

EPCOR

A Study of Ownership, Accountability and the Public Interest

PARKLAND INSTITUTE

A Report Prepared for the Parkland Institute
September 2005



EPCOR:
A Study of Ownership, Accountability and the Public Interest

Diana S. Gibson
This report was prepared for
the Parkland Institute
September, 2005. © All rights reserved.

Contents

Executive Summary 1
1. Introduction 5
2. Background: the corporatization of Edmonton 's utilities and the formation of EPCOR 6
3. Accountability and public and private sector enterprises 8
    Public sector enterprises 8
    Direct public operation of an enterprise 8
    The Crown Corporation model 9
    Private Sector Enterprises 9
    Private sector, public interest enterprises 10
    Regulation and accountability 11
4. Accountability and EPCOR 13
5. The future accountability of EPCOR 19
    The risk of privatization 19
    An opportunity to serve the public interest 21

To obtain additional copies of the repor t
or rights to copy it, please contact:
Parkland Institute
University of Alberta
11045 Saskatchewan Drive
Edmonton, Alberta T6G 2E1
Phone: (780) 492-8558 Fax: (780) 492-8738
Web site: www .ualberta.ca/parkland
E-mail: parkland@ualberta.ca

ISBN 1-894949-08-0

About the author

Diana Gibson is the Research Director at the Parkland Institute. She has conducted research, administered projects and taught in areas of corporate accountability, privatization of public services, health care, education and welfare reform, international development, trade and globalization.

Acknowledgements

Thanks go to Ricardo Acuña for encouragement and guidance on the content of this report, and Bonnie Ferguson and three anonymous sources for valuable information provided.

About the Parkland Institute

Parkland Institute is an Alberta research network that examines public policy issues. We are based in the Faculty of Arts at the University of Alberta and our research network includes members from most of Alberta's academic institutions as well as other organizations involved in public policy research. Parkland Institute was founded in 1996 and its mandate is to:

- conduct research on economic, social, cultural, and political issues facing Albertans and Canadians.
- publish research and provide informed comment on current policy issues to the media and the public.
- sponsor conferences and public forums on issues facing Albertans.
- bring together academic and non-academic communities.

Executive Summary

EPCOR is a unique organization, one with many contradictions. It was founded from Edmonton's power and water utilities, yet operates in other provinces and in the US. It is owned by the City of Edmonton, yet is not answerable to the public, and takes no operational direction from the City. The City has rejected privatization of EPCOR, and yet privatization attempts continue and EPCOR has issued shares that trade on the Toronto Stock Exchange. These contradictions raise the issue of EPCOR's accountability. And at a time when the City of Edmonton is considering handing over its drainage system to EPCOR, consideration of accountability is urgent. Accountability and service of the public interest are topics that have been discussed in relation to government for centuries, and accountability mechanisms have been created, improved and refined. A renewed discussion of accountability, prompted by corporate scandals like Enron and Nortel, has brought the focus around to business enterprises. Publicly-owned business enterprises tend to have a broad set of accountabilities, and are often explicitly required to serve some aspect of the public interest. Direct public operation of an enterprise has the greatest degree of accountability, and enables full democratic control of the organization's activities. The Crown Corporation model reduces direct accountability in favour of independent operations, but still has significant transparency mechanisms and public interest mandates.

Modern, large business corporations, in stark contrast, have one accountability - to maximize profits for shareholders. And despite the fervent wishes of the Corporate Social Responsibility movement, business corporations are legally unable to sacrifice profits to serve some other social or environmental goal. Proponents of the corporatization* and privatization of publicly-operated enterprises often seek to justify their claims by asserting that regulation will be adequate to protect the public interest. However, in reality, regulation as a means of protecting the public interest suffers from a number of shortcomings in comparison with direct public operation of an enterprise. Regulation is often ill-informed due to information asymmetry, and it is inefficient. It is a blunt instrument that tends to cause collateral damage and thus is used rarely. It is often ineffective at stopping the proscribed activity, and at achieving the ultimate policy goal.

* Corporatization, also termed commercialization, is the conversion of publicly-operated services into independently-operated, government-owned corporations.

However, other business forms, such as sole proprietorships, partnerships and corporations managed by their owners, can serve public-interest goals other than profit maximization. And private sector, public interest enterprises, such as cooperatives and non-profit social enterprises, can be set up in a way that requires them to do so. Such public interest enterprises can be quite large and successful, and they currently operate in many sectors, including utility management.

EPCOR operates at the corporate end of the accountability spectrum; its primary accountability concern is in relation to shareholders and growth. On EPCOR's board there is a lack of participation and oversight by City Council and other stakeholders. The utilities EPCOR controls are no longer the subject of democratic decision-making, and there is no requirement for public transparency. The City can not set the operational priorities and decisions of EPCOR utilities to further City priorities like environmental protection or wisely managed, cost-efficient development. Finally, direct accountability to the public has been curtailed, as the corporatized utilities are no longer subject to the *Freedom of Information and Protection of Privacy Act.* Key documents governing EPCOR's accountability relationship with the City are unavailable to the public.

The above concerns respecting EPCOR's low level of accountability and its focus on profit maximization at the expense of other public priorities are also applicable to the proposal to transfer the City's drainage services to EPCOR. Corporatization of drainage would greatly reduce accountability, and the ability of the City to control development.

The supporters of corporatization tend to downplay and disregard the above accountability concerns, instead advancing a number of rhetorical contentions. They assert that transparency in financial reporting would be improved by corporatization, while ignoring the fact that the City can currently require whatever degree of transparency it wants, indeed more than EPCOR could provide. They assert that governance by board members would allow for utilization of valuable expertise, while ignoring the fact that the City can also employ a board structure, and recruit exactly the expertise needed. They assert that corporate borrowing would be clean-cut and easy, while ignoring the fact that the City can keep utility and other program financing entirely separate, and can access cheaper financing than a corporation. They assert that marrying drainage and water management under one roof would be a "natural progression," while ignoring the fact that their coordination can be managed by

agreements, as was pointed out in an earlier City Report supporting the organizational separation of water from drainage when EPCOR was formed.

