TORONTO CITY CLERK

Clause embodied in Report No. 4 of the Policy and Finance Committee, as adopted by the Council of the City of Toronto at its meeting on May 18, 19 and 20, 2004.

14

2003 Annual General Meeting - Toronto Hydro Corporation

(City Council on May 18, 19 and 20, 2004, adopted this Clause, without amendment.)

The Policy and Finance Committee recommends:

(I) the adoption of the report (May 3, 2004) from the City Solicitor; and further, that the Chief Administrative Officer, the Chief Financial Officer and Treasurer and the City Solicitor be requested to review the Toronto Hydro Shareholder Direction dated July 1, 1999, amended and restated as of October 3, 2002, as approved by City Council, to determine if the Shareholder Direction requires amendment in view of the time elapsed since its last amendment and the pending changes in legislation which might affect Toronto Hydro; and report thereon to the Policy and Finance Committee; and

(II) that the report (April 26, 2004) from the Chief Financial Officer and Treasurer be received; and a copy thereof be forwarded to the Audit Committee for information.

The Policy and Finance Committee submits the following report (May 3, 2004) from the City Solicitor:

Purpose:

To transmit the agenda and annual report of Toronto Hydro Corporation for shareholder consideration.

Financial Implications and Impact Statement:

There are no financial implications as a result of the adoption of this report.

Recommendation:

It is recommended that the recommendations embodied in the attached report (April 28, 2004) from Toronto Hydro Corporate be adopted.

Background:

To comply with the requirements of subsection 94(1) of the *Business Corporations Act* (Ontario), R.S.O., c.B.16 (the “OBCA”), the directors of Toronto Hydro Corporation (“THC”) are required to call an annual meeting of its shareholders (i.e. the City of Toronto) by no later than fifteen (15) months after holding the last preceding annual meeting. The last annual shareholder meeting for THC was held on February 4, 5 and 6, 2003.

Conclusion:

In order for the THC board of directors to function effectively and in order for the City of Toronto, as shareholder, to be in compliance with the requirements of the OBCA, it is recommended that Council approve and adopt the resolutions attached to this report.

Contact:

Lorraine Searles-Kelly, Solicitor, Legal Services, Tel: (416) 392-7240, Fax: (416) 397-5624; e-mail: lsearles@city.toronto.on.ca

List of Attachments:

Appendix A - Resolutions of the Sole Shareholder
Appendix B - Additional Report from THC

(Report dated April 28, 2004, addressed to the
Policy and Finance Committee from Mr. Lawrence D. Wilde,
General Counsel and Corporate Secretary, Toronto Hydro Corporation)

Purpose:

To comply with the requirements of subsection 94(1) of the *Business Corporations Act* (Ontario), R.S.O., c.B.16 (the “OBCA”), the directors of Toronto Hydro Corporation (“THC”) are required to call an annual meeting of its shareholders (i.e. the City of Toronto) by no later than fifteen (15) months after holding the last preceding annual meeting. The last annual shareholder meeting for THC was held on February 4, 5 and 6, 2003.

The directors of Toronto Hydro Corporation therefore hereby submit and recommend that this report and attached shareholder resolutions be reviewed by the Policy and Finance Committee and approved by City Council at its next meeting. As the next available City Council meeting will be held after May 6th, 2004 (the deadline, under the OBCA, to hold the next annual general meeting for THC), the enclosed report and proposed shareholder resolutions contain an acknowledgement and waiver of such deadline by City Council.

Recommendations:

It is recommended that City Council, as the sole shareholder of THC, hold an annual shareholder meeting to:

(1) approve and adopt the shareholder resolutions attached to this report;

(2) authorize and direct appropriate City officials to take the necessary action to give effect thereto; and

(3) receive any additional reports attached hereto, for informational purposes.

