

## RISKS OF FAILURE IN REGULATORY GOVERNANCE\*

Dan McFadyen and George Eynon

### SUMMARY

Failures in governance can jeopardize the responsibility of regulatory authorities to protect the public. Since governments set mandates for regulatory authorities under their jurisdiction, it's up to the former to mitigate the risk with effective oversight and legislation.

Effective oversight should be founded on the five core principles of good governance: accountability, leadership, integrity, stewardship and transparency. In practice, regulatory authorities need leadership, ethics and a culture committed to good governance. They need strong relationships with stakeholders, effective risk management, both internal and external compliance and ongoing monitoring, evaluation and support.

Unfortunately, jurisdictions do not always follow these principles and practices. As an example, several agencies found that the Alberta Energy Regulator, significantly exceeded its mandate in establishing an affiliated consultancy. Controls and processes to protect against conflicts of interest failed, while board oversight and AER leadership did not create a healthy corporate culture and the CEO grossly mismanaged public funds and assets.

The results of three investigations into the AER led to new processes for board and CEO accountability, improved staff relations, retraining, closer watch of executive expenses, and improved channels of communication between the CEO and board and the board with government. Above all, the government of Alberta learned that when pursuing new and innovative activities, it must

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carefully define mandates; and that effective whistleblowing processes are vital to uncovering misdeeds.

While the investigations focused on wrongdoing at the top, this paper identifies three other areas of concern. First, there is a lack of co-operation among regulatory agencies. Second, Self-Regulating Professional Organizations (SRPOs) are often reluctant to engage on issues involving licensed corporate entities or professionals. Third, members often see SRPOs as clubs rather than regulators.

These flaws are evident in the AER's case. Anywhere from 10-50 individuals were involved, directly or indirectly, in wrongdoing — including public servants, licensed professionals and members of quasi-regulatory associations or societies. Many of these people were professionals bound by clear codes of conduct, but these professionals did not approach their respective SRPOs with complaints about inappropriate behaviours at their employer.

To ensure regulatory bodies stay within their mandates, governments should define the limits of allowable activities and use open, competitive recruitment processes to find competent leaders. They should also consider appointing respected members of the relevant stakeholder community to the selection panel.

Governments must also establish competency and experience criteria for board members and the board chair to guarantee in-depth knowledge and avoid conflicts of interest; and back this up with transparent annual reports to government and the public.

Boards and governments should establish equally strict criteria for choosing a regulatory body's CEO, with an emphasis on exceptional leadership skills, openness to performance assessment and knowledge of risk management.

These are crucial steps if governments are to maintain public trust and confidence in regulatory agencies. Similar accountabilities should apply to agency employees who are members of SRPOs; they should be ready to seek guidance from SRPOs if faced with possible ethical breaches. Proper governance principles and best practices should be at the heart of every regulatory agency.

## RISQUES D'ÉCHEC DE LA GOUVERNANCE RÉGLEMENTAIRE\*

Dan McFadyen et George Eynon

### RÉSUMÉ

Les échecs de gouvernance peuvent mettre en péril la responsabilité des autorités de régulation en matière de protection des populations. Puisque ce sont les gouvernements qui confient les mandats aux autorités de réglementation relevant de leur compétence, il leur appartient d'atténuer le risque grâce à une surveillance et une législation efficaces.

La surveillance efficace devrait se fonder sur les cinq principes fondamentaux de la bonne gouvernance : la responsabilité, le leadership, l'intégrité, la diligence et la transparence. Dans la pratique, les autorités de réglementation ont besoin de leadership, d'une éthique et d'une culture vouée à la bonne gouvernance. Ils doivent entretenir de bonnes relations avec les parties intéressées, mener une gestion efficace des risques, assurer la conformité interne et externe ainsi qu'une surveillance, des évaluations et un soutien continu.

Malheureusement, les autorités ne suivent pas toujours ces principes. À titre d'exemple, plusieurs organismes ont constaté que l'Alberta Energy Regulator (AER) avait largement dépassé son mandat en créant un cabinet de conseil affilié. Les contrôles et processus de protection contre les conflits d'intérêts ont échoué, tandis que la surveillance du conseil d'administration et la direction de l'AER n'ont pas donné lieu à une culture d'entreprise saine. De plus, le PDG a mal géré les fonds et les biens publics.

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Les résultats de trois enquêtes sur l'AER ont conduit à de nouveaux processus de responsabilisation du conseil et du PDG, à une amélioration des relations de travail, au recyclage professionnel, à une meilleure surveillance des dépenses de la direction et à de meilleurs canaux de communication entre le PDG et le conseil, puis entre celui-ci et le gouvernement. Surtout, le gouvernement de l'Alberta a appris que lorsqu'il entreprend des activités novatrices, il doit soigneusement définir les mandats. Il a aussi appris que des processus d'alerte efficaces sont essentiels pour prendre connaissance des méfaits commis.

Alors que les enquêtes se sont concentrées sur les actes répréhensibles commis au sommet, le présent document relève trois autres domaines de préoccupation. Premièrement, il y a un manque de coopération entre les agences de réglementation. Deuxièmement, les organisations professionnelles d'autoréglementation (OPA) se montrent souvent réticentes à s'engager sur des questions qui impliquent des personnes morales ou des professionnels. Troisièmement, les membres considèrent souvent les OPA comme des clubs plutôt que comme organismes de réglementation.