The utilities and the citizens of Edmonton are at an important crossroads. Corporatization of utilities is often used as a stepping stone to full privatization, and EPCOR is at risk of privatization. Privatization of EPCOR would mean the complete and final loss of the public's control over the utilities. Utility rates (and Director and management salaries) would no doubt increase, while profits and corporate control move abroad. Profit maximization would over-ride the public interest in orderly city development, protection of the environment, and liveable wages to support families and communities.

And if the City's drainage service is handed over to EPCOR, the probability of privatization would increase substantially, along with the associated harms.

However, while the City continues to be the common shareholder of EPCOR, it is still in a position to preserve, and increase, the accountability and the public interest served by our utilities. Instead of proceeding down the path of corporatizating drainage, the city could keep it on as a city function, and could seek to achieve any of the goals it identifies for drainage services within its current structure. Furthermore, the City could take any number of steps to increase the accountability of EPCOR's utilities, for instance:

- appointing Councillors, consumer and other stakeholders to the EPCOR Board, and asserting its ability to approve operational plans and budgets and activities that could have an impact on City development plans and priorities.
- prohibiting both City Administration and EPCOR from investigating or considering further corporatization (or privatization).
- bringing EPCOR's utilities back under City management, with fair operating rules (e.g. to prevent preferential regulatory treatment or taxpayer subsidy of the utilities) in order to ease concerns about costs and unfair competition.
- converting EPCOR into a Utility Cooperative, the owners of which would be the consumers in locations served by EPCOR.

These and other options for increasing, rather than decreasing, the accountability of our utilities, are deserving of further study. It is vital that the City do so, while it still can.

1. Introduction

EPCOR is a unique organization. It is a group of enterprises originally created from the City of Edmonton's electrical and water utilities. Yet the EPCOR group bids on contracts elsewhere in Alberta, and as far away as Ontario, the BC coast, and Washington State. EPCOR is owned by the public, its sole common shareholder being the City of Edmonton. Yet it apparently is not answerable to the public for its business decisions, and takes no direction from Council other than in relation to dividends. After significant debate, Edmonton City Council decided against privatizing EPCOR in 1999. Yet in 2002, EPCOR, through subsidiary EPCOR Preferred Equities, began to raise capital by issuing preference shares, and these shares now trade on the Toronto Stock Exchange.

With these apparent contradictions, the accountability of EPCOR is in need of further examination. Parkland Institute undertook this study to examine EPCOR's accountability in light of its apparent interest in taking over sewage and drainage services from the City of Edmonton. The sewage and drainage infrastructure represent an enormous proportion of Edmonton's asset base, and sewage and drainage construction is a vital municipal instrument for controlling development in Edmonton. Hence the possible corporatization of these services holds tremendous financial and policy implications for the City.

Section 2 of this Report provides a context to the discussion by outlining EPCOR's formation from City-operated utilities, describing its current operations, and noting the attempts to privatize it. Section 3 discusses the motives and accountability structures of various types of organizations. It points out the narrow motives (profit maximization) and accountabilities (to shareholders only) of business corporations, and offers comparisons to other types of organizations - government, publicly-owned enterprises, and public interest business organizations - that serve wider public interests and have broader accountability mechanisms. Section 4 locates EPCOR at the far end of the spectrum of organizational motives and accountability structures, noting that it is operated essentially as a business corporation. Section 5 concludes that EPCOR is at serious risk of privatization, noting some of the consequences for Edmonton's residents and utility consumers if EPCOR were to be privatized, and points out alternatives to privatization that would serve the public interest and be accountable to the public.

2. Background: the corporatization of Edmonton's utilities and the formation of EPCOR

EPCOR's core, founding utilities were formerly departments of the City of Edmonton. In 1996, the natural gas, electricity and water utilities were merged to form EPCOR. In 2001, the Provincial Government imposed competition in the electricity market. The same year, EPCOR, which was formerly more integrated with the City, was separated and made to operate in a more commercial manner. EPCOR's website describes its transformation into a business corporation and its corporate response to being given the "freedom to conduct business" in a competitive market:

> The Board's governance structure was amended in 2001... The new structure permitted EPCOR's Board of Directors to operate independently - at arm's length from its sole Shareholder, the City of Edmonton. It also supported the need for regulatory oversight when dealing with essential elements such as electricity and water.
>
> With the freedom to conduct business, the Board embraced best practices that put EPCOR on equal footing with private sector corporations.
>
> With the opening of competitive electricity markets, EPCOR executed an aggressive growth strategy to capitalize on opportunities. Acquisitions and capital investments were targeted and, within three years, EPCOR doubled in size.[1]

EPCOR now operates throughout Alberta and into B.C., Ontario and the Pacific Northwest, providing energy and energy related services (from electricity generation, distribution, transmission and marketing to end-use customers) and water purification and distribution, and water heater rental services. Now, with more than $4 billion dollars in assets, EPCOR ranks 107th on the Financial Post Top 500 based on revenue, with over 60% of this revenue generated outside the City of Edmonton. EPCOR is the 12th largest non-publicly traded corporation in Canada.