Background:

City Council, by the amendment and adoption of Clause 1 of Report No. 10 of the Strategic Policies and Priorities Committee, at its meeting of June 9, 10 and 11, 1999, authorized the incorporation of THC. The City of Toronto is the sole shareholder of THC.

THC is the parent of the following subsidiaries:

(1) Toronto Hydro-Electric System Limited, which distributes electricity;

(2) Toronto Hydro Energy Services Inc., which manages an existing portfolio of electricity contracts and is engaged in the development and sale of energy efficiency products and services;

(3) Toronto Hydro Street Lighting Inc., which provides street lighting and related ancillary services;

(4) Toronto Hydro Telecom Inc., which leases fibre optic cable capacity and provides managed data services;

(5) 1455948 Ontario Inc., which was incorporated for the purpose of holding an equity interest in the EBT Express partnership, an organization providing electronic data management and transaction services through an electronic business transaction hub; and

(6) 1512830 Ontario Inc., which was incorporated by Toronto Hydro Corporation and Toronto Hydro Energy Services Inc. for the purposes of holding investments in wind power and other generation projects.

2003 Annual General Meeting

City Council, as sole shareholder of THC, is to consider the following items at this annual general meeting:

(1) waiver of the May 6th, 2004 deadline (as provided by subsection 94(1) of the OBCA) to hold this annual general meeting;

(2) audited financial statements for the 2002 completed financial year and the auditor's report for that period (unaudited financial statements up to the third (3rd) quarter of 2002, ending September 30, 2002, having been provided to City Council on December 9, 2002);

(3) audited financial statements for the 2003 completed financial year and the auditor's report for that period;

(4) re-appointment of the incumbent auditors for the 2003 financial year and re-authorization of the THC board of directors to fix their remuneration for this period; and

(5) receipt the additional report attached hereto, for information purposes.

Comments:

(1) Extension to May 6th, 2004 Deadline for Annual General Meeting:

As noted above, subsection 94(1) of the OBCA requires that the directors of THC call an annual meeting of its shareholders (i.e. a meeting of the Council of the City of Toronto) by no later than fifteen (15) months after holding the last preceding annual meeting. The last annual shareholder meeting for THC was held on February 4, 5 and 6, 2003. The OBCA therefore requires that City Council hold the next annual shareholder meeting by no later than May 6th, 2004.

As the audited financial statements required to be approved by City Council at the annual general meeting were not available until the end of March 2004, and the City Council meetings between the end of March 2004 and May 6th, 2004 were devoted exclusively to budget matters, the directors of THC and the City Solicitor agreed that the deadline to hold THC's annual general meeting would be extended to the next ensuing Council meeting.

The enclosed proposed shareholder resolutions therefore contain an acknowledgment and waiver by City Council regarding the extension to the May 6th, 2004 deadline for THC's annual general meeting.

(2) Financial Statements:

The shareholder received the 2002 third quarter interim financial statements of THC on December 9, 2002. Audited financial statements for the 2002 and 2003 completed financial years, and related auditor's reports, have been delivered by THC and reviewed by the Chief Financial Officer and his comments are presented in a separate report before this Committee. The financial statements of THC are on file with the City Clerk's office.

(3) Re-Appointment of Auditor and Authorization of THC Directors to Fix Remuneration:

At the last preceding annual general meeting, the shareholder resolved to appoint the incumbent auditors, Ernst & Young LLP, Chartered Accountants ("E&Y") until the close of the next annual meeting of the shareholder, or until a successor is appointed, and further resolved and authorized the directors of THC to fix the auditor's remuneration.

The Board of Directors of THC now recommends that the shareholder re-appoint E&Y as auditor for THC for the fiscal year 2004 or until the close of the next annual meeting of the shareholder, whichever is later. The directors of THC further recommend that City Council resolve and authorize the directors of THC to fix the auditor's remuneration for this period.

(4) Other Items:

It is recommended that the shareholder receive the report attached as Appendix B hereto, for information purposes. The original is on file with the City Clerk.

