

TO:	CHAIR AND MEMBERS STRATEGIC PRIORITIES AND POLICY COMMITTEE MEETING ON MAY 16, 2016
FROM:	MARTIN HAYWARD MANAGING DIRECTOR, CORPORATE SERVICES AND CITY TREASURER, CHIEF FINANCIAL OFFICER
SUBJECT:	LONDON HYDRO INC. AMENDED AND RESTATED SHAREHOLDER DECLARATION

RECOMMENDATION

That on the recommendation of the Managing Director, Corporate Services and City Treasurer, Chief Financial Officer, with the concurrence of the City Manager, the attached proposed By-law (Appendix "A") BE INTRODUCED at the Municipal Council Meeting to be held on May 17, 2016:

- a) TO RATIFY AND CONFIRM the Resolution of the Shareholder of London Hydro Inc. approving the Shareholder Declaration for London Hydro Inc., attached to the By-law as Schedule "1";
- b) TO AUTHORIZE the Mayor and City Clerk to execute the Resolution of the Shareholder; and
- c) TO AUTHORIZE the Mayor and City Clerk to execute the Shareholder Declaration attached to the Resolution of the Shareholder as Schedule "A"

PREVIOUS REPORTS PERTINENT TO THIS MATTER
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Board of Control – September 12, 2007 - London Hydro Inc.
Board of Control – July 16, 2008 - London Hydro Inc.

BACKGROUND

London Hydro Inc. (London Hydro) is a corporation with share capital incorporated under the *Business Corporations Act, R.S.O. 1990 c. B16*. The Corporation of the City of London (the City) is the sole shareholder. London Hydro is managed by a Board of Directors appointed by City Council.

London Hydro is a regulated electrical Local Distribution Company (LDC). Local Distribution Companies (LDC's) such as London Hydro take power from high voltage transmission lines and deliver the power to residential, commercial and industrial customers.

London Hydro is regulated by the Ontario Energy Board (OEB). The OEB is an independent self-financing, provincially-owned corporation whose responsibility includes regulating the province's electricity sector to among other things, protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.

As the sole shareholder of London Hydro, the City of London:

- Appoints and/or changes the composition of the Board of Directors
- Receives dividends declared by the Board of Directors
- Determines appropriate governance, by-laws and share structure

- Approves changes in ownership (acquisitions, mergers or sale), subject to the approval of the OEB

What is a Shareholder Declaration?

The purpose of the shareholder declaration is to outline the expectations of the shareholder relating to the principles of governance and other fundamental principles and policies of the corporation and any subsidiaries. The shareholder declaration provides a greater level of detail and specificity for some of the governance matters addressed in London Hydro's general operating by-law and the applicable legislation.

The current shareholder declaration was passed by Council on October 1, 2007. It remains unchanged except for one small amendment made in 2008 to remove the restriction on the number of terms a director may serve.

The current shareholder declaration was created as a result of a strategic review of London Hydro conducted by Navigant Consulting on behalf of the City. Navigant recommended that the City and London Hydro clarify London Hydro's governance structure to provide some certainty of the City's expectations on the strategic initiatives that London Hydro may pursue as well as the debt structure and dividend policy for the corporation.

Key elements of the shareholder declaration identified when it was introduced in 2007 include provisions for a capital structure consistent with industry norms and sound financial principles that allows London Hydro to maximize its return on investment; a dividend policy; reporting requirements for any offer for joint venture, partnership, strategic alliance or other venture and corporate combination and disposition guidelines. The shareholder declaration also sets the number of directors at seven; one member of Council and six other at large members serving 3 year staggered terms.

The Shareholder Declaration includes the following:

- 1) Interpretation – Article 1
- 2) Permitted Business Activities – Article 2
- 3) Standards of Governance – Article 3
- 4) Board of Directors – Article 4
- 5) Financial Policies, Risk Management and Strategic Planning – Article 5
- 6) Shareholder Approvals and Communications – Article 6
- 7) Annual Resolutions and Meetings – Article 7
- 8) Matters Requiring Shareholder Approval – Article 8
- 9) Revisions to this Declaration – Article 9
- 10) Confidentiality – Article 10
- 11) Notices – Article 11
- 12) Corporate Combination and Disposition Guidelines - Schedule "A"

What are the Proposed Changes to the Shareholder Declaration?