1 http://www.epcor.ca/About+EPCOR/Governance/

Although corporatized, EPCOR has not (yet) been privatized. In 1999 Edmonton City Council considered privatizing parts or the whole of EPCOR. A report presented by RBC Dominion Securities argued that the City would obtain greater financial benefits from selling EPCOR and investing the proceeds. A report by the University of Alberta's Parkland Institute reached the opposite conclusion.[2] After significant public discussion and controversy, Council finally voted to reject privatization. Since then returns to the City have grown substantially - from $70.5 million in 1999 to $120.5 million for 2004. The dividend is set to increase annually by $10 million until it reaches a pre-established cap based on profit levels ("60% of earnings available to common shares of EPCOR in the applicable year").[3] EPCOR's annual dividend to the City is now well over 10% of the City's operating budget.[4]

The 1999 attempt was not the first attempt to remove Edmonton's utilities from public ownership. In 1928, 26 years after City Council purchased the Edmonton Electrical Lighting and Power Company, Canadian Utilities offered to take it over. Council unanimously rejected the offer. Then in 1930, Calgary Power (forerunner of TransAlta) proposed to take it over. And in 1983 Alderman Paul Norris called for sale of Genesee power generation plant.[5]

Nor have the privatization proposals stopped since 1999. Only one year after Council's most recent rejection of privatization, the Edmonton Chamber of Commerce sent a letter to City Councillors suggesting privatization of the power-generating and retail assets of EPCOR.[6] On October 5, 1999, City Council had rejected a motion that would have directed "City Administration [to] give no further consideration to the sale of all or part of EPCOR during the term of this Council."[7]

The discussions of the corporatization of City services to EPCOR, and the potential privatization of EPCOR, have sparked a debate around accountability. This debate parallels a wider public discussion around the issue of accountability.

2 Taft, Kevin and Myron Gordon "Light Among the Shadows: The Open and Shut Case Against Privatizing EPCOR" (Edmonton: Parkland Institute, University of Alberta, July 1999).

3 http://www.epcor.ca/About+EPCOR/Governance/

4 The City's operating budget is $1,218M: http://www.edmonton.ca/CityGov/corpservs/budget_2005/budget_at_a_glance.pdf

5 Taft, Kevin and Myron Gordon "Light Among the Shadows: The Open and Shut Case Against Privatizing EPCOR" (Edmonton: Parkland Institute, University of Alberta, July 1999) at p.34.

6 Taft, Kevin and David Cooper "Change & Opportunity: EPCOR in a De-regulated Electricity Industry" (Edmonton: Parkland Institute, University of Alberta, December 2000) at p.6.

7 City Council Meeting Minutes October 5, 1999 p.14. Item H.1.a.

3. Accountability and public and private sector enterprises

In recent years there has been an increasing public discussion of accountability. In relation to government, this discussion has been going on for hundreds of years, and we have created, refined and strengthened our government accountability structures. However, in recent years, the public debate around accountability has expanded to other institutions, including business enterprises. A wave of corporate scandals - Enron, WorldCom and Nortel to name a few - sparked a broad discussion in the media of corporate accountability. Commentators and even political leaders note that some corporate executives have been abusing and defrauding shareholders, and that reforms are needed to ensure greater accountability and protection of shareholders' interests.

The accountability discussion begs the questions: accountability to whom, and for what? The answer to this question is that accountability depends on the institution involved.

Public sector enterprises

As noted above, centuries of evolution have expanded the accountability of government. For instance, the franchise has been expanded to include all races and both sexes. And beyond the narrow electoral accountability that comes from being voted in and out of office by the citizenry, it is generally accepted that governments are accountable to serve the broader public interest. The mechanisms for government accountability have also been refined, and operations made more transparent. This is true not only of government's regulatory or fiscal policy role, but also of its role as a steward of publicly-owned enterprises in Canada's mixed economy.

Direct public operation of an enterprise

Direct public operation of an enterprise enables the broadest range of accountability mechanisms: detailed reporting to government; increased - often legislated - access to information by the public; added media scrutiny; scrutiny by City Councillors or (provincially and federally) the Official Opposition; scrutiny by an Ombudsman, the Auditor General, or other impartial bodies; the receipt of policy and operational direction from the government; integration of policy and operational activities with that of other government branches or departments; etc. Public operation of an enterprise enables full

control over the goals and objectives of that enterprise, its operations, and its impacts on public priorities such as community well-being, fees and rates paid by households and businesses, and the environment.

The Crown Corporation model

Crown corporations are a step removed from government, although still owned by the government. They operate more as independent enterprises. However they still have significant accountability mechanisms. Crown corporations are accountable to the public via the relevant Minister of the Crown, and Parliament (or the legislature for provincial Crown corporations). They follow the overall relevant policy of the government, and have public interest objectives prescribed in their founding documents. The government not only appoints the board of directors, but also approves the crown corporation's long-term plans and can issue directives to it (through Parliament or some other such transparent channel). Parliament approves the budgets of most crown corporations, and parliamentary committees review their operations.

Private Sector Enterprises

As noted above, much of the broader public discussion of accountability was prompted by corporate scandals, and this discussion has focussed on accountability to shareholders. Indeed the *only* accountability that modern, large business corporations have is to maximize profits for the benefit of their shareholders.[8] This accountability is purely financial. This peculiarly narrow form of accountability can, and does, create strange outcomes; even if a corporation harms its shareholders in one way - e.g. undermining their communities or polluting their air or water - it is nonetheless required to do so if it maximizes profits for those shareholders.

Many in the "corporate social responsibility" (CSR) movement,[9] which has existed under varying guises for decades (an older name for the same concept is "good corporate citizenship") have recently adopted the language of accountability. These CSR advocates suggest that corporations ought to consider themselves "accountable" to a wide range of stakeholders, including employees, communities, and the environment. The content of the term "accountability" for these CSR proponents entails voluntary actions, such as corporate philanthropy, better communications with the public, and efforts to reduce community and environmental impacts of corporate activities. Such efforts can manage risks and yield increased profits, and this is the motive behind successful CSR, as embodied in the CSR slogan: "doing

8 "Modern, large business corporations" refers to substantial business corporations in which ownership is separate from management. The term "corporation" is used in this sense in the remainder of this report, except where specified otherwise. The accountability of small corporations where the owner runs the business is briefly discussed later in this report, but is irrelevant to the subject matter of this paper. Large, closely held corporations where the owners are the same as the managers are both rare and irrelevant to the subject matter of this paper

9 See, for example, http://strategis.ic.gc.ca/epic/internet/incsr-rse.nsf/en/Home, or http://www.cbsr.bc.ca.

well by doing good."