Appendix A

Toronto Hydro Corporation
(the "Corporation")

Resolution of the City of Toronto ("Sole Shareholder")

1. Extending Deadline for Annual General Meeting

RESOLVED THAT:

The Sole Shareholder hereby provides its acknowledgement and waiver of the requirement under subsection 94(1) of the *Business Corporation Act* (Ontario) to have held this annual general meeting of the Corporation by no later than May 6th, 2004.

2. Appointing Auditor

RESOLVED THAT:

Ernst and Young LLP, Chartered Accountants, is hereby appointed the auditor of the Corporation to hold office until the close of the next annual meeting of the shareholders of the Corporation, or until a successor is appointed, at such remuneration as may be fixed by the directors and the directors are hereby authorized to fix such remuneration. The Corporation's directors are authorized to pass the requisite resolutions giving effect to the foregoing, and any and all such resolutions passed by the directors of the Corporation regarding same are hereby confirmed and ratified.

* * * * * * * * * *

The foregoing resolutions are hereby consented to by sole shareholder of the Corporation pursuant to the *Business Corporation Act* (Ontario).

Dated as of this ________ day of ___________, 2004

City of Toronto

____
per: Joesph Pennachetti
City Treasurer

per: Ulli Watkiss
City Clerk

Approved as to Form per: ____
Anna Kinastowski, City Solicitor

Authorized by Clause ____ of Policy and Finance Committee Report No. ____ adopted by Council at its meeting of _____, 2004.

per: Ulli Watkiss
City Clerk

Appendix B

(Report dated April 23, 2004, from Mr. Clare R. Copeland,
Chairman, Toronto Hydro Corporation Board)

Toronto Hydro Corporation 2003 Report to the Shareholder

Recommendation:

It is recommended that this report be received for information.

Purpose:

This report highlights our key achievements for 2003. Our core business – distributing electricity – is a necessity of modern urban life. The Board of Directors of Toronto Hydro Corporation reports that 2003 was a successful year of operation. Initiatives undertaken in 2003 have strengthened the operational, environmental, customer, employee and financial elements of the company leading to enhanced shareholder value. We remained focused on service reliability, workplace safety, operational excellence and sound financial management.

2003 was yet another year of legislative and regulatory changes in the energy industry that THC responded to and implemented effectively. We met the Ontario Energy Board (OEB) performance based regulation customer service standards for the year. Our employees responded to the August 14, 2003 blackout in a professional, effective, and coordinated fashion that demonstrated the commitment to service and reliability that is part of the THC culture.

Keeping the lights on with the proper investments in maintenance and capital work is a priority role that we play for our customers. The Board of THC continues to ensure that this important piece of infrastructure of the City is properly maintained with continuing investments to maintain the state of good repair. The payment of our first dividend regarding 2003 results of operation of $29.2 million was made after due consideration of all aspects of THC's operation, including adequate investment in the infrastructure.

Background:

Toronto Hydro Corporation was incorporated as at July 1, 1999. THC was set up as an arms-length corporation with a board of directors consisting of eight independent directors plus three City Councillors with accountability for the operational and financial management of THC.

Toronto Hydro Corporation (THC) operates four major wholly owned affiliates in the electricity distribution, energy management services, telecommunications services and streetlighting businesses. Toronto Hydro-Electric System Limited (THESL), our electricity distribution business, holds 96 percent of the assets and accounts for 98 percent of the gross revenue of the company. We serve 590,109 residential customers and 78,564 commercial and industrial customers in the City of Toronto. We own and operate the electricity distribution grid within the City of Toronto. Power is delivered to our grid from generating stations located throughout the province through the province's transmission system to 35 terminal stations located throughout the City. THC distributes the electricity through 16,781 kilometers of underground and overhead lines.

