

Governance

Municipally Owned Utilities

Council for Clean & Reliable Electricity Conference
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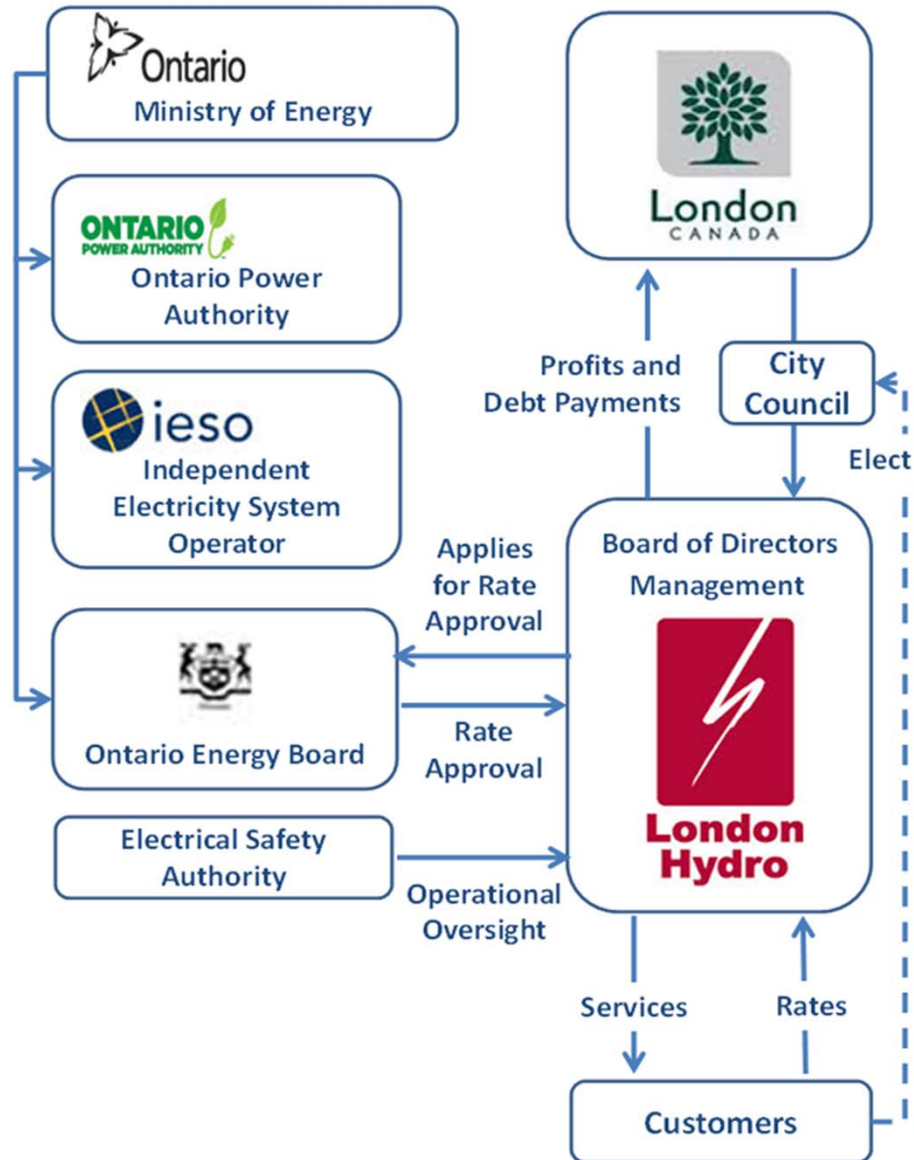
Outline

1. Introduction to London Hydro
2. Board of Directors
3. London Hydro's Shareholder Agreement
 - a. Issues and Challenges
4. Merger, Acquisition, Amalgamation & Divestiture (MAAD)
5. Summary Observations

London Hydro at a Glance

- Electricity Assets: \$240 M
- 2013 Rate Base: \$280 M
- 2013 Energy Sales: 3,346,458 MWh
- 2013 Revenue: \$404 M; Net Income: \$14.1 M
- Electricity Customers: 150,000
- Water Customers: 101,000
- Service territory 422 square kilometers; 61% urban & 39% rural.
- Approx. 300 employees
- Average Peak Load of 690 MW (Max Peak Load of 719 MW)

Governance Structure of London Hydro



What is Corporate Governance?

Corporate Governance is ...
... the system
by which organizations are
directed and controlled.