However, despite the good intentions and fervent wishes of the CSR movement, corporate law is crystal clear. Modern, large business corporations have one accountability, and only one accountability: the maximization of share value, i.e. profits. They owe this duty to their shareholders and to nobody else.[10] Corporate shareholders literally own the corporation; the corporation is their property and they entrust the corporate directors to use this investment to maximize their returns. Indeed, if corporate directors sacrifice profits to pursue some other goal, laudable or otherwise, they can be fired and even sued by their shareholders. Such lawsuits, while relatively infrequent, do take place.[11]

This singular, profit-focused accountability is quite different from the accountability structures of both governments and other commercial organizations. Commercial organizations such as sole proprietorships, partnerships and even corporations managed by their owners (normally quite small corporations) are all free to make decisions that place other goals, such as protection of employees, communities or the environment, on par with or even ahead of profit maximization. There are alternative private enterprise structures that can carry out the same tasks as a business corporation while being required to serve the public interest.

Private sector, public interest enterprises

Private sector business forms such as co-operatives and social enterprises (businesses owned by non-profit organizations) often have multiple accountabilities, for instance to their customer/members, employees, communities and/or the environment. Business organizations that have broader goals and accountability structures, whether owned in public or private sector, could be termed *"public interest enterprises."* Corporations in contrast, could be termed *private* interest enterprises. The public interest goals and broad accountabilities of public interest enterprises do not prevent them from being successful economic players. Desjardins Group[12] and Mountain Equipment Coop[13] are two examples of familiar and very successful Canadian cooperative businesses. There are now over 10,000 cooperatives and credit unions operating in Canada,[14] holding combined assets of $167 billion and employing over 160,000 Canadians.[15] Goodwill, more formally known as Goodwill Enterprises International,[16] is a household name. Makivik Corporation, a non-profit organization dedicated to advancing the interests of the Inuit of

10 J.A. VanDuzer The Law of Partnerships and Corporations (Toronto: Irwin Law, 2003) at pp. 271-2.

11 For example, when Henry Ford attempted to keep Ford car prices down to levels where most working people could afford to purchase a car, he was successfully sued by his brother in law, a shareholder. His brother in law, Mr. Dodge, took the proceeds of the suit to form his own car company. Dodge v. Ford Motor Co., 170 N.W 688 (Mich.S.C. 1919).

12 www.desjardins.com

13 www.mec.ca

14 Canadian Co-operative Association, "About Co-operatives." 2004, http://www.coopcca.com/aboutcoop/whatisacoop/ at p.1..

15 Canadian Co-operative Association, "Statistics" www.coopcca.com/aboutcoop/statistics/.

16 http://www.goodwill.org

Nunavik, Northern Quebec, owns several subsidiary corporations employing over 1,500 people.[17] Interestingly, there are a number of utility cooperatives in other jurisdictions.[18]

Regulation and accountability

Corporatization of public services - their removal from government departments and conversion into commercially-operated, but government owned, business enterprises - is normally accompanied by regulation. Privatization is also normally accompanied by regulation. Regulation, the proponents of corporatization and privatization assert, will make the new enterprise serve the public interest through requiring compliance with rules and standards. This broad theoretical assertion, however, ignores the realities of regulation. In comparison to public ownership, and its efficient and comprehensive integration of the public interest, regulation has several shortcomings:

- The policy objectives of regulation are often ill-informed due to information asymmetry. Because a regulator has limited operational and financial information about a given industry and its members, it cannot set policy objectives that are as well-informed as they would be if the government were actually involved in the industry.
- Regulation is inefficient. It entails significant additional costs and delays such as negotiating standards, promulgating rules, monitoring compliance, investigating potential violations, and litigating to prove violations, obtain penalties and deal with appeals.
- Regulation is a blunt instrument. When a regulated party violates the law, the government can exhort or encourage better behaviour[19], and even order it, but its ultimate instrument is the blunt instrument of prosecution. Blunt instruments often cause unintended damage, and prosecutions are often seen as damaging to the corporation's employees and customers. For this reason, among others, regulators are often reluctant to employ available mechanisms, thus leading to even lower incentives for compliance.
- Regulation is often ineffective at preventing or stopping even the specific proscribed activity. For corporations, because of their exclusively financial motivation, the external accountability mechanisms need to speak financially in order to be effective, and it needs to speak at a level meaningful to the corporation. Corporations are the quintessential "rational" economic actor; they determine their course of action based on a rational consideration of the likely financial costs and benefits. Whether a corporation will comply with the law depends not only on the maximum penalty,

17 http://www.makivik.org/eng/subsidiaries/index.htm

18 See, for examples, http://www.ncba.coop/abcoop_util.cfm. The website for the Utility Connection lists 188 cooperative electrical utilities (utilities that serve more than 15, 000 customers) in the US: http://www/utilityconnection.com/page2a.asp

19 A comprehensive OECD study has found that encouraging voluntary compliance fails to protect the public interest. OECD, Voluntary Approaches for Environmental Policy: Effectiveness, Efficiency and Usage in Policy Mixes http://www.oecd.org/document/9/0,2340,en_2649_201185_2789257_119690_1_1_1,00.html The report "provides an in-depth assessment of the use of voluntary approaches, building on a number of new case studies and an extensive search of the available literature". The analysis focused "both on voluntary approaches used in isolation and on such approaches used as part of policy mixes" and notes that "there are few cases where such approaches have improved the environment beyond a business-as-usual baseline. It also raises doubts about their economic efficiency."

but also the likely penalty, further discounted by the likelihood of detection, the likelihood of a prosecution being commenced, the likelihood of a conviction being entered, and the likely outcome of appeals. Such probabilities are used in a corporation's cost-benefit analysis about a particular course of action or policy. [20] In practice, penalties are generally very low in comparison with a large corporation's annual budget (e.g. EPCOR being issued an administrative penalty in the amount of $3,500[21]). And with the last decade's substantial cuts in government regulatory staff, across Canada and at all levels of government, it is likely that a very large proportion of offences go undetected.