The corporate relationship between THC and the City is set out in a Shareholder Direction approved by Council on July 1, 1999. The Shareholder Direction sets out the City's objectives and principles for THC. The Board is responsible for determining and implementing the appropriate balance among the objectives and principles and for causing the Corporation to conduct its affairs in accordance with same.

The Shareholder's objectives in connection with its relationship with Toronto Hydro are as follows:

(a) the value of Toronto Hydro be maintained or increased;

(b) the Shareholder's income stream from Toronto Hydro be comparable to the Shareholder's estimated financial benefit if Toronto Hydro had been sold as a going concern;

(c) Toronto Hydro's consumers not be unduly impacted by the succession by Toronto Hydro of Toronto Hydro Electric Commission; and

(d) Environmental impacts related to Toronto Hydro be improved.

The following key principles are excerpted from the Shareholder Direction that currently govern the operations of Toronto Hydro:

(a) The Business is integral to the well being and the infrastructure of the City of Toronto.

It is in the best interests of Toronto Hydro and the community of stakeholders that Toronto Hydro conduct its affairs:

(i) on a commercially prudent basis;
(ii) in a manner consistent with the energy policies established by the Shareholder from time to time;
(iii) in accordance with financial performance objectives (and that the Board will use its best efforts to ensure compliance):

- THC will maintain a credit rating of A- or higher;
- THC will pay dividends based on 40 percent of the distribution company net income;
- THC will employ the most effective cost structures, implement cost reduction programs and maximize return on the Shareholder's equity;

(b) THC will provide a reliable, effective and efficient distribution system;

(c) THC will provide its services with an emphasis on customer orientation and satisfaction;

(d) THC will operate in a safe and environmentally-responsible manner;

(e) THC will promote energy conservation and environmental responsibility; and

(f) THC will operate in a manner that will protect and enhance the City's urban forest.

THC reports to the City Finance Department on a regular basis with its Board approved quarterly reports on budget to actual results, its three year business plan in December of each year and its annual audited consolidated financial statements in the first quarter of the following year. During the year, THC and City staff meet to review and discuss issues and progress as required.

The Board has incorporated the Shareholder Direction in its' adopted corporate vision of a "Top 10 utility providing a necessity of life". Our corporate strategy also embeds key elements of the Shareholder Direction in the following strategies:

(1) Operationally -Achieve Operational Excellence through process improvements, operating cost reductions, customer service, health and safety, effectively allocating resources and through management control and reporting systems and,

Manage and Grow Assets by maintaining asset performance data and asset records to facilitate effective asset investment, maintaining effective regulatory relationships, implementing effective risk management processes and assessing and implementing growth opportunities.

(2) For our customers, a commitment to customer service, targeted community programs, strong shareholder and stakeholder relationships and environmental leadership

(3) Developing our Employees through engagement and communication, learning and development, positive labour relations, performance management and by operating with strong corporate values.

(4) Building Shareholder Value in terms of financial, community and environmental contribution.

As reflected further in this report, THC has and continues to meet the objectives and principles set out by the Shareholder.

The First Five Years - Post Amalgamation

On January 1, 1998, the six local distribution companies, which had previously operated as commissions, were required to amalgamate to become one entity known as the Toronto Hydro Electric Commission. In the first five years post amalgamation, including the incorporation as an OBCA corporation, THC has successfully:

(a) improved lost time injury frequency by 76 percent and improved lost time injury severity by 79 percent in the five years of 1998-2002;

(b) reduced total costs by 25 percent in our distribution company from $520.00 per customer to $391.00 per customer through staffing reductions of 36 percent, reduced fleet levels of 55 percent, reduced cost of facilities by 19 percent, reduced external spending and consolidated call center operations to one location;

(c) responded successfully to a series of provincial and regulatory changes including electricity market opening on May 1, 2002, and processing customer rebate cheques in December 2002;

(d) successfully created new subsidiaries focusing on energy management, telecommunications services, and streetlighting services; and

(e) implemented management control and reporting systems that include balanced scorecards for every company and business unit, focusing on key performance indicators for financial, operational, customer and employee areas, that carry forward into performance management systems for all employees. Through daily reviews of work plans, weekly reviews of project schedules, and monthly analysis of financial performance, we closely track performance and make adjustments in response to changing conditions and priorities.