Ces failles sont manifestes dans le cas de l'AER. De 10 à 50 personnes ont été impliquées, directement ou indirectement, dans des actes répréhensibles, et cela comprend des fonctionnaires, des professionnels agréés et des membres d'associations ou de sociétés quasi-régulatrices. Beaucoup de ces personnes étaient des professionnels liés par des codes de conduite clairs, mais ils n'ont pas sollicité les OPA concernés pour se plaindre des comportements inappropriés chez leur employeur.

Afin de garantir que les organismes de réglementation respectent leurs mandats, les gouvernements devraient définir les limites des activités autorisées et utiliser des processus de recrutement ouverts et concurrentiels pour trouver des dirigeants compétents. Ils devraient également envisager de nommer, aux comités de sélection, des membres respectés du domaine concerné.

Les gouvernements doivent également établir des critères de compétence et d'expérience pour tous les membres du conseil afin de garantir un fonds de connaissances approfondi et d'éviter les conflits d'intérêts. Et ils devraient étayer cela au moyen de rapports annuels transparents présentés auprès du gouvernement et du public.

Les conseils d'administration et les gouvernements devraient établir des critères tout aussi stricts pour choisir le PDG d'un organisme de réglementation, en mettant l'accent sur des compétences exceptionnelles en matière de leadership, une ouverture à l'évaluation de la performance et une connaissance de la gestion des risques.

Ce sont là des étapes cruciales, en particulier si les gouvernements veulent maintenir la confiance du public dans les organismes de réglementation. Des responsabilités similaires devraient s'appliquer aux employés des organismes qui sont membres d'APO. Ces employés devraient être enclins à demander conseil à leur APO s'ils se trouvent confrontés à d'éventuels manquements à l'éthique. Les principes de gouvernance appropriés et les meilleures pratiques devraient être au cœur de chaque organisme de réglementation.

## **INTRODUCTION**

Governments set the mandates for regulatory authorities to ensure that they are compliant with the legislation and regulations governing their activity to protect public health, safety and welfare. Regulatory authorities must lead by example and hold themselves accountable for fulfilling their responsibilities to the same standard of compliance through consistent, certain and ethical behaviours. Failure to meet this standard of compliance results in loss of public confidence and trust in the authorities, and in the regulated entities under their jurisdiction. In many jurisdictions, governments delegate their regulatory responsibilities to arm's-length authorities. In Canada, there are two primary types of regulatory authorities.

### **ADMINISTRATIVE TRIBUNALS**

These are independent, specialized governmental agencies established under federal or provincial legislation to implement legislative policy. Administrative tribunals in Canada make decisions on behalf of federal and provincial governments when it is impractical or inappropriate for the government to do so. Tribunals, commonly called agencies, boards or commissions (ABCs), make decisions about a wide variety of issues, including disputes between people or between people and the government. Tribunals may also perform regulatory or licensing functions. Appointment to the governing boards of such tribunals is usually by cabinet, which ordinarily chooses members for their expertise and experience in the sector under regulation.

Tribunals are quasi-judicial entities, engaged in fact-finding with the power to impact personal rights. Their decisions are usually binding, with review permitted by the courts only on matters of errors in legal interpretation (Kuttner 2006).

### **SELF-REGULATING PROFESSIONAL ORGANIZATIONS (SRPO)**

SRPOs are non-governmental organizations with the power to create and enforce stand-alone professional regulations and which promote ethics, equality and professionalism. Many self-regulate through enabling legislation and regulation that permit the authority to act independently of government. The legislation and regulation set the mandate, regulatory responsibilities and often organizational requirements, including aspects of governance. Any applicable laws or governmental regulations will apply and be foremost, while those set by the SPRO become supplemental.

SPROs are responsible for granting professional licences to practise and setting standards which a professional must meet to become a member. Once the SPRO sets regulations and provisions to guide activity, those rules are binding on members of the profession they regulate. Professional members failing to operate within the given regulations and codes of conduct and ethics are subject to investigation by the organization, and the imposition of penalties, including limits to practice. The organizations' professional members elect the governing boards or councils of most SPROs; commonly, governments have the right to appoint additional public members (Hayes 2019).

There are also many quasi-SRPOs constituted as associations — clubs or societies — of various professions rather than as regulators, that also have rules of conduct binding on their members.

For the regulatory authorities, maintaining the confidence and trust of the regulated entities (and their members), is key to their success in the eyes of both the public and the governments to which they are accountable. Any loss of confidence and trust of the regulatory authority can lead to an erosion of public trust in the regulated entities and in the economic and social contributions of the sectors in which these entities operate. Any erosion of trust can precipitate increasing disputes between individuals, communities and the regulated entities over concern for public safety, health and welfare. These disputes can become economically, socially and politically disruptive. The failure of effective governance of and by the regulatory authority is a major risk to loss of confidence in and trust of regulatory authorities.

Professional members of any SRPO can and should seek advice from their SRPO's regulatory staff members if they find themselves in untenable positions of being required to perform work that could potentially breach their codes of conduct and ethics.

More generally, governments often enact whistleblower legislation to provide an avenue for employees to report any ethical and/or illegal behaviours or actions within their department or organization to an appropriate authority. The whistleblower legislation provides anonymity for the whistleblower and protection from any repercussions. Indeed, it was a whistleblower's complaint that prompted the investigations in the example of failures in regulatory governance cited in this paper.

In this paper, we examine good principles and practices for the governance of regulatory authorities and the risks of failure in their effective governance. We draw on a recent example of failures in regulatory governance by the Alberta Energy Regulator (AER) — a tribunal responsible for regulating Alberta's oil and natural gas industry. In 2019, the Alberta auditor general, the ethics commissioner and the public interest commissioner each undertook independent investigations of financial and human resources mismanagement in the formation of ICORE (International Centre of Regulatory Excellence) by the AER.

