Final Elenchus Recommendations (Extracted from Elenchus Final Report)

LDC Ownership, Governance, and Performance

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GUIDANCE

- **Recommendation 1.1: The OEB guidance should be consistent with the principles in G20/OECD guidance, aligned with financial and securities regulator guidance, and consistent with the major sources for best practices in Canada, including ICD/Osler's *Directors' Responsibilities in Canada* and CCGG's *Building High Performance Boards*. The OEB should tailor its guidance to focus on the areas of greatest importance to regulated utilities and rate regulation.**

- **Recommendation 1.2: The OEB guidance should be structured in accordance with the following principles:**

    - **Principle #1: The responsibilities of the board and of directors should be defined and transparent**: The board of directors is responsible for setting the utility's strategy, overseeing the risk of the utility, monitoring the financial and operational performance of the utility, and selecting and evaluating the CEO.

    - **Principle #2: Directors should exercise their independent judgment in the best interests of the utility with appropriate balance given to the interests of customers**: Directors must be skilled in a variety of areas (including technical skills such as legal, engineering, accounting, and regulatory, and governance skills such as integrity, collegiality, and strategic thinking) and committed to the long-term best interests of the utility, including balancing the interests of customers and shareholders. They must be able to challenge management while working cooperatively in the long-term best interests of the utility.

    - **Principle #3: The structure of the board should support the effective and efficient operation of the board as it fulfills its responsibilities, particularly the exercise of independent business judgment in the best interests of the utility**: The roles and responsibilities of the board, the committees and the individual directors must be clear and robust. The structure of the board may vary, depending upon factors such as the complexity of the business and the overall corporate structure.

- **Principle #4: The board should adopt policies and practices which facilitate high performance and which ensure that the conduct of the board meets the highest standards of skill, integrity, and diligence**: The directors (and the board as a whole) must conduct themselves with the highest integrity, using the appropriate tools to govern conflict of interest, risk, strategy, stakeholder interests, communications, and assessment. They must have the policies and practices in place to support high performance and continuous improvement.

***RECOMMENDED DRAFT GUIDANCE* PREPARED BY ELENCHUS**
(NOT AN OEB DOCUMENT)

Purpose of the Guidance
Good corporate governance among Ontario's regulated utilities will benefit utilities and their stakeholders (including customers) and will assist the Ontario Energy Board (OEB) to discharge its regulatory mandate. This Guidance sets out the OEB's perspective regarding the principles of good corporate governance, and the associated structures, policies and practices. The purpose of this Guidance is to:

- Promote best practices in utility corporate governance, particularly in the areas of key focus for the OEB
- Incent continuous improvement in utility corporate governance

This Guidance is consistent with national and international principles and best practices, and it is also consistent with Canadian securities regulation guidance. The OEB Guidance is less detailed than securities regulation guidance, and is focused on the issues of greatest relevance for the OEB's regulation of utilities.

This Guidance reflects good corporate governance principles and is applicable to all rate regulated natural gas and electricity utilities in Ontario and Ontario Power Generation. This Guidance does not set mandatory requirements or minimum standards. However, utilities are expected to consider this Guidance in developing their own corporate governance practices. Utilities will be required to disclose their governance practices, along with their analysis of how their practices align with the principles and practices contained in this Guidance.

The Guidance is organized according to the following key principles of good corporate governance:

- **Principle #1: The responsibilities of the board and of Directors should be defined and transparent.**
- **Principle #2: Directors should exercise their independent judgment in the best interests of the utility with appropriate balance given to the interests of customers.**
- **Principle #3: The structure of the board should support the effective and efficient operation of the board as it fulfills its responsibilities, particularly the exercise of independent business judgment in the best interests of the utility.**

- **Principle #4: The board should adopt policies and practices which facilitate high performance and which ensure that the conduct of the Board meets the highest standards of skill, integrity and diligence.**

Principle #1: The Responsibilities of the Board and of Directors should be defined and transparent.

Best Practices include:

- The board of directors adopts a written mandate in which it acknowledges responsibility for the stewardship of the utility and sets out its responsibilities, including:
    - Adopting a strategic planning process and approving a strategic plan
    - Identifying the principal risks of the utility's business, and ensuring the implementation of appropriate systems to manage these risks
    - Succession planning (including selecting and evaluating the CEO)
    - Monitoring financial and operational performance of the utility and ensuring appropriate internal controls and information systems
    - Developing the utility's approach to corporate governance, including an assessment process
    - Adopting measures for receiving feedback from stakeholders
    - Setting the expectations and responsibilities of directors, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials, and director assessment process.
    - The board develops clear position descriptions for the chair of the board and the chair of each board committee.
- The board, together with the CEO, develops a clear position description for the CEO, which includes delineating management's responsibilities.