Cadbury Committee Report (UK 1992)

London Hydro's Board of Directors

1. Peter Johnson, HBA, MBA, LL.B.; Chair
2. Mohan Mathur, Ph.D., P.Eng., FCAE; Vice Chair
3. Marilyn Sinclair, BA
4. Bernard Borschke, B. Comm, FCA
5. Gabe Valente, BA, B. Comm, CPA, CA
6. Connie Graham, ICD.D, BSc Biochemistry
7. Mayor Joe Fontana – Municipal Council representative

Shareholder Agreement

1. Board appointments – 7 Board members (6 independent + 1 municipal council representative)
2. Shareholder approval – report to municipal council regarding any mandatory initiatives in excess of \$2.0 million + approval for any expenditure in excess of \$2.0 million in the regular business
3. Right to inspect
4. Statutory approval for amalgamation, dissolution or creation of any subsidiary
5. Dividend policy – 40% of net income declared as dividend

Issues & Challenges:

1. Pre-emption of Board's responsibility for any business transactions
2. Conflict in decision making – business confidentiality vs. open municipal council meetings
3. Limit on Board's authority on expenditures in excess of \$2.0 million
4. Often challenging to satisfy the contradictory demands of municipal council

How Active is Your Board?

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- 0 Very Passive (“Rubber Stamp Board?”)
 - 1 *Management theory?*
 - 2
 - 3 *Stewardship theory?*
- 4 Moderate (Oversight not Control?)
 - 5 *Agency theory?*
- 6 Quite Active (Oversight, Direction, Control?)
 - 7 *Democratic theory?*
 - 8
 - 9 *Stakeholder theory?*
- 10 Very Active (“Micro-managing Board?”)

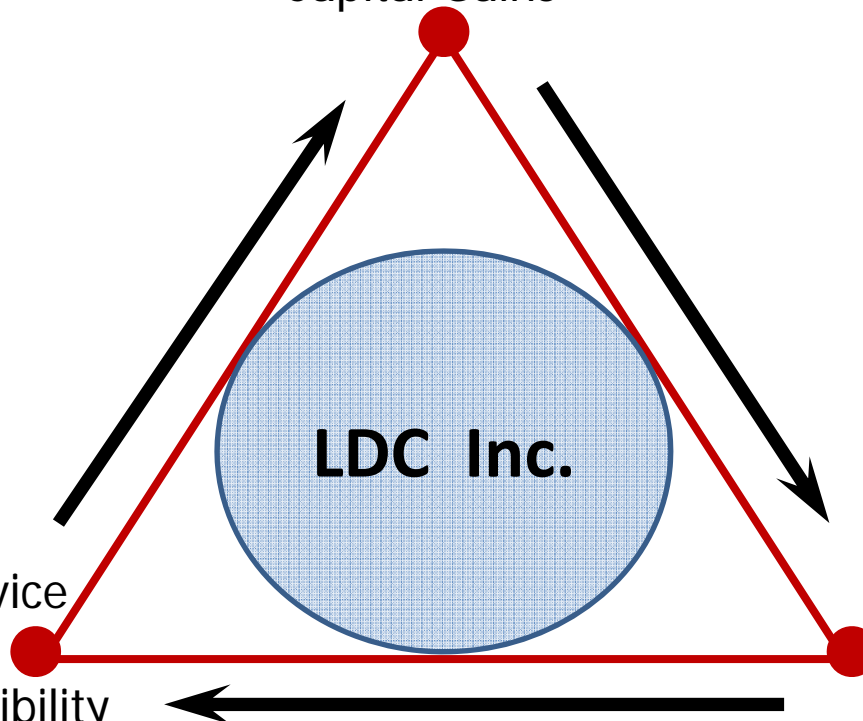
Different Strokes for Different Stakeholders

All LDCs are for profit and taxable corporations

- Shareholder(s)
- Growing Rate Base
 - Return on Equity
 - Consistent Dividends
 - Capital Gains

