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energy insider

Jan 26, 2021

The Collingwood Judicial Inquiry: Lessons for Ontario's Electric Utilities

By Ron W. Clark and Stephen Crawford

The Transaction and Inquiry

In a transaction closing on July 31, 2012, the Town of Collingwood sold 50% of its interest in Collus Power Corporation, the local electricity distribution company ("**LDC**") serving the Collingwood service area, to PowerStream Incorporated.

However, after a new municipal council was elected in Collingwood in 2014, questions arose about the transaction. A judicial inquiry was eventually launched, led by Associate Chief Justice Frank N. Marrocco, to investigate allegations of conflicts of interest, unfair advantages given to PowerStream throughout the procurement process and potential malfeasance by certain parties.

The Report

The Collingwood judicial inquiry published its report, entitled "Transparency and the Public Trust: Report of the Collingwood Judicial Inquiry," on November 2, 2020.[1] It contains 306 recommendations relating to best practices in corporate governance and municipal governance. A number of these recommendations are relevant to LDCs, and there are some important insights to be drawn from these recommendations.

The Report details the history of the Collus share sale, as well as the history of a separate transaction in which the proceeds of the Collus share sale were used to fund construction of certain structures at Collingwood's arena and pool facilities. This article deals with lessons arising out of the share sale.

The Report focuses in large part on the roles of the then-Mayor of Collingwood and the then-President and CEO of Collus who, at various times, was also Executive Director, Engineering and Public Works at Collingwood and interim Chief Administrative Officer of Collingwood.

The Report found that the CEO was the driving force behind the transaction, and that he believed that a merger or strategic transaction with another utility could provide greater resources for Collus's future activities. The Report found this objective (of obtaining more resources for Collus so that it could pursue opportunities for growth) was at odds with Collingwood's goals at that time, which were focused on debt reduction and greater efficiencies.

Collingwood Council approved the creation of a Strategic Partnership Task Team and moved forward with an RFP process based on the identification of a strategic partner to purchase 50% of the shares of Collus. However, the Report describes this step as causing the Task Team to "unwittingly [move] forward with a plan that resulted in prioritizing Collus's interests over those of the Town: the pursuit of a strategic partner."

PowerStream was ultimately selected as the strategic partner and would acquire 50% of the shares of Collus. It was selected over competing higher bids based on non-financial factors. Legal counsel to Collus* was only obtained after PowerStream was selected as the strategic partner. The Mayor declined to heed advice to obtain independent counsel for the Town.

Conflicts of Interest and Duties of Directors and Councillors

Overview

Often, a mayor or municipal councillor of a municipal shareholder of an LDC will also sit on the board of the LDC or its holding corporation. When an individual has these dual roles with respect to an LDC, each of the LDC, the individual and the municipal shareholder should be mindful of the differing obligations and duties imposed on that individual by virtue of their roles – and be aware of whether that individual is wearing their "director hat" or their "councillor hat" when making any particular decision.

Fiduciary Duty and Duty of Care

Section 134(1) of the Ontario *Business Corporations Act* ("**OBCA**") requires directors and officers of a corporation to "act honestly and in good faith with a view to the best interests of the corporation," and to "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."

Interpretation of the Fiduciary Duty

Courts have interpreted this as a fiduciary duty, and subsection 134(3) specifies that, subject to restrictions contained in any unanimous shareholders' agreement (or shareholder declaration, in the case of a single shareholder), "no provision in a contract, the articles, the by-laws or a resolution relieves a director or officer from [the duties mentioned above]." As described by the Supreme Court of Canada in *People's Department Stores*[2]:

The statutory fiduciary duty requires directors and officers to act honestly and in good faith vis-à-vis the corporation. They must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation. They must avoid conflicts of interest with the corporation. They must avoid abusing their position to gain personal benefit. They must maintain the confidentiality of information they acquire by virtue of their position. Directors and officers must serve the corporation selflessly, honestly and loyally.

May Not Favour Individual Shareholders

In fulfilling this duty to act in the best interests of the corporation, a director must consider the interests of the corporation as a whole and not favour any particular shareholder. This means that the director cannot be biased in favour of the shareholder that nominated them, even if they are also a municipal councillor or mayor of that shareholder. As discussed in *820099 Ontario Inc. v. Harold E. Ballard Ltd.*[3]:

It may well be that the corporate life of a nominee director who votes against the interest of his "appointing" shareholder will be neither happy nor long. However, the role that any director must play (whether or not a nominee director) is that he must act in the best interests of the corporation… The nominee director's obligation to his "appointing" shareholder would seem to me to include the duty to tell the appointer that his requested course of action is wrong if the director in fact feels this way. Such advice, although likely initially unwelcome, may well be valuable to the appointer in the long run. The nominee director cannot be a "Yes man"; he must be an analytical person who can say "Yes" or "No" as the occasion requires (or to put it another way, as the corporation requires).