Principle #2: Directors should exercise their independent judgment in the best interests of the utility with appropriate balance given to the interests of customers.

Best Practices include:

- The board has a majority of directors who are independent of management and independent of affiliates, and are not the employees or councillors of municipal shareholders.
- If the board does not have a majority of directors who are independent of management and independent of affiliates, and are not the employees or councillors of municipal shareholders, then a majority of independent directors (who are not municipal employees or councillors) approves board decisions in areas involving significant potential conflict of interest, for example dividends and related-party debt. Alternatively, a committee of such directors reviews such issues for purposes of making recommendations to the Board as whole.
- The chair of the board is an independent director (and not an employee or councillor of a municipal shareholder).
- There are term limits for board directors to facilitate board renewal.
- The independent directors (who are not employees or councillors of municipal shareholders) hold regularly scheduled meetings at which other directors and members of management are not in attendance (*in camera*).
- The Board develops a skills matrix for directors. Directors are nominated on the basis of their skills and competencies, their integrity, and their commitment to the work of the board. The board adopts a policy and/or targets relating to the identification and consideration of women as directors.
- The board ensures that all new directors receive a comprehensive orientation.
- The board provides continuing education opportunities for all directors, to enhance their skills as directors and to ensure their understanding of the utility's business remains current.

Principle #3: The structure of the Board should support the effective and efficient operation of the Board as it fulfills its responsibilities, particularly the exercise of independent business judgment in the best interests of the utility.

Best Practices include:

- The board appoints the necessary committees to fulfill its responsibilities and conduct its work effectively. Generally there is an Audit Committee. Other committees could include Human Resources, Nominating, Governance, and Risk.
- Each committee has a written charter that establishes the committee's purpose, responsibilities, structure and operations.

Audit Committee

- A majority of directors on the Audit Committee are independent (and not employees or councillors of municipal shareholders) and all are financially literate.
- The Audit Committee is responsible for overseeing the financial reporting process, including:
    - Overseeing the work of the external auditor
    - Pre-approving all non-audit services to be provided by the external auditor
    - Reviewing the utility's financial statements and MD&A
    - Overseeing the work of internal audit
    - Overseeing the system of internal controls

Human Resources and Compensation

- A majority of the Directors on the Human Resources Committee are independent (and not employees or councillors of municipal shareholders).
- The Human Resources Committee is responsible for:
    - Reviewing and approving corporate goals, objectives and policies relevant to CEO selection and compensation
    - Selecting the CEO, evaluating the CEO's performance, and determining the CEO's compensation level based on the evaluation (or making recommendations to the board)

    - Making recommendations to the board with respect to non-CEO officer and director compensation
    - Succession planning for CEO and senior executives
    - Human resource oversight, including labour relations, ethical conduct and compensation policies

Nominating Committee

- A majority of directors on the Nominating Committee are independent (and not employees or councillors of municipal shareholders).
- The Nominating Committee is responsible for identifying and recommending new director nominees by considering:
    - The necessary competencies and skills for the board (skills matrix)
    - The competencies and skills of the existing directors
    - The competencies and skills of each nominee
    - Any policy and/or target relating to diversity on the board, including women

Governance Committee

- A majority of directors on the Governance Committee are independent (and not employees or councillors of municipal shareholders).
- The Governance Committee is responsible for
    - Recommending board policies and processes for effective and efficient governance
    - Recommending policies for the evaluation of individual directors and the board overall
    - Reviewing the corporate bylaws
    - Overseeing plans for board education, including new director orientation, director education and development, and board development

Risk Committee

- A majority of directors on the Risk Committee are independent (and not employees or councillors of municipal shareholders).

- The Risk Committee is responsible for:

    - Developing processes and practices to identify, measure and mitigate risk, including in the areas of enterprise risk, financial management, and cybersecurity

    - Developing recommendations for the corporation's risk tolerance policy

    - Overseeing the processes and controls in place to manage risk

Principle #4: The Board should adopt policies and practices which facilitate high performance and which ensure that the conduct of the Board meets the highest standards of skill, integrity and diligence.

Best Practices include:

Code of Conduct

- The board adopts a written code of business conduct and ethics (applicable to directors, officers and employees). The code includes standards that are designed to promote integrity and to deter wrongdoing and address the following issues:

    - Conflicts of interest

    - Protection and proper use of corporate assets and opportunities

    - Confidentiality of corporate information

    - Fair dealing with the utility's security holders, customers, suppliers, competitors and employees

    - Compliance with laws, rules and regulations

    - Reporting of any illegal or unethical behaviour

- The board is responsible for monitoring compliance with the code. Any waivers from the code that are granted for a director or executive officer are granted by the board (or a board committee) only.