## **PUBLIC SECTOR GOVERNANCE PRINCIPLES AND BEST PRACTICES**

The past three decades have seen an increasing focus on governance in the public sector as governments have moved to adapt private-sector management practices to improve efficiency and effectiveness. In particular, for arm's-length government-authorized agencies, boards and commissions (ABCs), including administrative tribunals, there has been a growing focus on ethical, effective and reliable governance oversight, including of the chief executive. This is essential to sustaining the integrity, credibility and trust of any regulatory authority with the government, the public and the regulated entities.

Throughout this time, an extensive body of literature has evolved on good governance principles and practices for the public sector. In December 2008, the British Columbia auditor general prepared a report, “Public Sector Governance — A Guide to the Principles of Good Governance.” The guide presents five core principles of good governance and a framework of practice to implement them which provide an excellent roadmap to ensure effective governance in the public sector (see Tables 1 and 2).

**TABLE 1. FIVE CORE PRINCIPLES OF GOOD GOVERNANCE**



Source: “Public Sector Governance - A Guide to the Principles of Good Governance.” Office of the Auditor General of British Columbia

**TABLE 2. HOW CAN THESE PRINCIPLES BE PUT INTO PRACTICE?**

The elements that constitute good public-sector governance, and upon which practices can be modelled, can be demonstrated as the components of a house.



Source: Australian National Audit Office, "Public Sector Governance," 2003.

1. **Leadership, ethics and a culture committed to good public sector governance**  
The implementation, evaluation and improvement of a public sector organization's governance structures and processes are the responsibility of leaders, and without such commitments, there would be no foundation to build on.
2. **Stakeholder relationships (internal and external)**  
Understanding the various roles, accountabilities and needs of each stakeholder group contributes to strong relationships, and supports the success of the three central components, or "windows", of the "House of Governance".
3. **Risk management**  
This provides a public sector organization with the means to understand and address risks in order to better achieve its objectives.
4. **Internal compliance and accountability**  
An efficient and well-governed public sector organization will ensure that internal controls and accountabilities are clearly defined and consistent with the organization's objectives.
5. **Planning and performance monitoring**  
Governing bodies that review and foster better planning and performance monitoring will be more effective and relevant.
6. **External compliance and accountability**  
External scrutiny is an integral part of work in the public service and meeting these accountabilities is one of the measures of success for public sector organizations.
7. **Information and decision support**  
Information management is critical for a public sector organization to meet its objectives and accountabilities, namely by ensuring that the right information gets to the appropriate people in a timely manner.
8. **Review and evaluation of governance arrangements**  
Ongoing review, evaluation and adjustments of governance arrangements are a key process and this includes the governing body checking its own structures, processes and overall performance.

Source: "Public Sector Governance – A Guide to the Principles of Good Governance." Office of the Auditor General of British Columbia

These principles and practices provide a helpful roadmap for any public-sector organization to follow to ensure effective governance. However, roadmaps only provide direction; it is up to the user to heed and follow the guidance to arrive successfully at the destination. As with any roadmap, there are always off-ramps and pathways that provide the user with alternatives. These alternatives often present risks that, if not properly assessed and evaluated, will lead to failure to arrive at the destination. In the following case study, we examine a regulatory authority's failures as the consequences of deviating from sound governance principles and practices.

## **CASE STUDY – ALBERTA ENERGY REGULATOR**

### **BACKGROUND: REGULATORY ENHANCEMENT PROJECT**

In mid-2010, under then-premier Ed Stelmach, following a competitiveness review of the oil and natural gas fiscal regime, the government of Alberta initiated a regulatory enhancement project (REP) to review the regulatory framework of Alberta's oil and natural gas sector, to improve its effectiveness, efficiency, fairness, predictability and transparency. A significant focus of this was the creation of a one-window regulator for the sector.

With the election of Alison Redford as premier in October 2011, the government of Alberta increasingly focused on the growing negative environmental perceptions of Alberta's oil and gas industry, particularly the oilsands. This led to increasing momentum for the REP to demonstrate that Alberta was a best-in-class oil and natural gas regulator, with an emphasis on environment and stakeholder interests. This included promoting a new concept of "regulatory diplomacy" through which the government would publicize its best-in-class regulatory regime nationally and internationally, ostensibly to change negative national and international perceptions of its oil and gas industry.

Throughout 2012, the Alberta Department of Energy increased its efforts toward regulatory diplomacy, pressuring the then-Energy Resources Conservation Board (ERCB) to expend effort and resources on regulatory diplomacy. This included demands that the ERCB actively participate in regulatory hearings underway in the United States on TransCanada Pipeline's (now TC Energy) Keystone XL project.

While the ERCB regularly met with visiting international jurisdictions interested in learning about and understanding its approach to oversight, it refused to engage in regulatory hearings in other jurisdictions, not only because this was beyond its legislated mandate, but also as it would be disrespectful of another regulator's jurisdiction and proceedings. However, the interest in regulatory diplomacy became an undocumented theme in the REP. It also became a policy objective for senior Alberta government officials responsible for advancing the REP.

The REP culminated in the establishment of the Alberta Energy Regulator (AER) through the proclamation of the *Responsible Energy Development Act* (REDA) in June 2013, followed immediately by the appointment of an AER board and CEO. The AER's mandate was typical of the mandates for most oil and natural gas regulators.