The significant changes to the shareholder declaration are to sections 4.6, 5.6, Article 6, 8.7, 8.8, 8.12 and the corporate combination and disposition guidelines in Schedule "A". These are discussed below. Some minor amendments such as new definitions, formatting, typographical and grammatical corrections have also been made. All of the proposed amendments have been reviewed and approved by London Hydro.

Sections 4.6 and 8.8 - Directors' Compensation

Currently section 4.6 provides that:

"The Shareholder shall establish compensation for directors of the corporation, the Chair and any other officers who are directors of the Corporation in amounts sufficient, in

the opinion of the Shareholder acting reasonably, to attract candidates with necessary qualifications and consistent with industry norms and standards for comparable Ontario electricity distribution utilities. A director that is a member of Council shall receive no additional compensation for acting as a Director.”

Section 8.8 prohibits the corporation from changing altering or amending the compensation of a director without the approval of the shareholder.

It is proposed that section 4.6 be amended by adding the wording:

“The Shareholder acknowledges and agrees that if no compensation adjustment is specified by the Shareholder for the directors pursuant to section 8.8, the compensation for the directors shall be increased annually in accordance with the policy of the Council for remuneration of elected official and citizen appointments.”

The Board of Directors have not received an increase for a number of years. Given the complexity and fiduciary responsibility associated with being a director of London Hydro, it is deemed important to have remuneration at a minimum to keep pace with inflation. This amendment provides that, unless otherwise directed by the shareholder, the annual adjustment will follow the increase outlined in Council policy 5(32) for “Remuneration for Elected Officials and Appointed Citizen Members”.

Section 8.8 includes an amendment to provide that increases in accordance with the policy of the Council for Remuneration of Elected Officials and Appointed Citizens will not require shareholder approval.

Section 5.6 - Return to Shareholder

Section 5.6 has been amended to provide that any special payment declared by the Board will be made within two years of the declaration date on a date or within a range of dates set by the Board. The current wording provides for such special payment to be made on April 30th of the year following in which it applies.

This change allows London Hydro to manage cash flow requirements over a reasonable timeframe.

Article 6 - Shareholder Approval

The following section has been deleted from the declaration:

“Reports to Council re Mandatory Initiatives. The Board shall advise the shareholder in the form of a written report containing appropriate details with respect to expenditures relating to smart meters or other government or regulatory mandated initiatives where any such initiative could reasonably be expected to result in capital expenditures in any fiscal year in excess of \$2,000,000 (two million dollars).”

It is open to Council as shareholders to request any information concerning the capital investments of London Hydro, not just those limited to mandatory initiatives.

Section 8.7- Approval of Joint Ventures, Partnerships, Strategic Alliances

Under section 8.7, shareholder approval is required for the corporation to enter into any joint venture, partnership, strategic alliance or other venture if the exposure to the corporation is \$2 million in the aggregate. It is proposed to increase this amount to \$5 million in the aggregate.

The greater dollar limit is reasonable from a business perspective and provides the London Hydro Board with greater flexibility.

Section 8.12 - Approval for Expenditures in Respect of Unregulated Competitive Business

Under section 8.12, shareholder approval is required for the corporation to incur any expenditure in respect of an unregulated, competitive business, whether within the regulated distribution company or otherwise in excess of \$2 million. It is proposed to increase this amount to \$5 million. It is noted that a business plan in support of such expenditure is required.

In addition to the dollar limit change, the section clarifies the requirement for a business plan in advance.

Schedule "A" - Corporate Combination and Disposition Guidelines

Section 8.7 provides that the corporation shall not, without shareholder approval, enter into any joint venture, partnership, strategic alliance or other venture where the exposure to the corporation is \$5 million or more in the aggregate. Section 8.7 further provides that the shareholder shall follow the Corporate Combination and Disposition Guidelines set out in Schedule "A" in assessing any such opportunity.

Section 3 included the following clause:

"(c) there should be established appropriate and fair arrangement to address Corporation's employees in the proposed disposition arrangements".

This clause has been deleted so as to ensure that the City will not be responsible for London Hydro's employees in the event of a disposition.

Schedule "A" included a due diligence checklist which has been removed. This checklist was provided to the City and London Hydro in 2005 by Navigant Consulting. As noted earlier, Navigant Consulting was retained by the City to do a strategic review of London Hydro's potential future ownership options because the Province of Ontario was trying to reduce the amount of LDC's from 90 utilities to about six.