- Regulation is often ineffective at achieving the ultimate public policy goal. Even when the blunt instrument prevents or stops a particular proscribed activity, regulated parties can often find a way to "do an end run", often at the expense of the ultimate public policy goal.[22] There are many examples of privatizations where regulations have resulted in failures to achieve stated policy objectives such as lower prices for customers (many utilities in North America), or have had negative impacts on other areas of public policy, such as customer safety (e.g. British Rail).

To summarize, in comparison with public operation of an enterprise as a means of protecting the public interest, regulation tends to be relatively ill-informed, inefficient, blunt, ineffective, limited by resources, and profoundly affected by budget cuts. As EPCOR Chairman Hugh Bolton observed in relation to regulation of corporate governance:

> "My view, to put it bluntly, is that investors and others should not take the mere existence of rules as a guarantee that everything is what it seems. Our faith is misplaced when we pile on new regulations and treat them as a cure-all. Too often, in cases like Enron or WorldCom, the problem is not a lack of rules, but an underlying sickness is being tacitly ignored, or worse, willfully concealed."[23]

20 Such cost-benefit analyses are commonly used by corporations. One example was the 1971 decision by the Ford Motor Co not to fix a known tendency of the gas tanks on its Pinto model cars to explode on impact. The corporation calculated that it would cost $11 per car to fix the problem, and made a further calculation of how much they would have to pay in damages for 180 people they estimated would die as a result of not fixing it. Because they estimated it would cost more to fix the cars than to pay legal damages for the deaths and injuries, they decided against fixing the cars. (Strobel LP. Reckless homicide? Ford's Pinto Trial. South Bend, Indiana: And Books, 1980). This is not isolated behaviour, but rather the corporate norm; GM undertook the same cost-benefit analysis, with much the same results, in respect of its Chevrolet Malibu (Bakan J. The corporation. (Toronto: Viking Canada, 2004)). Corporate reputation risks are included in cost-benefit analyses, but the vast majority of offences do not even get reported in the media, let alone spark public outrage sufficient to make a dent in the bottom line.

21 According to the Environmental Law Centre's Enforcement Search Service http://www.elc.ab.ca/enforcement/index.cfm, on January 1, 2002, EPCOR Water Services Inc was issued an Administrative Penalty in the amount of $3,5000 under Alberta Environmental Protection and Enhancement Act (AEPEA) s.69 for commencing construction of a Wastewater Treatment Plant without an approval. On August 3, 1999 EPCOR Utilities Inc had been issued a Warning Letter under AEPEA s.101 for failing to clean up spilled oil at the Edmonton Power South Service Centre yard in a timely manner.

22 For instance, when Health Canada managed to obtain legislation prohibiting tobacco advertising, tobacco corporations moved to branded sponsorships and promotions. When legislation was passed prohibiting the public use of corporate names, tobacco corporations created subsidiaries with similar names (e.g. Player's Racing). Most recently tobacco corporations obtained a court ruling that allows a return to the use of corporate names.

23 "Will rules work? Expectations and effects of corporate governance reforms" June 2005. http://www.epcor.ca/NR/rdonlyres/89B3ED93-65ED-4648-809A-17F0D01B258A/0/ICDremarks.pdf, at p.3.

4. Accountability and EPCOR

EPCOR operates at the corporate end of the accountability spectrum; its primary accountability concern is to maximize profits and growth for its shareholder.

On EPCOR's Board, there is a lack of participation and oversight by City Council and other stakeholders:

- As the EPCOR website's Governance page states: "The Board's governance structure was amended in 2001 to prepare the company for success in newly deregulated electricity markets. The new structure permitted EPCOR's Board of Directors to operate independently - at arm's length from its sole Shareholder, the City of Edmonton." [24]
- EPCOR's Chairman of the Board states "EPCOR's Board operates independently of the Shareholder with the full authority to make strategic business decisions."[25]
- Unlike EnMax, the City of Calgary's power corporation, no council members are on the Board of Directors of EPCOR. EPCOR's Board "is comprised of business leaders from Vancouver, Calgary, Edmonton and Toronto, who have no affiliation to the Shareholder, or interest in EPCOR. As stipulated in a Unanimous Shareholder Agreement, neither City Councillors nor City officials sit on the Board" [26]
- In 1995, City Council decided against having representation on EPCOR's Board of the views of employees, residential consumers, small business and commercial/industrial customers.[27]

EPCOR's public communications reflect the lack of broader organizational accountability, and the growth and profit orientation of a business corporation:

- EPCOR's webpage on Governance states: "With the freedom to conduct business, the Board embraced best practices that put EPCOR on equal footing with private sector corporations."
- EPCOR's webpage on Governance also states that excellence in governance "can be measured on two fronts - growth and shareholder return."[28]

24 http://www.epcor.ca/About/Governance/

25 http://www.epcor.ca/NR/rdonlyres/F2404B43-B641-4D60-9451-894F0AC3D82F/0/DirectorApril2005_Bolton.pdf.