*“2(1) The mandate of the Regulator is*

- (a) to provide for the efficient, safe, orderly and environmentally responsible development of energy resources in Alberta through the Regulator’s regulatory activities, and*
- (b) in respect of energy resource activities, to regulate*
  - (i) the disposition and management of public lands,*
  - (ii) the protection of the environment, and*
  - (iii) the conservation and management of water, including the wise allocation and use of water, in accordance with energy resource enactments and, pursuant to this Act and the regulations, in accordance with specified enactments.”<sup>1</sup>*

While the mandate did not include any reference to regulatory diplomacy, the appointment of a CEO (who was instrumental in shepherding the REP) and a board chair (hired as an external consultant to advise the government during the development of the REDA), who were both sensitized to the Alberta government’s intent for regulatory diplomacy, led to entrenching regulatory diplomacy as part of AER’s strategic planning. This intent subsequently became an integral part of AER’s Best-in-Class Project, and a regulatory diplomacy strategy as reported in the AER 2014/15 Annual Report Executive Summary:

*“Best-in-Class Project*

*Alberta’s oil and gas activities attract international attention, which means that the regulator operates on the world stage. For this reason, we need to define what it means to be best in class, find consensus on what makes a high-performing regulator, and know where we rank in meeting that goal, which is why we launched the Best-in-Class Project with the University of Pennsylvania’s Program on Regulation. Considerable work has gone into the project this past year and we eagerly anticipate the university’s findings in the summer of 2015. From these findings, we can define what it means to be best in class, and that definition will then guide our path in the years ahead—one that our stakeholders helped to choose and confirm.*

*What’s Next*

*Regulatory Diplomacy*

*We have developed a national/international strategy, with a key element being to advance the AER’s credibility through “regulatory diplomacy,” through which the AER demonstrates national and international leadership on regulating energy resources. Through regulatory diplomacy, we will create strategic alliances with our national and international stakeholders and work to influence, inform, and elevate provincial, national, and international energy regulation practices.”*

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<sup>1</sup> *Responsible Energy Development Act.*

These circumstances established the conditions for governance failures by the CEO and the board, which resulted in significant mismanagement of the financial and human resources of the AER and reputational damage with the government, the public and its regulated entities.

## **FINDINGS OF INVESTIGATIONS INTO ALBERTA ENERGY REGULATOR MISMANAGEMENT**

In 2019, as a result of a whistleblower's complaint, the Alberta auditor general, the ethics commissioner and the public interest commissioner separately launched investigations into mismanagement at the AER. Each agency released reports on its findings along with recommendations. Summarized below are the key findings and recommendations, and some lessons learned, pertinent to failures in governance, from the reports.

### **REPORT OF THE AUDITOR GENERAL OF ALBERTA**

Relevant Key Findings to this discussion:

- AER engaged in activities outside of its mandate and public money was spent inappropriately on ICORE activities.
- Controls and processes to protect against potential conflicts of interest failed.
- AER Board oversight was ineffective.
- The tone at the top at AER did not support a strong control environment or compliance with policies.

Relevant Key Recommendations to improve oversight:

- Ensuring the effectiveness of processes to evaluate corporate culture and senior executive performance.
- Obtaining formal and periodic assertions from management that activities comply with legislation and AER policies, including policies related to conflict of interest.
- Ensuring officers in key risk management, compliance and internal control roles are well-positioned and supported to provide complete information about AER activities.
- Reviewing and approving CEO travel and expenses.
- Ensuring the primary channel of communication to the responsible Ministers is through the Board.
- Establishing processes to engage with executive staff, and other staff within the organization, to gain comfort that all significant matters have been brought to the attention of the Board.
- AER staff is made aware of and is sufficiently trained on recent enhancements to AER's whistleblowing process, consistent with Section 6 of the *Public Interest Disclosure (Whistleblower Protection) Act*.

Lessons to be learned were:

- A healthy corporate culture, including tone at the top, matters above all else.
- A healthy corporate culture is paramount to ensure organizations remain focused on their mandate. Accurately gauging corporate culture is not easy, but boards and management must find ways to obtain assurance that their organizations are operating in a safe, respectful, and productive manner.
- Directors need to be vigilant and ask challenging and probing questions of management, particularly when new risks to the organization emerge.
- Directors routinely walk into a boardroom possessing less information about the organization than management. They may therefore be inclined to defer to management, and there is a risk that directors are not always asking the right questions. Directors should continue to probe and ask hard questions if they are not satisfied risks are being properly identified and mitigated. Through this examination, it became clear that the former AER Board Chair's and the former AER CEO's confidence in ICORE deterred others from questioning ICORE further. Because the CEO wields significant power within an organization, boards need to establish processes to engage with other executive and staff in the organization to gain comfort that all significant matters have been brought to the attention of the Board.
- In pursuing new and innovative concepts, government organizations need to ensure any specific activities are an appropriate fit within their mandate.
- The external environment tends to change much faster than governing legislation, and as government organizations seek to introduce operational innovation, it is important they confirm that new activities are within the mandate.
- Effective whistleblowing mechanisms are critical in uncovering undesired practices.
- The events at AER further reinforce the importance of whistleblower processes to surface problematic activities within an organization. Whistleblowers are often the only effective source of information to uncover inappropriate behaviors.

## **REPORT OF THE PUBLIC INTEREST COMMISSIONER OF ALBERTA**

Summary of the key findings

- The CEO grossly mismanaged public funds in establishing and supporting the operations of ICORE ... (The CEO's) actions constitute a wilful and reckless disregard for the proper management of AER funds.
- The CEO grossly mismanaged public assets by misappropriating or by attempting to misappropriate the intellectual property of the AER ... (The CEO) demonstrated a wilful and reckless disregard for the management of the public assets (i.e., intellectual property) of the AER.