The due diligence checklist has been removed because it is considered out of date. If the City is asked to approve a joint venture, partnership, strategic alliance or other venture under section 8.7, it will have to complete its own due diligence. The best practice would be to structure the due diligence outside of the shareholder declaration. Standards would be tailored based on the specific transaction that the City would be reviewing and would include recommendations from legal and other experts conducting the review and advising the City.

What is a Unanimous Shareholder Declaration?

London Hydro operates under the *Business Corporations Act*, S.O. 1990. While the City is the sole shareholder, it is not the manager of the corporation. The directors manage and supervise the business, affairs and operations of London Hydro. Directors owe a fiduciary duty solely to the corporation. In exercising their powers and duties they must act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Section 1.2 of the Shareholder Declaration states:

"Except as and to the extent provided in Section 5.4 and Article 8, this Shareholder Declaration is not intended to constitute a 'unanimous shareholder agreement' under the OBCA or to formally restrict the exercise of the powers of the Board"

Section 108 of the *Business Corporations Act* provides as follows:

Unanimous shareholder agreement

108 (3) Where a person who is the registered holder of all the issued shares of a corporation makes a written declaration that restricts in whole or in part the powers of the directors to manage or supervise the management of the business and affairs of a corporation, the declaration shall be deemed to be a unanimous shareholder agreement.

Where shareholder has power, etc., of director

108 (5) A shareholder who is a party to a unanimous shareholder agreement has all the rights, powers, duties and liabilities of a director of a corporation, whether arising under this Act or otherwise, including any defences available to the directors, to which the agreement relates to the extent that the agreement restricts the discretion or powers of the directors to manage or supervise the management of the business and affairs of the corporation and the directors are relieved of their duties and liabilities, including any liabilities under section 131, to the same extent.

To the extent that section 5.4 and Article 8 of the shareholder declaration restrict the discretion or powers of the directors to manage or supervise the management of the business and affairs of London Hydro, the directors will be relieved of their duties and liabilities, including any liability to employees for wages, and the City, as shareholder, will acquire all of the rights, powers, duties and liabilities of the directors as it relates to these matters. In such instance, the City as the shareholder will be subject to the same liabilities and obligations as are imposed on directors under the *Business Corporations Act* and the common law including fiduciary obligations, standard of care, the duty to disclose interest in material contracts and liability for tortious conduct.

In keeping with the Navigant Report, sections 5.4 and Article 8 include significant issues which the Council would want to control including dividend policy, issuance, redemption and purchase of sales, joint ventures or partnerships, borrowing other than in the ordinary course of business, sale or transfer of assets other than in the ordinary course of business and assuming financial obligations that would increase the ratio of debt to equity on a consolidated basis above 70:30.

Section 5.4 and Article 8 of the Shareholder Declaration provides as follows:

5.4 Dividend Policy. The Board shall use its best efforts to declare and pay a regular dividend to the Shareholder. The payment of any dividend shall be subject to the following:

- (a) As a target, annual dividend payment are expected to comprise 40% of annual net earnings of the Corporation;
- (b) Where annual net earnings of the Corporation exceed normal net earnings, the Board shall consider declaring a special payment in an amount equal to such excess net earnings; and
- (c) No dividend is to be declared where to do so would, in the Board's reasonable opinion, impair the Corporation's ability to carry out necessary or appropriate improvements and maintenance of existing infrastructure.

ARTICLE 8 MATTERS REQUIRING SHAREHOLDER APPROVAL

Without Shareholder approval given in accordance with Section 6.1 of this Shareholder Declaration, the Corporation or any Subsidiary respectively shall not:

Statutory Approval Rights.

8.1 change the name of the Corporation or a Subsidiary; add, change or remove any restriction on the business of the Corporation or a Subsidiary; create new classes of shares; or in any other manner amend its articles of incorporation or make, amend or repeal any by-law;

8.2 amalgamate with any other corporation(s) other than amalgamations which may, under the OBCA, be approved by a resolution of directors;

8.3 take or institute proceedings for any winding up, arrangement, or dissolution of the Corporation or its Subsidiaries;

8.4 apply to continue the Corporation or any Subsidiary under the laws of another jurisdiction;

Additional Approval Rights.