2003 Business Environment

In late 2002, Bill 210 dramatically changed the operation of the electricity market effectively shutting down the active retail electricity market. In 2003, THC adapted and implemented new provincial legislation and responded to regulatory changes from the Ontario Energy Board (OEB) and the Ontario Securities Commission (OSC). Customers were impacted with these changes and responded with twice as many calls than normal to our call centers.

Bill 210 also required municipal councils to confirm the original decision to commercialize the distribution company. City Council passed the required Council resolutions in February 2003.

On October 17, 2003, the OEB renewed our distribution company's license for a 20 year period;

2003 Performance Highlights

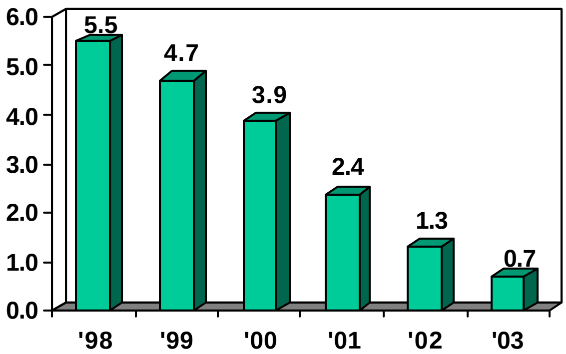
In accordance with the Shareholder Direction and through its corporate strategy, THC and its subsidiary companies performed well in 2003 in the key areas of operations, environment, customer service, employees and financial.

1. Operations:

(a) Achieved the best performance in safety since amalgamation both in terms of frequency of injuries and severity of injuries. Actual severity of 13.8 is a 6 percent decrease from 2002 and 8 percent better than the 15.0 target. Actual frequency of 0.70 is a 50 percent reduction from 2002 and a 46 percent improvement versus the goal of 1.30. In 2003, we experienced 11 lost time injuries compared to 23 in 2002.

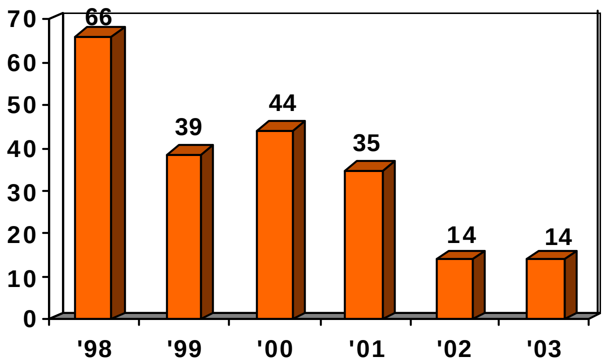
Over the past six years, we have achieved a 87 percent reduction in workplace accidents. The charts below demonstrate this significant achievement that was attained through our effectiveness in accident investigation, implementation of our Early and Safe Return to Work program and with collaboration with CUPE Local One.

Injury Frequency



Number of disabling injuries per 200,000 employee hours worked

Injury Severity



Number of days lost per 200,000 employee hours worked

(b) successfully responded to the August 14, 2003 blackout by restoring power to some parts of the City within 7 hours and to the entire City within 27 hours. Effectively ensured that City key services including the TTC were supplied with uninterrupted power through the week that followed when restrictive supply was in effect.

(c) implemented key process improvements in the distribution system and most particularly in the material and work scheduling processes. Process improvements increased crew utilization to 63 percent; had materials required for work issued on time and in full 94 percent of the time; enabled 103 percent achievement of planned capital and maintenance work. However, this process improvement initiative included a target to reduce inventory levels which was not met.