- The CEO grossly mismanaged the delivery of a public service through the diversion of AER resources to support ICORE ... In overseeing the diversion of AER staff from their duties (and himself from his own duties), (the CEO) demonstrated a wilful and reckless disregard for the delivery of a public service.

#### Summary of the key recommendations

- While the AER has taken steps to recover payments for services and expenses it made under its formal agreements with ICORE (NFP), my investigation confirmed that deliberate efforts were made to underreport and conceal both the time devoted by AER employees to ICORE-related matters, and the expenses incurred in advancing ICORE (NFP) and its objectives.
- My investigation found a culture within the AER that discouraged employees from voicing concerns. This report is part of a continuing process for the organization, not an end to this matter. Now that wrongdoing has been confirmed and detailed, steps must be taken to repair its effects and to prevent any future recurrence.

### **REPORT OF THE OFFICE OF THE ETHICS COMMISSIONER OF ALBERTA**

#### The key findings:

- In my view, the CEO breached s. 23.925 (1), (2) and (4) of the Conflicts of Interest Act. As the Chief Executive Officer of the AER and a Senior Official under the Conflicts of Interest Act, the CEO made decisions in the carrying out of his office or powers, and influenced or sought to influence decisions to be made by or on behalf of the AER, knowing that the decisions might further his private interests and improperly further the private interests of subordinates. He also failed to appropriately or adequately disclose a real or apparent conflict of interest to the Board of Directors of the AER.
- The AER Board, including the Chair, the Deputy Minister of Energy, and the Minister of Energy were selectively briefed throughout. They were not told things that would raise concerns. However, I have not investigated or considered whether the Board asked appropriate questions about ICORE and properly supervised it.

#### The key recommendations

- One of the basic shortcomings of board governance is that boards are not supposed to be involved in the daily operation of a corporation. Boards are to set high level policy and have an overall supervisory function. As a result, boards are frequently unaware of the daily activities of a corporation. The only knowledge that boards have is what is presented to the board by management. Management, for the most part, controls what information a board has and how the information is presented. Only aggressive questioning by boards on topics where the board has some idea that there is a problem has any chance of overcoming this shortcoming. Even then, boards can be effectively stone walled by management.

- It is important that the larger, particularly commercial, provincial agencies, boards, and commissions have a robust matrix for the composition of their boards. In making appointments, the government should respect that matrix and appoint properly qualified members to fit the needs of the board. In addition, all board members should have director training, whether provided by the Government or through organizations like the Institute of Corporate Directors.
- It also should be standard practice that all communications, oral or written, from an agency, board, or commission to the Minister responsible (or ministerial staff) be through the chair of the board. All written material to the Minister or Department should be approved by the chair. In addition, the chief executive officer should provide a weekly report of any oral communication with the Deputy Minister to the chair.

## **THE ROLE OF SRPOS AND THEIR RELATIONSHIPS WITH OTHER REGULATORY AGENCIES**

In addition to the findings of the three investigations into AER mismanagement, we examine the role that agencies regulating the various professions and their licensed professional members should have played.

We identify three areas of concern. First, there is a lack of co-operation among regulatory agencies in general. Second, there is an apparent reluctance of SRPOs to engage on issues involving their licensed corporate entities and/or licensed professionals. Third, it is a commonly held idea by members that the SRPOs are associations — clubs or societies — of professionals, rather than regulators of their professions.

In the case study examined here, three separate entities independently investigated the AER, focussing on the actions of the CEO and board chair.

Many other individuals — estimates vary from 10 directly and as many as 50 indirectly (OAG Report, 24) — appear to have been involved in some fashion with ICORE, though not always by their own choice. These included many erstwhile public service employees in the government of Alberta (civil servants), some licensed members of professional regulatory authorities (accountants, engineers, lawyers et al.), and members of quasi-regulatory associations or societies (administrators, board members, civil servants, economists et al.). Most if not all these individuals operated under clear codes of conduct and ethics, stated in clear and concise one-page statements. The involvement of those individuals, while apparently not as egregious as that of the CEO and board chair, required the SRPOs to examine, as regulatory authorities, the roles they and their members had a duty to play.

Unfortunately, the SRPOs did not collaborate in the investigation processes, despite the fact that the conduct and ethics of individual professional members was at the core of the issues; they did not ask to be involved, nor did the investigators invite them to collaborate.

The Alberta Public Service Code of Conduct and Ethics documents the expectations for government employees to act with impartiality and integrity and without any conflict of interest. The following excerpt is most relevant to the discussion of the roles of SRPOs and their individual professional members.

***“Furthering Private Interests***

- (1) *Employees are in conflict of interest and in violation of this Code if they:*
  - (a) *Take part in a decision in the course of carrying out their duties, knowing that the decision might further a private interest of the employee, their spouse or minor child, or*
  - (b) *Use their public role to influence or seek to influence a Government decision which could further a private interest of the employee, their spouse or minor child, or*
  - (c) *Use or communicate information not available to the general public that was gained by the employee in the course of carrying out their duties, to further or seek to further a private interest of the employee, their spouse or minor child.”*

The commentary in the following section and in the conclusions applies as much to the individuals — the erstwhile public service employees, licensed members of professional regulatory authorities and members of quasi-regulatory associations or societies — and to the SRPOs of the various types to which they belong, as to the two main subjects of the case study.

## **RISKS OF FAILURE IN GOVERNANCE AND MEANS TO MITIGATE THESE RISKS**

The case study illustrates some of the specific risks of failures in regulatory governance and the unfortunate consequences that can result. This section will examine some of the key risks of failures in regulatory governance and how jurisdictions can mitigate against these risks.