Confidentiality

Part of this fiduciary duty is a duty of confidentiality. Directors must be careful to observe this duty of confidentiality at all times, and in particular, municipal councillors who act as directors of an LDC or its holding corporation should take care not to disclose confidential information to the municipality that is obtained as a result of the councillor's position as a director of the corporation.

Conflicts of Interest for Directors

A director is obliged to avoid conflicts of interest with the corporation. This is not simply limited to personal interests of the director conflicting with the interests of the corporation – conflicts can also arise in situations in which the director may not have an explicitly personal stake, including if the interests of the municipality of which the director is a councillor conflict with the interests of the corporation.

Conflicts of Interest for Councillors

It is instructive to compare conflicts of interest in the corporate context, which are interpreted broadly, with the rules relating to conflicts of interest applied to municipal councillors under the *Municipal Conflict of Interest Act* ("**MCIA**"). While municipal councillors are trustees of the public interest, the MCIA defines conflicts of interest relatively narrowly, focusing on pecuniary (i.e. monetary) interests.

However, the Report also warns against considering "pecuniary interest" as the sole criterion in assessing whether a councillor is subject to a conflict of interest:

…it is far too easy to misconstrue the *Municipal Conflict of Interest Act* as addressing all the kinds of conflict of interest that Council members must confront. Despite its name, the *Municipal Conflict of Interest Act* does not provide a complete conflict of interest code for municipal actors. It addresses the pecuniary interests of a narrowly defined group of family members related to a Council member which are by virtue of the *Act* deemed to be pecuniary interests of the Council member. Council members are obligated to avoid all forms of conflicts of interest or, where that is not possible, to appropriately disclose and otherwise address those conflicts.[4]

Role of the Municipal Shareholder and Reporting/Control Mechanisms

Often, the impetus for an LDC amalgamation or sale comes from the LDC itself, since the LDC's officers and directors have experience, expertise and connections within the industry and are the first to become aware of an opportunity. Officers and directors of the LDC can provide valuable insight when a strategic transaction or sale is being considered, and they play an important role in addressing operational and transitional matters while the transaction is being finalized. Ultimately, though, the municipal shareholder is the owner of the LDC, and municipal council must take charge of evaluating the merits of any transaction that affects the municipality's shares of the LDC.

There are a number of ways for a municipal shareholder or shareholders to exert control over a subsidiary LDC. As a first step, a unanimous shareholders' agreement (or shareholder declaration, in the case of a single shareholder) will require that before taking certain major actions, approval of the municipal shareholder(s) must be obtained for those actions. The scope of what is subject to approval can vary, depending on the level of control that the shareholders wish to exert and the level of strategic autonomy that they wish to give to the LDC to pursue opportunities for growth. Nevertheless, major transactions such as amalgamations or sales of the entire business will inevitably require shareholder approval (though perhaps at a threshold of less than 100% of shareholder votes).

When a potential transaction arises that will require shareholder approval, the municipal councils should be informed at an early stage so that councillors can make fully informed decisions and delegate certain tasks as appropriate. Functionally, once municipal council gives a tentative approval to proceed with exploring a transaction, a smaller task force or team usually performs due diligence, assesses the merits of the transaction and reports back to municipal council. Reporting structures should be thoughtfully structured to ensure that councillors have all necessary information to be able to properly evaluate the transaction, and municipal shareholders should retain separate counsel to provide them with independent legal advice on the transaction.

In particular, LDCs and their municipal shareholders should be careful when one individual might have a monopoly of access to the council and thus be able to control and filter the information that council receives. This concern often arises when one individual holds multiple roles (e.g. a municipal councillor who also sits on the board of the LDC or its holding corporation), and is therefore naturally placed to be a liaison between the LDC and municipal council.

It is crucial that municipal shareholders obtain independent legal counsel when evaluating a merger or sale transaction involving an LDC, since as was seen in the Collus transaction, the incentives of the LDC and the incentives of the municipal shareholder are not always aligned.

Procurement Processes

LDCs and their shareholders should strive for fairness and transparency in procurement processes, including situations like the Collus transaction where bids are solicited from third parties for the sale of shares of the LDC. All parties should consider the nature of the proposed transaction in determining

whether a sole-source procurement is appropriate or if multiple bidders should be solicited. Once a bidding process is underway, care should be taken to act in good faith, to be even-handed among all bidders and to follow the rules and processes set out in the procurement documents (e.g. the RFP document and its accompanying rules/procedures). The tendering party in the procurement should avoid any asymmetric information sharing among the bidders.

