STAFF REPORT
ACTION REQUIRED

Toronto Hydro Corporation – Application to OEB to Regulate Street Lighting Assets

Date:	July 28, 2009
To:	City Council
From:	Deputy City Manager and Chief Financial Officer
Wards:	All Wards
Reference Number:	P:\2009\Internal Services\Cf\cc09020cf – et (AFS #10293)

SUMMARY

Toronto Hydro Corporation (THC), through its subsidiary, Toronto Hydro Energy Services Inc. (THESI), currently provides street lighting services to the City of Toronto under a 30-year Street and Expressway Lighting Service Agreement (SLA). The cost of electricity associated with street lighting is passed through to and paid for by the City under this agreement.

On June 15, 2009, THC, through its subsidiaries, applied to the Ontario Energy Board (OEB) to have the street lighting assets deemed regulated electricity distribution assets, and to have those assets and related operations merged with Toronto Hydro-Electric System Limited (THESL), its wholly-owned, regulated electricity distribution subsidiary.

This report describes the implications of the THC application and the actions taken by staff to ensure that the City's interests are protected. The deadline for seeking intervenor status is July 31, 2009. Council ratification of staff seeking intervenor status at the Ontario Energy Board is required. Outside legal assistance has been obtained.

RECOMMENDATIONS

The Deputy City Manager & Chief Financial Officer recommends that:

1. Council ratify the actions taken by the Deputy City Manager and Chief Financial Officer and the City Solicitor to intervene in the Toronto Hydro street lighting applications before the Ontario Energy Board.

2. To the extent that Shareholder approval may have been required prior to Toronto Hydro making these street lighting applications to the Ontario Energy Board, such Shareholder approval now be given by Council.

3. The Deputy City Manager and Chief Financial Officer be authorized to continue to instruct the City Solicitor on the City's intervention to the Ontario Energy Board with respect to the Toronto Hydro street lighting applications, in order to safeguard the City's financial and other interests with respect to the Street and Expressway Lighting Service Agreement with THESI.

Financial Impact

If the applications are approved by the OEB, THC anticipates that costs related to street lighting activities may be recovered through regulated electricity rates for distributed un-metered loads (such as the City's street lights). The City's SLA may continue (subject to OEB approval), and all payments under the contract may be offset against the regulated electricity rate based charges in determining the net cost to the City.

THC indicates that regulation of street light assets is intended to improve operating efficiency and contribute to improved system safety, simplify contract administration, and in some cases allow costs, such as eligible investments in street lighting conservation initiatives, to be recovered from the broader rate base, reducing the costs to the City. OEB oversight could affect the amount and timing of costs recovered from the City for street lighting services, particularly unplanned or newly identified costs, where these costs would otherwise be subject to contract adjustment discussions between the City and THC under the existing agreement. However, the transition is expected to continue to provide for a fair and appropriate costing of the service.

The value of all of these combined changes is not known, although THC states that direct operating savings in the $0.5 m to $1.0 million range will be obtained. The full impact will ultimately be determined by the OEB as part of the approval of these applications and the approval of any future THC rate case or issue-specific applications.

The regulation of the street lighting assets by the OEB means that the City's contractual options to buy back (such as at the end of the contract term) and subsequently operate the street lights would be subject to OEB oversight and approval, and in the extreme could even be subject to transfer tax. However, these considerations are (a) contingent on a decision to repatriate the assets; (b) not likely to be relevant until contract expiry and (c) subject to mitigation through appropriate discussion with the OEB and the Province.

The anticipated cost for the legal services of Cassels Brock & Blackwell, LLP is within the delegated authority of the Deputy City Manager and Chief Financial Officer and the City Solicitor.

ISSUE BACKGROUND

Until 1989, street lighting in Toronto was operated by municipal hydro-electric commissions under the regulation of Ontario Hydro. In 1989, Ontario Hydro required that the municipal hydro-electric commission assets and operations be transferred to the municipal beneficiaries of the service, in order that the related costs would be born directly by each municipality.