26 http://www.epcor.ca/About/Governance/

27 City Council Meeting No.40 Minutes September 12/13, 1995 at pp.1093 and 1097.

28 http://www.epcor.ca/about+epcor/Governance

- EPCOR's Chairman of the Board points out the corporate growth imperative: "one fact is unchanged. Growth is still EPCOR's only option. Management and the Board are committed to significantly increasing the size and scope of EPCOR's operations over the coming five years." [29]

Corporate growth, sustainability, and community impacts

In Dr. Seuss' children's book The Lorax, the Once-ler character told the story of his business and its constant need to grow, which ultimately resulted in its failure and in great community harm. The growth imperative is an integral element of competitive business corporations, and of publicly-owned corporations that are set up to operate with the same mandate as competitive business corporations.

"Business is business and business must grow...
I had to grow bigger. So bigger I got."
- The Once-ler, in Dr. Seuss, The Lorax (Random House: Toronto 1971) at pages 37-39.

"The alternative [to growth] is to wither on the vine...
growth was EPCOR's only option. And so grow we did."
Remarks by Hugh Bolton, Chair of the Board, EPCOR AGM March 5, 2005

EPCOR does have a number of CSR initiatives, as noted on its "Citizenship" webpage.[30] As is typically the case, these include philanthropy, better communication with the public, and a range of environmental and community activities. In the classic CSR mould, EPCOR's Senior Vice President of Public & Government Affairs states: "Being a good corporate citizen and doing the "right thing" is simply good business."[31] We have already seen that, in reality, what is "good for business" isn't always "doing the right thing". Indeed, where the two conflict, a business corporation has to choose profit maximization. A business corporation's accountability structure, unlike that of a publicly-operated enterprise, doesn't allow for any other choice, and EPCOR is set up and operated as a business corporation.

The utilities owned by EPCOR are no longer the subject of democratic decision-making by ratepayers and citizens and their representatives. In corporatizing, the City of Edmonton has reduced the accountability of the water and power utilities. For instance:

- The utilities no longer answer directly to the City for operational decisions.

29 Remarks by Hugh Bolton, Chair of the Board of EPCOR, EPCOR AGM March 5, 2005 http://www.epcor.ca/NR/rdonlyres/8104043F-E0F3-4074-A44E-FBE816B2C341/0/AGMChairman0500505.pdf, at page 5.

30 http://www.epcor.ca/citizenship

31 http://www.epcor.ca/citizenship

- The public, through its elected Mayor or a Councilor, can no longer require the utilities to answer detailed questions in a City Council Meeting, nor to take operational direction from that meeting.

Question 9: If Drainage moved to EPCOR, how would this impact Council's ability to manage development patterns?

Response: *Drainage Services is the major service that either facilitates development or impedes development. Under the existing model, there is a strong pro-active approach in working with Planning and Development Department and the development community to ensure orderly, cost-effective development occurs. City Council, through its approvals and policy directions on servicing, does control development. In fact, City Council controls growth through its approval or denial of servicing. The model which moves Drainage Services to EPCOR removes that direct control; City Council would not have direct control.*

- City of Edmonton Asset Management and Public Works Department, "Feasibility Study - City of Edmonton Drainage Services and EPCOR Water Services - Presentation at City Council Meeting," August 23, 2005, at p.4.

Moreover, the City can no longer change the operational priorities and decisions of the utilities to integrate them with those of other branches of the City. For instance, a municipally-operated water or sewage provider could make servicing decisions to control development, or set rates to internalize the costs of sprawling subdivisions and encourage more compact communities - "smart growth".[32] In contrast, a corporatized utility like EPCOR will generally bid competitively to obtain the contract to provide such services, and will not be inclined to reduce profitability in order to serve broader municipal development goals, preserve the character of the community, or protect the environment or the interests of taxpayers.

Such strategic implications of corporate utility management were noted in a Council meeting back in 1998, when a City Administration report stated: "It should be noted that EPCOR's water distribution business and some aspects of the electrical business have strategic implications for other City plans and operations." Nonetheless, at that time, the City Administration had not actually studied those implications and potential impacts: "Administration has not reviewed this report[33] in terms of the long range impact which a loss of City control of EPCOR might have on these City operations."

32 See, for example, http://www.smartgrowth.org/, http://www.greenontario.org/smartgrowth/; http://www.smartgrowth.bc.ca/index.cfm.

33 City Council had instructed the City Manager and City Administration "to retain expert consultants to provide a comprehensive, objective and detailed financial and risk management analysis of EPCOR Utilities Inc." [emphasis added] June 23, 1998 Minutes, Item E.1.e. "Review of EPCOR Utilities Inc."

Finally, direct accountability to the public has been curtailed by the corporatization of the utilities. Citizens used to be able to access information about their local utility using the *Freedom of Information and Protection of Privacy Act.* In 1999, a legislative committee argued that the Act should be amended to exclude EPCOR and ENMAX because they are "required by statute to compete for business" and would be placed by the Act at an unfair disadvantage to their competitors.[34] The Act was amended and EPCOR and ENMAX are no longer included in the definition of "local government body."[35] Thus citizens are no longer entitled to use the Act to obtain information about this publicly-owned corporation.

EPCOR now takes the position that it will not provide to the public key documents such as its Unanimous Shareholders Agreement.[36] As noted above, that Agreement determines who can sit on the Board of Directors. It also determines a lot of other key factors relating to accountability. For instance, the 1996 Unanimous Shareholders Agreement had allocated specific powers between the Board and City, such as: control over the sale of EPCOR assets; the purchase of, or merger with other corporations; determination of operating and capital budget allocations among programs; the undertaking of new business activities; and the declaration of dividends within the City's Utility Fiscal Policy and otherwise. The 1996 Unanimous Shareholders Agreement has been replaced with a newer version; the EPCOR Governance webpage hints that significant governance changes have taken place: "The Board's governance structure was amended in 2001 to prepare the company for success in newly deregulated electricity markets." EPCOR will not release the new Agreement. And, at the time of writing of this report, the City of Edmonton had, in response to a request to see the new Agreement, stated that it would only consider a request to see the document under the *Freedom of Information and Protection of Privacy Act.* City staff had only released the 1996 version because it was attached to City Council meeting minutes (unlike the current Agreement). Thus it appears that not only is EPCOR at the low end of the organizational accountability spectrum, but also that the citizens of Edmonton are not entitled to know just how low it is.