8.5 issue, or enter into any agreement to issue, any shares of any class, or any securities convertible into any shares of any class, of the Corporation or any Subsidiaries respectively;

8.6 redeem or purchase any of the Corporation's or its Subsidiaries' outstanding shares;

8.7 enter into any joint venture, partnership, strategic alliance or other venture, including without limitation ventures in respect of the generation or co-generation of electricity if the exposure to the Corporation is \$5,000,000 (five million dollars) or more in the aggregate. In assessing such opportunity, the Shareholder shall follow the Corporate Combination and Disposition Guidelines set out in Schedule "A";

8.8 change, alter or amend the compensation of any member of the Board beyond the prescribed annual increase set forth in Section 4.6 of this Shareholder Declaration;

8.9 borrow money or give security on the assets of the Corporation other than in the ordinary course of business, or in connection with the purchase of assets;

8.10 enter into any agreement, transaction or other arrangement which would cause the municipality to be liable to pay transfer tax under section 94 of the *Electricity Act*;

8.11 sell any distribution assets other than in the ordinary course of business;

8.12 incur any expenditure in respect of an unregulated, competitive business, whether within the regulated distribution company or otherwise, in excess of \$5,000,000 (five million dollars) and if in excess of \$5,000,000 (five million dollars), any Shareholder approval in respect thereof will require a business plan in support of such expenditure;

8.13 assume any financial obligation that would increase the ratio of debt to equity of the Corporation, on a consolidated basis, above 70:30;

8.14 make any decision or take any action that could reasonably be expected to materially and adversely affect the regulatory or tax status of the Corporation; and

8.15 enter into any agreement or arrangement to dispose of, by way of sale, transfer, exchange or lease, any real property, except in the ordinary course of business.

Consultation with London Hydro

Pursuant to section 9.1 of the declaration, the City has consulted with London Hydro about the proposed amendments. London Hydro's board has reviewed and approved the proposed amendments.

RECOMMENDED BY:	CONCURRED BY:
MARTIN HAYWARD MANAGING DIRECTOR, CORPORATE SERVICES AND CITY TREASURER, CHIEF FINANCIAL OFFICER	ART ZUIDEMA CITY MANAGER

Attachments:
Appendix "A" – By-law to ratify and confirm the Resolution of the Shareholder

APPENDIX "A"

Bill No.
2016

By-law No. A.-

A by-law to ratify and confirm the Resolution of the Shareholder of London Hydro Inc. authorizing and approving a Shareholder Declaration for London Hydro Inc.

WHEREAS London Hydro Inc. is a corporation incorporated under the *Business Corporations Act* R.S.O. 1990, c.B.16;

AND WHEREAS subsection 104(1)(b) of the *Business Corporations Act* provides that a resolution in writing dealing with all matters required by this Act to be dealt with at a meeting of shareholders, and signed by all the shareholders or their attorney authorized in writing entitled to vote at the meeting, satisfies all the requirements of this Act relating to that meeting of shareholders;

AND WHEREAS the Corporation of the City of London is the sole shareholder of London Hydro Inc.;

AND WHEREAS Subsection 5(3) of the *Municipal Act, 2001* provides that a municipal power shall be exercised by by-law;

The Municipal Council of The Corporation of the City of London enacts as follows:

1. The Resolution of the Shareholder of London Hydro Inc. authorizing and approving the Shareholder Declaration for London Hydro Inc., attached as Schedule "1" is ratified and confirmed.
2. The Mayor and City Clerk are authorized to execute the Shareholder Declaration and the Resolution of the Shareholder ratified and confirmed under section 1 of this by-law.
3. This by-law comes into force on the day it is passed.

PASSED in Open Council on the 17th day of May, 2016.

Matt Brown
Mayor

Catharine Saunders
City Clerk

First reading - May 17, 2016
Second reading - May 17, 2016
Third reading - May 17, 2016

SCHEDULE "1"

LONDON HYDRO INC.
(the "Corporation")

WHEREAS subsection 104(1)(b) of the *Business Corporations Act (Ontario)* (the "Act") provides that a resolution in writing dealing with all matters required by the Act to be dealt with at a meeting of shareholders and signed by all the shareholders or their attorney authorized in writing entitled to vote at the meeting, satisfies all the requirements of the Act relating to that meeting of shareholders;

AND WHEREAS

The following resolution signed by the sole shareholder of the Corporation entitled to vote thereon, is hereby passed pursuant to the provisions of the Act:

SHAREHOLDER DECLARATION

NOW THEREFORE BE IT RESOLVED THAT the undersigned, being the sole shareholder of the Corporation, hereby approves the Shareholder Declaration for London Hydro Inc. as set out in the attached Schedule "A".

DATED as of the day of , 2016.

THE CORPORATION OF THE CITY OF LONDON

Per: Matt Brown, Mayor

Per: Catharine Saunders, City Clerk