In 1999, THC was incorporated under the *Electricity Act, 1998* including the OEB-regulated distribution company and the non-regulated subsidiary operating companies. In 2005, the City sold its street lighting assets to Toronto Hydro Street Lighting Inc. (THSLI) and entered into a 30-year SLA. THC later merged THSLI's operations with THESI.

THC's applications to the OEB to transfer the street lighting assets to another subsidiary corporation and subsequently merge that corporation with THESL, the OEB-regulated distribution company with the result that the street lighting assets will be part of the distribution company, raises some issues of concern to the City. Outside legal counsel has reviewed the THC applications, the SLA, the City's Shareholder Direction and the relevant legislation. The major issues raised are set out in this report under the Comments section.

COMMENTS

For convenience, reference may be made to THC in different places throughout this report, rather than the referring to the specific subsidiary company.

Senior THC and City staff met on May 28 and again on June 12 to discuss the implications of the planned application by THC to seek both the regulation of its street lighting assets and the merger of the street lighting business with its regulated business in THESL. THC took the position that it is able to transfer assets between affiliates such as in the proposed restructuring under the terms of the City's Shareholder Direction and the SLA with the City. To the extent THC's authority under the Shareholder Direction could be questioned, out of an abundance of caution, Shareholder approval of the THC applications is being sought in the recommendations in this report. THC submitted its applications to the OEB on June 15th, 2009, expecting that the OEB would require 90 days to make its determination. The OEB has set a July 31, 2009 deadline for seeking intervenor status.

Given the urgency and importance of this matter, staff retained Cassels Brock & Blackwell LLP as outside legal counsel, to provide advice on how the City's rights might be impacted by the applications, and to advise whether the City should participate in the OEB proceedings in light of any potential impact on City costs and future asset repurchase rights. Outside legal counsel has recommended that the City intervene to safeguard the City's interests,

THC advised that the restructuring of these assets and operations into the regulated business of THC is consistent with its efforts to streamline operations, enhance profitability, and improve the safety of THC operations. Furthermore, THC believes that regulation may create new opportunities to invest in more efficient street lighting technology and recover these costs through the Ontario Power Authority's Conservation and Demand Management incentives, rather than directly from the City through contract adjustments.

THC has stated that it believes the City's SLA will continue to be in force and effect. THC has indicated that absent this OEB-application initiative it would likely be seeking increases in City payments through the 5-year review provisions of the agreement to recover a portion of the costs for the recent contact voltage mitigation work in the winter of 2009, and to offset the higher-than-expected cost of asset degradation. In a regulated environment, such costs and recoveries would be reviewed and regulated by the OEB based on regulated rates of return on investment, and factored into the electricity rates paid by the City. OEB oversight could affect the amount and timing of costs recovered from the City for street lighting services. THC's view is that in the long run, the transition should result in a fair and appropriate costing of the service.

The advice from outside legal counsel indicates that under a regulated environment the OEB would have the power to review the relationship to ensure that it complies with OEB Codes, policies and legislation. For example, distribution service agreements are limited to 5 years without OEB approval, whereas the SLA has a 30-year term. Similarly if a distribution licence is granted in respect of the street lighting assets, it would also affect the City's ability to repatriate ownership of the lights in the future, since the assets would be subject to OEB regulation and oversight. The street lighting services agreement currently provides for a City right to repurchase the street lighting assets should they ever be subject to a bid for acquisition by a third party, or at the end of the 30 year service agreement. In a regulated environment, the buy back options under the service agreement would be subject to OEB approval, including potentially the pricing criteria, and any buy back of the street lighting assets would have to be done by a new City corporation, since the City can't directly own or operate distribution assets.

Based on the above noted concerns, Cassels Brock & Blackwell LLP have advised that they feel that the City should intervene in the THC applications before the OEB, to protect, to the extent possible, City's interests including the recognition of its rights under the SLA. Their retainer will be extended so that they can assist the City with this matter, including representing the City before the OEB.

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SIGNATURE

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