LDCs and their shareholders should be careful not to allow procurements to functionally be run as if they are a sole source procurement, while masquerading as a multiple source procurement. If one bidder is heavily favoured over another (including before the RFP is announced), then it skews the process and may result in less favourable outcomes for the tendering party. The tendering party should ensure that it acts in good faith and in an even-handed manner among all parties when sharing information about an upcoming or ongoing procurement, when preparing the procurement documents, and when soliciting and evaluating bids.

In particular, once an RFP or other tender is issued, the common law requires that the tendering party follow the rules and procedures set out in the tender. The "Contract A, Contract B" principle was first set out by the Supreme Court of Canada in the case of *Ron Engineering*[5], and was further built upon in *M.J.B. Enterprises*[6] and *Martel Building*[7]. It establishes that there are two different types of contracts formed with bidders. "Contract A" is established between a procurer and a bidder upon the bidder's submission of a compliant bid in response to a tender. Contract A governs the terms of the procurement process, while "Contract B" is the subsequent contract for goods and services. Procurement law requires procurers to act fairly and consistently in the evaluation of bids, and the principles of fairness and good faith are implied terms of the Contract A that is formed when a bidder submits its compliant bid. Contract A can be thought of as a contract between the procurer and each bidder that the rules and processes set out in the procurement documents will be followed, and that the procurer will act fairly, consistently and in good faith while doing so. If the procurer deviates from the evaluation criteria set out in the original tender, then a disappointed bidder could argue that Contract A was breached and therefore sue for breach of contract.

Key Lessons for LDCs

There are three main lessons for LDCs to be drawn from Justice Marrocco's conclusions in the Report:

1. LDCs, their affiliates and their directors should understand and be mindful of the obligations and duties of individuals playing multiple roles at the LDC and its affiliates, particularly when they are both a director of the LDC or its affiliate and a municipal councillor of a shareholder. While municipal conflict of interest legislation applicable to municipal councillors focuses on conflicts where the councillor may have a pecuniary (i.e. monetary) interest, the duties of a director of a corporation go much further. The OBCA imposes a fiduciary duty on directors to act in the best interests of the corporation, a duty that is not altered or diminished by the method by which the director was elected (e.g. if they were a nominee of a particular municipal shareholder). In acting in the best interests of the corporation, the director must be even-handed among all shareholders and not favour the shareholder that nominated them, or the shareholder of which they are a municipal councillor.

2. While the officers and directors of an LDC have expertise and knowledge of the electricity distribution sector and can provide valuable insight when considering a strategic transaction involving the LDC, the municipality (in particular, municipal council) must take responsibility for decision-making on such major transactions. The LDC, as the asset owned by the municipal shareholder(s), should not be "in charge of selling itself", as Justice Marrocco describes the Collus transaction in the Report. Instead, the municipal shareholder(s), as owner of the asset, should take an active role in managing the asset and ensuring that the proposed transaction provides optimal value to shareholders. In doing so, they should be mindful of the potential for misaligned incentives, and also keep in mind that after the transaction is complete, management of the LDC (and its board) will be obliged to act in the interests of all shareholders. Municipal shareholders should retain separate counsel from the LDC and receive independent legal advice in respect of potential transactions, since their interests will not always be aligned with those of the LDC.

3. LDCs and their shareholders should strive for fairness and transparency in procurement processes, including situations like the Collus transaction where bids are solicited from third parties for the sale of shares of the LDC. All parties should consider the nature of the proposed transaction in determining whether a sole-source procurement is appropriate or if multiple bidders should be solicited. Once a

bidding process is underway, care should be taken to act in good faith, to be even-handed among all bidders and to follow the rules and processes set out in the procurement documents (e.g. the Request for Proposals document and its accompanying rules/procedures). The tendering party in the procurement should avoid any asymmetric information sharing among the bidders.

*Disclosure: Aird & Berlis LLP acted for Collus on the transaction.

[1] "Transparency and the Public Trust: Report of the Collingwood Judicial Inquiry," Associate Chief Justice Frank N. Marrocco, November 2, 2020.

[2] *People's Department Stores Ltd (1992) Inc., Re,* 2004 SCC 68 at 35.

[3] *820099 Ontario Inc. v. Harold E. Ballard Ltd.,* [1991] O.J. No. 266 (Ont. Gen. Div.).

[4] Marrocco Report, vol.1, p. 21.

[5] *The Queen (Ont.) v Ron Engineering, [1981] 1 SCR 111*.

[6] *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd., [1999] 1 SCR 619*.

[7] *Martel Building Ltd. v. Canada, 2000 SCC 60*.

Authors

Ron W. Clark
Partner
T 416.865.7701
rclark@airdberlis.com

Stephen Crawford
Associate
T 416.865.4725
scrawford@airdberlis.com