The concerns raised above around accountability and service of the public interest would also apply to the proposal to transfer Edmonton's drainage services to EPCOR. Accountability to City government and to citizens would be vastly reduced, and the City would lose the leverage it has, through drainage, to promote planning and development in a way that serves the interests of its residents and

34 http://www.assembly.ab.ca/pro/FOIP/report5.htm

35 http://www.qp.gov.ab.ca/documents/Acts/F25.cfm?frm_isbn=0779729218

36 The author's attempts to obtain such documents directly from EPCOR were rejected.

Question 13: With a change of ownership to EPCOR, how much influence and 'clout' would residents have on service provision and priority decision making, as for example in the 'flash flooding' of the summer of 2004?

Response: *With a change of ownership, the administration believes that residents would experience a loss of influence and 'clout' on service provision and priority decision making that currently exists in the City of Edmonton model. Citizens can now influence decisions regarding drainage by contacting Drainage Services directly, through their Ward Councillors or through Transportation and Public Works Committee and City Council processes. All decisions are made in an open and transparent forum.*

In EPCOR's current model, citizen input is through a Public Advisory Committee or directly to communications staff. All Board of Director and Shareholder decisions are made in-private with no requirement for public transparency.

- City of Edmonton Asset Management and Public Works Department, "Feasibility Study - City of Edmonton Drainage Services and EPCOR Water Services - Presentation at City Council Meeting," August 23, 2005, at p.6.

voters. Moreover, citizens would not know how much accountability has been lost.

The supporters of corporatization tend to downplay the above concerns about accountability and the public interest as "relationship-related," or to ignore them altogether. Instead of addressing them head-on, they tend to offer a number of unrelated arguments, which appear to be long on rhetoric and short on substance. For instance they suggest[37] that:

1. *Corporatization creates a more transparent arrangement with the municipal owner, because the corporation must file separate financial statements that show the funds flowing between corporation and shareholder.* In reality, there is no advantage here; municipalities that operate a utility can simply instruct the utility and its own accounting department to show the flow of funds on the books. Indeed municipal operation can enable the municipality to provide operational-level instructions to the utility to provide greater transparency in both its internal financial data collection and reporting.

37 Some of these arguments are also presented in "WATERTIGHT: The case for change in Ontario's water and wastewater sector", Ministry of Public Infrastructure Renewal, http://www.pir.gov.on.ca/userfiles/HTML/cma_4_42432_1.html, section 5 Governance.

2. *Governance by board members provides the opportunity to draw on the expertise of objective, qualified and professional private citizens with the right range of business, financial and technical experience.* Again, there is no advantage here; municipalities that operate utilities can have a Board of Directors structure, and can fill the Board with people who have the needed skills, expertise and objectivity.

3. *With recourse to service revenues, a corporatized utility would be able to borrow on its own behalf to fund major projects, on market terms and conditions, without competing with other municipal needs under the constraints of the Municipal Act.* Once again, there is no advantage here; municipalities can simply make a decision to keep financing functions and priorities separate from those of other municipal operations. Compared to an independent corporation, government operated enterprises tend to pay lower financing costs.

4. *It is a "natural progression" to move drainage under the same umbrella as water services, and that planning and operational coordination would be served best by having the utilities under the same ownership.* Again, there is no advantage here; the relationship between the various utilities can be managed by agreements, and does not need to be managed by ownership. As noted in the February 1, 1996 City Administration Report that supported the transfer of the water utility to EPCOR:

> "Water's relationship with drainage should not be an issue. Historically water and drainage were first brought together... in one department, then were again separated... into two departments. The key planning and operational relationships between water and drainage will be secured through the Management Agreement..."[38]

38 City Council Meeting No.13 Minutes February 6, 1996, Item G.02 "Incorporation of the Water Utility", report dated February 1, 1996.

5. The future accountability of EPCOR

The risk of privatization

While corporatization sharply curtails public accountability, full privatization eliminates public accountability. And as discussed in section 2 above, there have been many attempts to privatize EPCOR. Certainly its corporatization, whether deliberately or not, has had the effect of making it easier to privatize. The issuance in 2002 of preferred (non-voting) shares to private sector shareholders, again whether deliberately or not, would make it easier to justify the privatization of EPCOR: because the EPCOR group already has partial private ownership, full privatization would be a "natural progression". It is quite possible that this argument will be advanced by EPCOR management, interested investors, privatization service providers, or others.

> "Commercialization of a utility is sometimes used as a 'stepping stone' to full privatization."
>
> Ontario Ministry of Public Infrastructure Renewal, Consulting Series for the Development of a Long-Term Water and Sewer Investment and Financing Strategy, KPMG, Study 7, Analysis of Business Models and Their Applicability to Ontario, http://www.pir.gov.on.ca/userfiles/HTML/cma_4_35990_1.html at p.33.

Furthermore, EPCOR itself has privatized portions of its operations. For example, its 2003 Annual Report notes that it:

- "divested Union Energy, an EPCOR subsidiary in Ontario ...[and]
- sold a 50% interest in EPCOR's Genesee Phase 3 project to TransAlta Corporation."[39]

The fact that privatization of EPCOR was rejected in 1999 does not mean that privatization efforts have ceased permanently. Quite the opposite: history shows repeated attempts to privatize EPCOR, including initiatives post-1999. There is a very high likelihood that there will be attempts to privatize EPCOR in the near future. Given that privatization was fended off in 1999 by only the narrowest possible voting margin, that it is running on a fully corporatized model, with preference shares already being traded on the Toronto Stock Exchange, selected operations and subsidiaries being sold off, and energy prices rising, EPCOR is now a far more likely candidate for

39 http://www.epcor.ca/About+EPCOR/Financial+Reports/

privatization than it has ever been in its history. The transfer of drainage into EPCOR would do nothing to quell the calls for privatization; indeed it would make EPCOR a more attractive target. The impact of fully privatizing EPCOR would be the loss of any final vestiges of public accountability for those utilities. Privatization would result in the loss of ability to replace the Board of Directors when required in the public interest, and losing the ability to change EPCOR's constitutional and ownership structure.