Customers

- Quality of Service
- Lower Rates
- Social responsibility



Employees

- Exciting work
- Wages + Benefits
- Growth

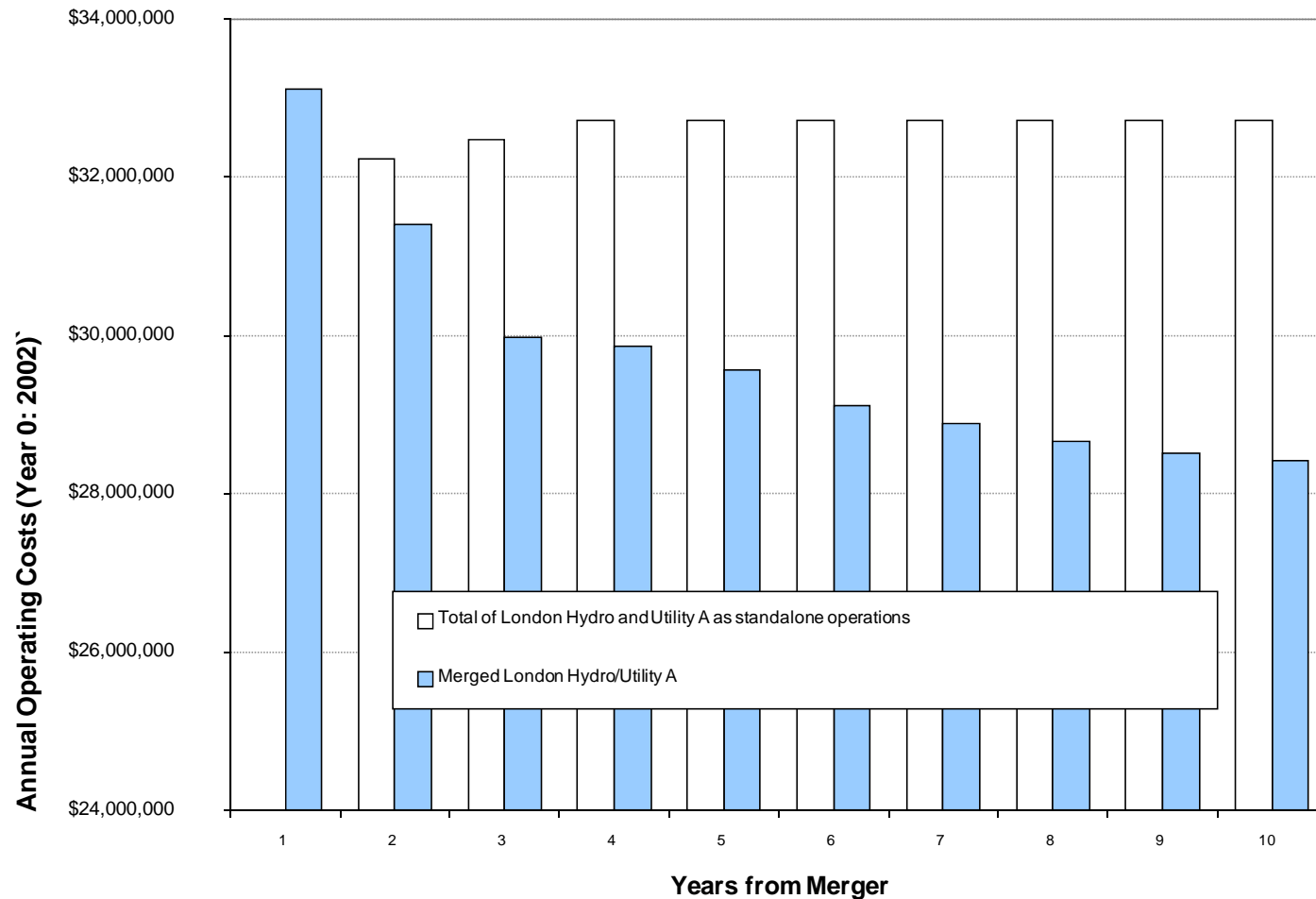
MAAD

1. Attempted approx. 4 mergers/acquisitions over the last 10 years
2. Identified significant benefits to all i.e. the Shareholder and customers
3. Always ran into roadblocks
4. Contradictory demands – local jobs, maximum benefit, controlling interest, lowest rates and best service
5. Municipal ownership is perhaps not conducive to MAAD