### **A. CLARITY AND RESPECT OF MANDATE**

#### **i. Failure**

The REDA established a clear mandate for the AER that did not include advocacy of or training for regulatory excellence. However, regulatory advocacy was a substantial consideration by the Alberta government during the development of the REDA and became embedded as a government policy objective during that time. Regulatory diplomacy is not typically within a regulatory authority’s mandate. If the government considered regulatory diplomacy an important policy objective, it should have included it in the AER’s mandate and prescribed how to implement it in the legislation. Without that clarity, the AER chose its own definition and implementation of regulatory diplomacy.

During development of the REDA, the future CEO of the AER served as deputy minister of both the Energy and Environment departments and was responsible for shepherding the development of the REDA. Likewise, the future AER board chair served as an external consultant to advise the government on its development. Both individuals became highly sensitized to the government's policy intent for regulatory diplomacy as a result of their intimate involvement in the development of the REDA. Their selection led to the AER subsequently undertaking the Best-in-Class Project, a key objective of which was:

*"Through regulatory diplomacy, we will create strategic alliances with our national and international stakeholders and work to influence, inform, and elevate provincial, national, and international energy regulation practices" (Alberta Energy Regulator 2014-15).*

To implement this objective, the AER proceeded with the creation of the International Centre of Regulatory Excellence (ICORE).

We do not know whether the government made these appointments to realize its regulatory diplomacy policy objective or failed to follow a rigorous selection process. However, it is clear that appointing a CEO and board chair sensitized to regulatory diplomacy as government policy led directly to the AER undertaking a significant initiative outside its legislated mandate.

It is also clear that the individuals selected for the two most senior leadership roles did not respect that legislated mandate. This lack of respect and adherence to governance principles of ensuring accountability and transparency and to principles of leadership and stewardship led to the AER undertaking a significant initiative outside its mandate.

## **ii. Mitigation**

In setting out the legislated mandates for regulatory authorities, governments need to be clear that they reflect explicit regulatory policy intents and objectives.

The legislation should also clearly prescribe the authorities and processes the regulatory authority must follow, including adequate transparency and accountability requirements, to ensure that the regulatory authority is operating within its mandate.

The regulatory authority must only undertake regulatory activities consistent with its clearly specified mandate and legislation. Regulatory authorities must never undertake activities on their own initiative that are not explicitly prescribed in their mandate even though they might be seen as consistent with policy intents of government. If the regulatory authority believes there is a gap in its mandate or that the mandate does not include an implicit government policy, the regulatory authority should raise the issue openly and transparently with government and request clarity in its mandate and legislation before acting.

Governments should follow open, rigorous and competitive recruitment processes when selecting the leadership of regulatory authorities. Governments should select individuals based on their competencies and experience in the sector(s) they will be regulating.

Governments must ensure that potential appointees clearly understand the authority's mandate. Furthermore, they must ensure that potential appointees are not biased, or even perceived to be biased, toward objectives not prescribed in the mandate.

As part of the process, we recommend governments consider appointing respected members of the regulatory authority's stakeholder community to the selection panel, to ensure that recruitment is open, rigorous and objective.

## **B. BOARD DUTY OF CARE**

### **i. Failure**

Section 9, Duty of Care of the REDA, states:

- “(1) Every director, hearing commissioner and officer of the Regulator, in carrying out powers, duties and functions, shall*
- (a) act honestly and in good faith,*
  - (b) avoid conflicts of interest, and*
  - (c) exercise the care, diligence and skill that a reasonably prudent person would exercise under comparable circumstances.*
- (2) The Regulator shall establish and maintain policies and procedures addressing the identification, disclosure and resolution of matters involving conflicts of interest of directors, hearing commissioners, officers and employees of the Regulator.”<sup>2</sup>*

This duty of care statement is consistent with the governance principles of stewardship, accountability and transparency, and with the governance practices of leadership, ethics and a culture that promote good governance, internal risk management, external compliance and accountability, and review and evaluation of governance.

In this case, the board failed to exercise its duty of care and was negligent in its oversight responsibilities of its own and the CEO's conduct, and the AER's activities. As summarized in the auditor general's report:

*“AER Board oversight processes were lacking or not followed.*

- The AER Board did not ask management to provide critical ICORE-related information*
- The AER Board did not include ICORE as a meeting agenda item for more than a year while ICORE activities ramped up.*
- In September 2018, the AER Board reasserted its support for ICORE, while outstanding allegations and concerns still existed.”*

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<sup>2</sup>

*Responsible Energy Development Act, Statutes of Alberta, 2012, Chapter R17.3.*

Clearly, the board failed to exercise its duty of care to ensure that:

- Processes were in place to evaluate corporate culture and senior executive performance, and to engage with executive staff to ensure all significant matters were brought to the board's attention; and
- Periodic assessments and assurances were sought from management that all activities were in compliance with the mandate and legislation, including policies related to conflicts of interest.

The evidence suggested that these failures were in part due to the alignment of the AER CEO's and board chair's support for the creation of ICORE, which deterred other directors from questioning its creation even if they had concerns. As noted above, the sensitization of both individuals to the policy objective of regulatory diplomacy may have led to them rationalizing their actions to create ICORE. The evidence of conflicts of interest of the AER CEO (Public Interest Commissioner 2019) related to the opportunities of future employment with ICORE and the complicity of the AER board chair (Auditor General 2019, 33)<sup>3</sup> further complicated the situation.

The board failed in its oversight responsibility in at least two areas: first through a lack of respect for the principles of accountability and stewardship; and second, not implementing sound practices of risk management, internal compliance and external accountability, performance monitoring and review and evaluation of governance arrangements.