The City would also be in the position of losing future revenues. As noted above, there was a debate over whether the proceeds of privatization would yield greater or lesser annual revenues than maintaining EPCOR as a publicly-owned utility. Since that debate, and City Council's vote to reject privatization, the value of EPCOR has increased dramatically, as have its dividends.

Moreover, if EPCOR were to be fully privatized, then the utilities that it owns would be on the free market. The rates that Edmonton's residents and business owners would pay for power, water and possibly drainage would no longer be regulated by City Council. A promise, repeated many times in the original proposals to corporatize Edmonton Power, was that "City Council would not lose its ability to regulate local power rates."[40] This ability would be lost if EPCOR were fully privatized. This loss of rate control will be increasingly important, and potentially politically risky, as energy and water resources become more scarce and costly in the future. In England and Wales, annual bills for water and sewage rose by an average of 47% in a 9 year period after privatization, in inflation adjusted terms.[41]

And as resources become more scarce, conservation will be increasing as a political, social and environmental priority. However, a privatized utility profiting from sales would have no financial incentive to encourage conservation. Indeed a privatized utility would tend to regard demand reductions as revenue risks, and would have a strong financial incentive to encourage greater consumption. Furthermore, the profits made by the utilities would flow to shareholders, not to the City or its taxpayers. There is no guarantee that these shareholders would be based in Edmonton, and, considering the current trend toward concentrated utility ownership among a handful of US and French corporations, there is every likelihood that Edmonton's utilities would end up being owned and controlled by foreign corporations. And these foreign corporations, with no accountability to Edmonton's residents, would have a strong

40 E.g. City Council meeting minutes June 26, 1995, attachment L.1.a "Incorporation of Edmonton Power", at p.4.

41 Source of data: UK House of Commons, Research Paper 98/117, Appendix 2, Table 5 http://www.parliament.uk/commons/lib/research/rp98/rp98-117.pdf.

financial incentive to maximize their profits by raising local rates as much as possible, and cutting local costs (including local jobs and salaries) as much as possible. Notably, there may not be significant reductions in the compensation for Directors and upper management. In the United Kingdom, the compensation of the highest paid Directors of water utilities increased in a 7 year period after privatization by an average of 71%, and by as much as 200%, in inflation-adjusted terms.[42]

An opportunity to serve the public interest

At the present moment, the City is in a position to prevent further erosion of what accountability remains among its utilities, and to actually broaden and strengthen their accountability.

The first and most obvious step toward protecting and enhancing accountability and the public interest is to refuse the corporatization of drainage services. Keeping drainage as a City function will ensure that it can continue to serve the broader development goals of the City, and that it will remain accountable to citizens and ratepayers, both directly and through Council. The City could take the step of clearly identifying its own goals with respect to its drainage services (as distinct from EPCOR's goals) and could find ways to achieve them within the existing structure.

In addition to maintaining drainage as a publicly-operated enterprise, City Council could also act to enhance the accountability of EPCOR's utilities. Given its position as sole common shareholder of EPCOR, the City can take any number of steps, for instance:

1. The City could decide to appoint Councillors, consumer and other stakeholders directly to the EPCOR Board, require that annual operational plans and budgets be provided to, and approved by, City Council, and require that EPCOR seek City Council approval before bidding on contracts that could have an impact on City development plans and priorities.
2. The City could prohibit both City Administration and EPCOR from investigating or considering further corporatization (or privatization).
3. The City could bring EPCOR's utilities back under City management. Establishing fair operating rules (e.g. to prevent preferential regulatory treatment or taxpayer subsidy of the utilities) would ease concerns about costs and unfair competition. Bringing the utilities back to City management would restore public

42 Source of data: UK House of Commons, Research Paper 98/117, Appendix 2, Table 1 http://www.parliament.uk/commons/lib/research/rp98/rp98-117.pdf.

accountability and control over not just the operations of the utilities, but also over the impact of those utilities on other areas of public interest, such as community, other City policies and goals, the environment and employee protection. This accountability would, however, be owed only to the citizens of Edmonton; if the utilities continued operating in other jurisdictions, they would not be accountable to the citizens of those areas.

4. It could convert EPCOR into a Utility Cooperative. Utility cooperatives are quite common throughout the world,[43] and they not only provide electricity, water or drainage services, but also have broader accountabilities and serve a wider range of goals than profit maximization. The owners of a cooperative EPCOR would be the consumers in all the locations served by EPCOR.[44] Thus the accountability stakeholders would "match" the service delivery stakeholders.

These are just a few options for models that could increase, rather than decreasing, the accountability of Edmonton's utilities and their orientation toward serving a broader public interest. These models could be fleshed out in greater detail, and potential objections to them could be addressed to refine the model. Furthermore, other options are available. It would be prudent for the City of Edmonton to explore such public-interest, accountability-increasing models, while it still has the chance to do so and the ability to make a positive difference.

43 E.g. see http://www.wisc.edu/uwcc/links/utilitylinks.html

44 E.g. see http://www.aecc.com/about/the-cooperative-difference/



PARKLAND
INSTITUTE

11045 Saskatchewan Drive,
Edmonton, Alberta
T6G 2E1
Phone: (780) 492-8558
Email: parkland@ualberta.ca
Website: www .ualberta.ca/parkland

ISBN 1-894949-08-0