(d) completed $121 million in capital projects on our distribution system and operations. Our highly skilled staff completed this program on schedule and on budget. THC is continuing the renewal of its distribution system within a service area that is growing approximately 1 percent per year. We continued implementing systems to prioritize capital projects to achieve improved reliability results;

(d) consolidated the distribution systems control center to one location (with a backup facility in case of emergencies);

(e) surpassed the target for the distribution system's average customer outage with THC response at 44.47 minutes. Customers saw an average of 1.98 outages in 2003 lasting 87.98 minutes per customer deriving the average outage of 44.47 minutes. The Ontario Energy Board targets for 2003 were 2.1 outages per year lasting 82 minutes per customer for an average outage of 48 minutes;

(f) reduced the size of the fleet by 66 vehicles in 2003 while maintaining availability at 98 percent;

(g) finalized a twelve year agreement to provide radio communication services for the City saving costs to both the City and THC;

(h) continued contracting in services to reduce overall total costs with the establishment of an electrical test lab;

(i) improved operations at THESI, our energy management subsidiary, to achieve timely billing and collection results;

(j) continued to grow the energy management value added services to business customers and to manage the portfolio of electricity contracts

(k) exited the natural gas and electricity retailing business to reduce business risk and maintain the credit rating as per the Shareholder Direction;

(l) enhanced the operation and cost structure of our network operations center of THTI, our telecom company by providing services to Enersource Telecom. Network availability for data services averaged 99.999 percent with a mean time to repair of 4 hours;

(m) improved the risk profile of our telecom company with the addition of new blue chip customers such as Scotiabank, IBM (TD Bank), Symcor, Humber College, Alliance Atlantis;

(n) continued our telecom company's successful business model of capital investment after a new customer account is signed; and

(o) improved job tendering capability and developed unit costs for street lighting activities but incurred an overall net loss from operations;

2. Environment:

(a) THC was in compliance with environmental, health and safety regulations in 2003;

(b) migrated the entire diesel fleet of 400 to biodiesel fuel with no fuel related failures and introduced five new hybrid gasoline-electric cars to our 'Green Fleet';

(c) recognized by the Ontario Energy Association as "Company of the Year' and by the Electrical Distributors Association's "Environmental Excellence Award" for the Bio-diesel fuel project;

(d) Phase 1 environmental site assessments were completed for 272 substations. Seven of the nine priority 'A' properties that were identified as having containment including asbestos and PCB's were remediated in 2003;

(e) completed installation of our 750 kilowatt Wind Turbine at Exhibition Place in a joint venture with Windshare in December 2002. It began commercial production in August 2003 after significant testing and retrofitting to meet provincial electrical standards. By December 2003, 1 million kilowatts of energy were produced. A wind turbine education center with complete public access has been created at the base of the turbine;

(f) enhanced recycling at all work centers to 26 percent. A walk through audit was conducted and improvements have been put in place to enhance the 2004 recycling program target to 40 percent. Among the materials reclaimed from the distribution system were 619,000 pounds of copper and 251 tons of steel;

(g) received award for idling reduction and corporate sponsorship of the 2003 Repair Our Air Fleet Challenge;

(h) continued to be a major sponsor of the City of Toronto Tree Advocacy program, championed by Deputy Mayor Pantalone. THC has hosted tree planting initiatives on sites identified by the City for re-forestation. Over the past five years, we have contributed more than $200,000.00 to this program;

(i) continued support for the Ontario Forestry Association's education program through the Focus on Forests teaching guide, and the annual Envirothon competition;

(j) continued to be a major sponsor of LEAF (Local Enhancement and Improvement of Forests), which plants trees on private property at the request of property owners. We have contributed more than $100,000.00 to LEAF since 1998; and

(k) continued program of selective tree trimming in an environmentally friendly manner that only targets areas where reliability improvements can be made;