## ii. Mitigation

Governments need to establish clear competencies and experience criteria for the selection of board members for regulatory authorities. They must ensure open and rigorous recruitment and selection processes to identify prospective members with the required competencies and experience.

Key competency and experience criteria for board members should include:

- Knowledge of and experience in the sector.  
Individual members might have relevant knowledge and experience with differing aspects of the sector including technical operations, financial management and auditing, environmental sustainability and community/stakeholder relations. However, the board in total must have all these competencies.
- Knowledge and experience in corporate and/or public-sector governance.  
Government must provide training in governance if it is necessary to appoint members who do not have prior experience in this area.
- Assurance that members have no conflicts of interest, including financial and/or other interest in any entity subject to oversight by the regulatory authority.

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<sup>3</sup>

“Contrary to the Board process for all members to disclose potential conflicts prior to conducting Board business, the former AER Board Chair did not disclose his involvement with ICORE.”

Selection of the board chair must follow an even more rigorous process. Governments should apply the following criteria, in addition to the criteria and the recruitment and selection process for board members:

Knowledge of and experience with:

- Corporate and/or public-sector governance principles and practices including ensuring that all board members understand and exercise their duty of care to act independently and objectively;
- Policies and procedures that ensure the identification, disclosure and resolution of any real or perceived conflicts of interest of board members and/or senior executive members;
- Policies and procedures for effective evaluation of board and CEO performance.

To ensure the selection processes are open and rigorous, governments should establish panels to manage those processes that include both respected, independent individuals and government officials.

Governments must set clear expectations for transparent and fulsome annual reporting to government and the public by the regulatory authority and state them as part of the board's authority, responsibility and accountability.

All too often, regulatory authority staff prepares annual reports that the CEO approves following a perfunctory review by the board, including a foreword by the chair. Making the board responsible ensures they undertake a thorough and rigorous review of the information contained in the annual report and question staff members on the completeness and accuracy of the information.

As the sole shareholder of the regulatory authority, any government should hold an annual accountability meeting between the minister responsible and the board of directors, at which the board would report on its activity over the past year and provide assurance and evidence to the minister that they have responsibly executed their duty of care.

## **C. ETHICAL LEADERSHIP AND STEWARDSHIP**

### **i. Failure**

All three investigations by the auditor general, public interest commissioner and ethics commissioner found significant failures with the CEO's leadership.

- "The former AER CEO did not report or otherwise engage the mechanisms established under AER's Conflict of Interest Policy to ensure transparency and enable AER to protect its interests ... We found no evidence that appropriate disclosures were made respecting potential conflicts of interest, including to the AER Board. We also did not see that any analysis and management of conflict of interest risks occurred. In certain cases, evidence indicated an intentional override of controls" (Auditor General 2019, 28).

- “A common theme emerged — there were cultural problems within the corporate environment, including:
- “Employees who were vocal about expressing complaints were at risk of losing their job;
- “Information on ICORE was not widely shared;
- “Executives were guarded about what they would say at the Executive Leadership Team Table” (Auditor General 2019, 53).
- “The CEO grossly mismanaged the delivery of a public service through the diversion of AER resources to support ICORE” (Public Interest Commissioner 2019, 5).
- “In my view, the CEO breached s. 23.925 (1), (2) and (4) of the Conflicts of Interest Act. As the Chief Executive Officer of the AER and a Senior Official under the Conflicts of Interest Act, the CEO made decisions in the carrying out of his office or powers, and influenced or sought to influence decisions to be made by or on behalf of the AER, knowing that the decisions might further his private interest ...” (Trussler 2019, 28).

Additional evidence in these investigations established several senior AER executives as complicit in the mismanagement of public resources and would-be potential future beneficiaries. As well, the CEO and the complicit senior executives had deliberately withheld information on the financial and human resource implications of the creation of ICORE from the AER board and government representatives. Also, evidence established that the CEO and complicit senior executive were responsible for creating a dysfunctional corporate culture that included a lack of transparency and widespread fear of reprisal for voicing complaints and/or concerns about ICORE. Likewise, evidence established that many employees were unaware of AER’s whistleblowing process and those that were aware feared reprisal for speaking up.

Lack of respect for the principles of leadership (“tone at the top”), integrity and stewardship by the CEO, and of appropriate leadership, ethics good public-sector governance, internal compliance and accountability, and information by the CEO and complicit senior executives, led to the failure of ethical and respectful leadership of the regulatory authority.

## ii. Mitigation

As for board members, as noted above, governments and boards must establish clear competencies and experience criteria for selecting the CEO of the regulatory authority, and establish open and rigorous recruitment and selection processes that ensure prospective members meet the required competencies and experience. Besides the general criteria noted above for all board members, the CEO should have:

- Exceptional leadership skills, including a strong ethical foundation, integrity of leadership that creates respect and trust in employees, and support for open and transparent cultures;

- Self-awareness and commitment to 360-degree (multi-rater) performance assessments;
- Understanding of the use of a risk-management matrix for continually assessing corporate initiatives and internal controls and accountabilities, and that continually evaluate and assess risks.

Effective personality and competency assessment tools and thorough reference checks are keys to selecting a CEO with the appropriate leadership skills.

Governments and boards must establish clear expectations for the CEO's performance, as well as the processes to assess performance, such as access to the 360-degree assessments.

Boards should ensure that the regulatory authority has a well-developed and executed risk-management framework, managed by a senior executive. The executive must prepare and present to the board an annual assessment of internal and external risks to the regulatory authority, along with actions to mitigate those risks.

Boards should ensure that there are both effective internal and external value-for-money<sup>4</sup> audits.