Conflict of Interest

- The board develops processes and practices which promote independent decision-making by the board and which address issues of potential conflict of interest involving decisions on matters such as dividends, affiliate transactions, major investments, and non-utility business activities.

Risk

- The board develops processes and practices to effectively identify, measure, and mitigate risk. The board explicitly identifies the utility's risk tolerance and oversees the processes and controls in place to manage risk.

Strategy

- The board develops processes to ensure the development of a strong strategic plan. The board approves the utility's strategy, and the board oversees the implementation of the plan, the alignment with regulatory proposals, and the assessment of utility performance against the plan.

Stakeholder Interests

- The board develops processes and practices that promote effective consideration of stakeholder interests as part of the board's decision-making. This includes the consideration of the impacts of rate proposals on customers.

Communication

- The board develops processes and practices that promote effective and appropriate communication, including:
    - Information sharing between the board and management
    - Information sharing between the board and the shareholders
    - Disclosure of corporate governance practices

Assessment

- The board and its committees conduct regular assessments of their effectiveness.
- Each director is regularly assessed regarding his/her effectiveness.

MONITORING

- **Recommendation 2.1: The OEB should implement disclosure requirements for baseline utility corporate governance information.**

- **Recommendation 2.2: The baseline reporting should include disclosure of corporate governance practices in each of the areas identified in the guidance, and should include reporting in specific areas of interest from a regulatory perspective.**

    - **Board responsibilities**: Disclose all Unanimous Shareholder Agreements or Sole Shareholder Declarations. This will show the extent of the decision-making authority of the utility board of directors. Disclose the mandates and/or charters for the board and each of the committees.

    - **Director independence**: Disclose the name of each director and whether he/she is independent and the criteria used to determine independence and whether he/she is a councillor or employee of a municipal shareholder. If the majority of the board is not independent, provide an explanation of how the board maintains independent judgment.

    - **Director selection**: Disclose the necessary qualifications (e.g. the skills matrix) and selection process, including considerations of gender and diversity. Disclose orientation, education and development practices. Disclose the attendance record of directors (including committees).

    - **Board assessment**: Disclose the methods for assessing board and director performance.

    - **Significant board events**: Disclose material changes to board composition, risk profile, or business strategy. Disclose material acquisitions/investment, or health/safety/environmental/cyber security incidents.

- **Recommendation 2.3: The OEB should set a disclosure framework that ensures high quality and timely reports, is not overly burdensome, and is aligned with other reporting or regulatory activities.**

ASSESSMENT

- **Recommendation 3.1: The OEB should assess the corporate governance practices of individual utilities through the cost of service (or Custom IR) proceeding, or through some other process.**

- **Recommendation 3.2: The OEB should conduct periodic systemic assessments of governance practices against best practice and the OEB guidance.**

  The OEB should periodically (e.g. every two or three years) review the baseline disclosure information and identify best practices and high quality disclosure which could serve as benchmarks for others.

- **Recommendation 3.3: The OEB should conduct periodic systemic assessments of governance practices in key regulatory areas.**

  In applying a risk-based, criteria-driven approach to periodic reviews, the OEB should consider the following areas:

  - **Risk management**: Assess the policies and practices for board consideration of risk, controls, mitigation, etc., with particular attention to enterprise risk management, financial management and cybersecurity risk.

  - **Stakeholder interests**: Assess the policies and practices for considering the interests of stakeholders in key decisions (e.g. strategy, risk, major investments, dividends, etc.). Stakeholders include customers, debtholders, shareholders, employees, suppliers, etc.

  - **Conflict of interest**: Assess the policies and practices for identifying and addressing potential conflicts of interest in key areas (e.g. dividends, affiliate transactions, non-utility activities, etc.)

  - **Key regulatory issues**: Assess whether and how the board of directors engages on issues of key importance to the OEB's regulation (e.g. strategic plan, Distribution System Plan, rate proposals, cyber security).

  Elenchus does not recommend that the OEB undertake systemic assessments in all of these areas at once. The OEB should consider these (and other) areas against a set of risk-based criteria and identify one area for review each year or two.

- **Recommendation 3.4: The OEB should have direct interaction with utility board directors through an open process.**

  Elenchus recommends that the OEB convene a corporate governance conference every three years, which would provide an open forum for utility directors and senior executives to exchange views and ideas with the OEB and stakeholders

- **Recommendation 3.5: The OEB should conduct a periodic review of the guidance to assess whether it is still current in terms of best practices and whether it is still aligned with the OEB's regulatory priorities.**