Ivey Business School
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# Corporate Governance of Government-Owned Utilites:
## Lessons from EPCOR Utilities Inc.

By Guy Holburn and David Hay

*Hugh Bolton was appointed as Chair of the Board of EPCOR Utilities commencing January 1, 2000, and served in that position for 18 years, after which he was succeeded by Janice Rennie. During Bolton's tenure, EPCOR expanded its operations in power distribution as well as water and waste-water management across Canada and the United States, becoming one of the largest municipally-owned utilities in North America. During the 20-year period to 2018, the value of EPCOR's assets increased from $2.1 to $6.2 billion, the number of employees grew from 1,600 to 2,771, and cumulative dividend payments to the City of Edmonton totalled $2.3 billion. The company has been awarded more than 40 regional, national and global awards since 2000, and has been recognized as one of Canada's most successful government-owned companies.*

*Bolton discussed his experience as Chair and his insights about corporate governance in the municipal utility sector in a conversation with Guy Holburn, Professor at Ivey Business School, and David Hay, Director of EPCOR and of Hydro One. Janice Rennie, the current Chair of EPCOR and a board member from 1996 to 2004, shared her perspective on the early years of EPCOR's transformation after its incorporation in 1995. The following dialogue has been edited for clarity and brevity.*

### Can you take us back to EPCOR in the 1990s and provide some context around the structural changes to the electricity sector in Alberta?

**Rennie:** an important moment in EPCOR's modern history was Edmonton City Council's decision to incorporate Edmonton Power in 1995, transforming it from a city department to a business corporation wholly owned by the city. The decision was taken in the context of significant change in the province's electricity sector, which was restructured under the 1995 Electric Utilities Act, notably creating a competitive wholesale electricity market. This meant that EPCOR, which owned a large amount of generation capacity, had to shift from operating as a fully rate-regulated monopoly utility to a market environment where it had to compete for customers in the wholesale market. To survive in this environment, EPCOR needed to become more business-oriented and the mayor and council felt this would be more feasible as an independent business. Attracting management talent would be easier, and the utility could raise financial capital through its own debt placements at a time when municipal budgets were under pressure. The mayor at the time, Bill Smith, was a successful businessman, so he was supportive of making EPCOR an independent business entity, and he provided leadership on council. From the early years, council appointed experienced business executives to the board, beginning with Bob Phillips, a lawyer and former Husky executive, who was Chair from 1994 to 1999. So the late 1990s were a transformative period that helped to lay the foundation for EPCOR's subsequent growth.

**We see a range of corporate ownership structures in the electricity sector in Canada, although much of the industry is government-owned, which brings unique governance considerations. Going back to 2000 when you first joined the board as Chair, what was your approach to governance and the role of the board for a municipally-owned utility like EPCOR?**

**Bolton:** I was encouraged to apply for the position by the then mayor of Edmonton, Bill Smith, who introduced me to the new CEO, Don Lowry, who had a vision for the company at a time when the generation sector – in which EPCOR was heavily involved – was deregulating in Alberta. My priority when I started as Chair was to maintain a strong business-oriented board with directors who would complement the company's strategy – which meant recruiting from outside Edmonton. There was just one City councillor on the board, who shortly retired, and I had the opportunity to renew the board membership with 100% private sector directors. Doug Mitchell, a well-known Calgary executive, was the first director from outside Edmonton, and then Helen Sinclair, a Toronto-based director of TD Bank, joined the board too. We wanted to build a North American company so it was important to recruit the most talented directors from across the country. As the company has expanded into the United States, we have also recruited outstanding American directors as well. In 2014, Bob Foster joined the board, bringing experience as former President of Southern California Edison, Chair of the California Independent System Operator and Mayor of Long Beach.

**Let's turn to the Board's relationship with the shareholder, the City of Edmonton, and how this has evolved over time. What is the role of the city Council in governance matters and how have you and the Board managed the relationship with the City over the years?**

**Bolton:** The formal basis for EPCOR's governance structure and each party's role and responsibilities is specified in a Unanimous Shareholder Agreement (USA), which we worked out with the City over a period of six months. The USA gives the corporation considerably autonomy and flexibility to conduct its operations and practices without Council involvement. The main constraint is that the corporation cannot sell material assets (more than 50% of total corporate assets) without the permission of council.

Council's primary role as shareholder is to appoint new directors when terms expire – we extended the appointment term for directors to 10 years in the USA. I should note though that the Chair can be replaced each year by council! EPCOR's board identifies and proposes new board members to council for their approval. The mayor and council always knew who was retiring and what skills were needed for the board, and they had the ability to interview candidates in camera. During my time as Chair, council never refused a recommendation, and we were able to perpetuate a completely business-oriented board. We also had council support for compensating directors at a level needed to attract the best in the field and for instituting raises when needed. We knew that we couldn't compensate at the level of the private sector, and we had no equity to offer, so we settled on a range of $100,000 to $125,000 for director fees. Compensation of the board and senior management was always transparent to the public.

Of course, it was important to develop good relationships with the mayor, councillors and city staff. There is always a risk that the next mayor may not believe in the EPCOR model and want to intervene – the Chair has to manage this relationship through regular communication, transparency, respectful dialogue, and a policy of 'no surprises'. We would hold quarterly shareholder meetings at city hall and invite all the councillors and senior staff to attend.

