2013

Key drivers of EPCOR's growth

1. Governance structure reform

*"Our governance structure gives us the ability to run it as a business…**our governance separates the political from the operational**. All our assets and all our businesses are overseen by an arms-length board. There is not one political appointee or one elected official…It is a blue chip board of business people and leaders from across Canada"*

Don Lowry, CEO of EPCOR, Jan 30, 2011

2. Senior management talent, vision, and incentives; Board support

A tale of two utilities: governance

	EPCOR	Pleasantville Hydro
Board of Directors	11 independent business leaders	Mayor + 2 councillors + 3 business executives
Selection of directors	National search; skills-based criteria	Local search; political or community connections
Compensation of directors	Set by Board committee, peer benchmarking	Set by Council, less than market comp levels
Shareholder Agreements	Disposal of business	Dividend = 50% of net income
		Expenditures > $3m require Council approval
		Rates must encourage economic development
		HQ must remain in city

Board selection and compensation

- OECD recommends selection of independent, business-oriented board
- Effective monitoring of utility management requires relevant board expertise
  - Especially critical given complexity and challenges in Ontario's utility sector
- Market-based compensation needed to attract best candidates, maintain attention

Pleasantville Hydro Board

- Council representation on board can interject short-term political considerations into utility strategy and operations
- Potential areas of conflict with commercial objectives
  - Investment strategy beyond city boundaries
  - Facility siting and ops (e.g. tree trimming)
  - Charitable donations
  - Dividend payment level

Shareholder Agreements

- Shareholder Agreements are another mechanism by which City can impose constraints on LDC management
  - Political motivations
    - E.g. fix dividend payment, limit board compensation, local control
    - Can impede utility performance
- Circumvent role of Board, duplicate role of OEB

Shareholder Agreements: dividends

- Dividend set as fixed percentage of net income always likely to be too low or too high
  - Cash flow and capex needs of utility change
  - Management may complain if payout ratio is too high, but not if too low!
- Board with business expertise can provide credible advice to shareholder
  - Permit dividend optimization
  - Resist “piggy bank” attitude

Potential concerns

"The utility will not be accountable"

- City remains the shareholder, can fire board

"Rates will be too high"

- Distribution rates account for only ~20% bill
- Regulated by OEB to protect consumers
- Improved efficiencies will drive rates down

"Jobs will be threatened"

- Job *creation* possible if utility expands business
- Natural attrition can rebalance workforce if needed

Concluding thoughts

- Many Ontario LDCs exhibit a high degree of political control over boards and management
- Constraints on LDC geographic boundaries and activity scope do not reflect business logic
- Governance reforms that delegate greater authority to LDC management and boards can create significant value
  - City shareholders, ratepayers, employees, economy
- EPCOR's success demonstrates feasibility