The regulatory authority must conduct internal audits on an ongoing basis. An independent auditor must conduct the internal audits and report, through the regulatory authority's chief financial officer, to the board and/or the board's audit committee. Internal audits should include matters of concern to the board and matters identified as risks to the organizations.

External audits are usually conducted annually by a government auditor general, or in the absence of an auditor general, an independent auditing firm. Matters for annual external audits include standard financial audits as well as significant matters that present risk to the authority as agreed upon between the auditor and the board. Both internal and external audits should be reported to the board.

In addition to these audit processes, boards should ensure that an open and honest culture is a core principle reinforced through effective provisions and processes for individuals to be able to report unethical or illegal behaviours to an appropriate authority without fear of exposure or repercussion.

Besides regular interaction with the CEO, boards should ensure that they meet regularly with, and receive reports from, other senior executive members of the regulatory authority including the legal counsel, the chief financial officer and the chief operating officer(s).

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<sup>4</sup> See footnote 1.

## CONCLUSIONS

Public trust and confidence in regulatory authorities (including the self-regulatory professional organizations), is essential for sustaining public confidence that the activity undertaken in the authority's jurisdiction is safe, economically beneficial and environmentally responsible. A regulatory authority's governance failures can result in loss of public trust. Any erosion of trust can precipitate increasing disputes between individuals, communities and the public at large and regulated entities over concern for public safety, health and welfare. These disputes can become economically, socially and politically disruptive.

Governments and regulatory authorities — both tribunals and SRPOs of all types — must hold themselves accountable for fulfilling their responsibilities through consistent, certain and ethical behaviours.

The same accountabilities apply not just to the regulatory authorities but to all members of their staff who are professional members of the various types of SRPOs. They can and should seek advice from their SRPOs' regulatory staff members if they find themselves in the untenable positions of being asked or told to perform work that has the potential to breach their codes of conduct and ethics.

Governments and regulatory authorities need to adopt, implement and demonstrate best principles and practices for public-sector governance. Proper governance principles and practices are part of the core values of any regulatory authority and applied scrupulously.

Clarity and respect of mandate by government and the regulatory authority's board, CEO and senior executive; duty of care by the board in executing its governance oversight, and ethical leadership and stewardship by the CEO and senior executive, are all essential to ensuring that best governance principles and practices are applied scrupulously. Guarding against risks of failure in any or all these areas is the responsibility of both the government and the board.

In the recent paper, "The Structure of the Canadian Energy Regulator: A Questionable New Model for Governance of Energy Regulation Tribunals?" the authors explore the new governance model for the Canadian Energy Regulator (CER) from the implications for the management, operations and independence of the CER. The authors note that the CER governance model is an adaptation of the AER governance model established by the *Responsible Energy Development Act* with significant differences in the responsibilities and accountabilities of the CEOs and boards. Regarding the AER governance model, the authors state:

*"The AER model resembles a corporate sector model more closely than does the CER model. It is clear from the details of the AER structure that the board of directors has overall responsibility, not just for governance functions, but for "the **general management** of the business and affairs of the Regulator" and that the CEO is accountable to the board for **day-to-day operations**" (Harrison, McCrank and Wallace 2020, 9).*

Based on a brief summary of the findings of the auditor general, the public interest commissioner and the ethics commissioner, the authors conclude:

*'None of the three reports suggested that the **institutional** relationship between the board of directors and the CEO had contributed to the respective findings. Two of the reports, however, did comment on the absence of proper oversight by the board. The report of the Auditor General concluded that the board had been overly reliant on management and, further, had not received complete and accurate information about ICORE.<sup>79</sup> Board oversight was "ineffective."<sup>80</sup> The report of the Public Interest Commissioner found that the board did not appear to have the expertise, focus or detachment required to oversee the CEO.<sup>81</sup> The board was replaced soon after the release of these findings" (Harrison, McCrank and Wallace 2020, 9).*

In addition, the authors note that the AER CEO's view of the board as purely a governance board and not an operational one contributed to the CEO's failure to provide the board with the complete information it required to effectively fulfil its governance responsibilities. Equally, the board failed to hold the CEO accountable to provide the necessary information.

The authors come to similar conclusions as we do that the primary failure was not in the legislated mandate and the governance structure but rather in respect of mandate, duty of care and ethical leadership and stewardship.

There are some key regulatory governance safeguards governments and boards of regulatory authorities, including those of the self-regulatory professional organizations, should take against these risks of failure:

- Governments must prescribe clear legislated mandates for regulatory authorities that reflect their explicit regulatory policy intents and objectives. The legislation should also clearly prescribe the authorities and processes the authority must follow in carrying out its mandate.
- Governments must establish clear competencies and experience criteria for selecting the board members and the CEO of regulatory authorities and establish open and rigorous recruitment and selection processes that ensure prospective candidates meet the required competencies and experience.
- Governments must set clear expectations for transparent and fulsome annual reporting by the regulatory authority to the government and the public.
- Governments must hold an annual accountability meeting between the minister responsible and the regulatory authority board.
- In selecting a CEO, boards must use effective personality and competency assessment tools and thorough reference checks, to ensure candidates have the appropriate leadership skills.
- Boards must ensure the regulatory authority has a well-developed and executed risk-management framework, managed by a senior executive who is responsible for preparing and presenting an annual assessment of internal and

external risks to the regulatory authority, and the actions required to mitigate those risks.

- Boards should ensure that independent entities conduct effective internal and external value-for-money audits.
- Boards should ensure effective provisions and processes for individuals to be able to report unethical or illegal behaviours to an appropriate authority without fear or exposure or repercussion.

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