That said, when the train is on the tracks it is hard to knock it off: EPCOR has demonstrated strong performance over a long period of time – and the dividend has steadily increased – so it would be tough for a new mayor to significantly change the governance structure when the existing arrangements are working.

**Talking of financial issues, what was EPCOR's dividend policy and payments?**

**Bolton:** EPCOR has paid major dividends to its shareholder, the City of Edmonton. In 2000, the annual dividend was $70 million (47% of net income), which increased to $166 million by 2018 (56% of net income). Don Iveson, the mayor, said at one point that property taxes would be 10% higher without EPCOR's annual dividend. The City always knew what EPCOR's dividend plans were and we stuck to the strategy of increasing or maintaining dividends over time.

**EPCOR has undergone a dramatic transformation and expansion of its business since 2000, becoming a 'water and wires' company with more than half of its operating income derived from water services and one third from electricity distribution and transmission. An important step was divestiture of its power generation assets through an IPO of Capital Power in 2009, shortly after the global financial crisis. By 2016, EPCOR had electricity distribution, transmission and energy services operations throughout Alberta, and its water business in Canada had expanded into British Columbia and Saskatchewan. Following acquisitions in the United States, EPCOR has become the largest private water/waste-water operator in the southwest region. Can you walk us through the rationale for these strategic developments and how they were achieved?**

**Bolton:** The company's long-term vision of expansion in the rate-regulated network utility business required signicant financial capital, which we didn't have ready access to. We made two strategic sales of non-core assets which provided funds for investment. In 2003, we sold the Union Energy water heater business, raising over $400 million in the process, but we had to carefully explain to Council that EPCOR needed to retain the capital in order to execute on its strategy.

The bigger move came with the shift out of power generation which, following deregulation, had become a more volatile and risky business that wasn't a natural fit with our shareholder's risk tolerance profile. Selling equity in Capital Power needed council approval and we were also proposing to freeze the dividend (at $140 million) for four years so we could accumulate sufficient capital for a major acquisition. We met monthly with council and the mayor, who was supportive, to explain why an IPO in the aftermath of the financial crisis made sense and what EPCOR intended to do with the new capital – projected at $1 billion. There were some sleepless nights during this period. In the end, council voted overwhelming in favour of the Capital Power transfer with an 11-2 vote. The IPO was the only one in Canada in 2009.

We then spent some time patiently evaluating investment opportunities before deciding that the U.S. water utility sector was an attractive strategic fit for EPCOR. EPCOR already knew a lot about the water industry and rates of return were considerably higher in the U.S. than in Canada. Don Lowry, our CEO, went to Arizona to conduct due diligence, meet with all the stakeholders, and to assess whether an acquisition could be made at a reasonable price. It's quite a different environment down there – regulators are elected! – and you need senior management who are well connected and politically clued in. There were some gulps along the way but the acquisition of American Water in 2011 (for US $470 million) was a defining moment for EPCOR – and it has proved to be a very successful and profitable move. We subsequently expanded into Texas and New Mexico. None of these acquisitions needed Council approval. The board gets a lot of credit here for focusing on strategic issues during its board meetings in this period, and selecting the right CEOs and directors for the new businesses.

**Despite the demonstrable success of EPCOR over the last two decades, many municipal governments in Canada haven't proved willing to establish similar arms-length corporate governance structures with their LDCs. Why do you think this is the case and what advice would you have for local governments?**

**Bolton:** My view is that it would help a lot of LDCs to have corporate governance arrangements that reflect private sector standards and to appoint experienced business executives to their boards. It helps to have a mayor who fundamentally understands business and who can provide leadership to council. One example has been with EnMax in Calgary, which has moved to a more business-oriented governance structure. I hope that more will follow.

*Post script: Hugh Bolton passed away at the age of 82 after this interview was conducted. His obituary, published in the Globe and Mail, is available here.*

## AUTHORS

**Guy Holburn** is the founder and Director of the Ivey Energy Policy and Management Centre, and Professor of Business, Economics and Public Policy at Ivey Business School. His research and teaching focuses on regulation, governance and strategy issues in the energy and utilities sectors. He has published widely in top peer-reviewed academic journals, and authored more than a dozen reports on provincial and federal energy policies. He is a director of London Hydro and a member of the Council for Clean & Reliable Energy. Holburn has served as consultant to corporations and governments in Canada and the U.S., and he has testified in commercial litigation and at the Muskrat Falls Inquiry. He holds a PhD and MA from the University of California, Berkeley and a BA Hons. (First Class) from Cambridge University. Previously he worked for several years as a management consultant for Bain and Company in the U.K. and in South Africa.

**David Hay** is the Managing Director of Delgatie Incorporated, a strategic advisory firm. He is the former Vice-Chair and Managing Director of CIBC World Markets Inc., a role he held until 2015. From 2004 until 2010, he was President and Chief Executive Officer of New Brunswick Power Corporation. Mr. Hay sits on the boards of Hydro One and EPCOR Utilities Inc., and the Council of Clean and Reliable Energy. Prior directorships include Toronto Hydro-Electric System Limited, where he was Vice Chair, and Associated Electric & Gas Insurance Services Limited (AEGIS). Mr. Hay has also chaired both the Beaverbrook Art Gallery and SHAD Canada. Mr. Hay holds a Bachelor of Laws from Osgoode Hall Law School, York University and a Bachelor of Arts from the University of Toronto (Victoria College). He is a Fellow of the Ivey Energy Policy and Management Centre and holds his ICD.D.