Benefits of Consolidation

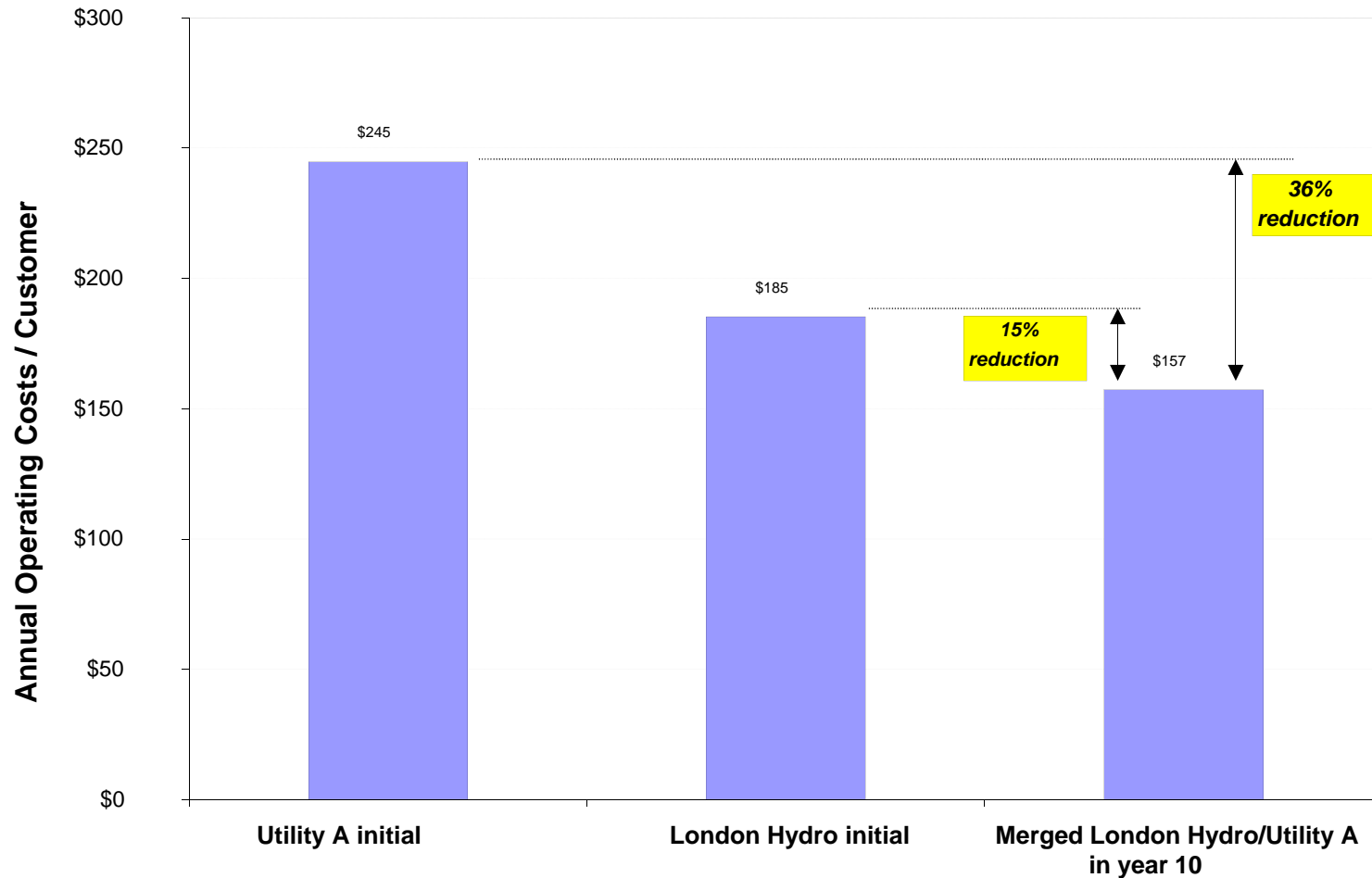
Results from a 2002 Regional Study

Table 1



Benefits of Consolidation Results from a 2002 Regional Study (cont'd)

Table 2



Consolidation Barriers

1. Municipal ownership
2. Desire to maintain (perceived) local municipal control
3. No market incentive (rate incentive) for consolidation
4. “Intervening” Hydro One service territory creates significant discontinuities / non-contiguous service territories
5. Transfer tax and departure tax (capital gains) discourages participation of private investors

Summary Observations

1. Utilities are for profit and taxable corporations
2. Municipalities should approach the governance of utilities as a business proposition and not a civic department
3. Should look to maximize shareholder value
4. Customer protection is in the hands of the regulator
 - a. Municipal Council has an erroneous view as consumer protector
5. Private equity should be allowed – in absence of this, there is only one buyer which by the way is just a transfer from one government to another government
 - a. Eliminate the transfer tax immediately: London Hydro PILs to date \$35 M; Transfer tax implication \$100+ M
 - b. As an alternative, consider increasing the private percentage sale from 10% to 49% before triggering a transfer tax
6. OEB should consider providing incentives for improved governance and consolidation e.g. 1%-2% additional return on equity