3. Customer:

(a) initiated a cross functional team with the call center, control room, customer response and distribution services to address the time needed to respond to emergencies and the length of customer outages;

(b) responded to 67 percent of all customer telephone calls within 30 seconds (OEB target: 65 percent);

(c) provided written responses to customer letters 93 percent of the time within 5 days (OEB target: 80 percent);

(d) provided emergency response 86 percent of the time within 60 minutes (OEB target: 80 percent);

(e) kept 95 percent of customer appointments on time (OEB target: 90 percent);

(f) provided cable locate services 91 percent of the time within 5 days (OEB target: 90 percent);

(g) provided 3909 customer connections for low voltage services within 5 days 99 percent of the time (OEB target: 90 percent);

(h) provided 212 customer connections for high voltage services within 10 days 99 percent of the time (OEB target: 90 percent);

(i) provided free training to our largest customers on the use and capability of smart interval meters and allowed them to access their interval meter data via the internet; and

(j) continued participation in community involvement activities including the Sci-Tech Science Fair, Earth Day, YMCA Corporate Challenge, White Ribbon Dad Walk, Clean Air Commute, Run for the Cure, United Way;

4. Employees:

(a) implemented a Code of Business Conduct for all employees, including an investigation process;

(b) completed leadership training for managers, 92 supervisors and 60 crew leaders; completed financial management training for all managers;

(c) signed a three year collective agreement in late 2002 with CUPE Local One, well in advance of the end of the existing agreement;

(d) in response to an aging workforce, implemented a Trades Training School with 16 students, 8 to become Certified Power Linepersons, and 8 to become Underground Cable Splicers; and

(e) completed an average of 5 days training per employee meeting Top 10 benchmark.

5. Financial:

(a) met financial targets on the corporate scorecard with operating expenses at $184.9 million; capital expenditures at $112.0 million and exceeded financial target for net income at 95.6 million;

(b) maintained strong credit ratings throughout 2003 at an A(low) from Dominion Bond Rating Service and A- from Standard & Poors;

(c) continued in 2003 to pay $66.7 million in interest on the $980 million promissory note to the City;

(d) increased cashflow to the City by declaring dividends to the City of $29.2 million with respect to the 2003 results of our distribution company

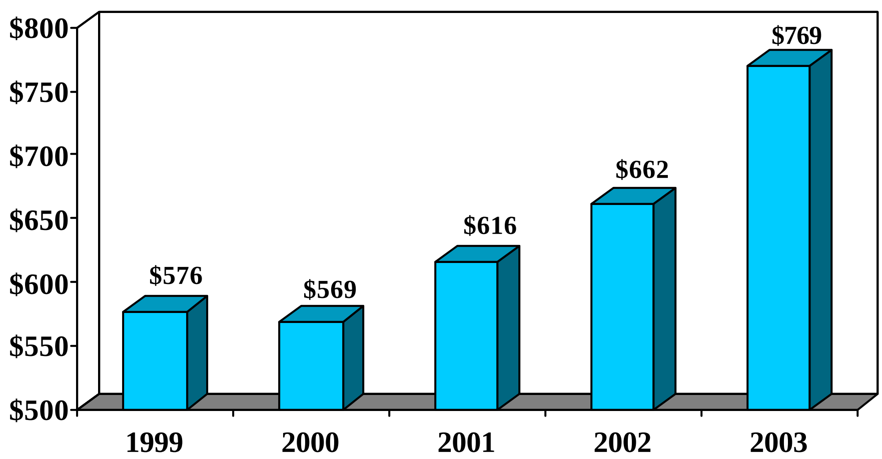
($ millions)	December 31, 2001 Actual	December 31, 2002 Actual	December 31, 2003 Actual
Interest on Long-term Note	41.9	66.7	66.7
Dividends	-	-	29.2
Total Amounts	41.9	66.7	95.9

(e) improved corporate liquidity by (i) successfully completing our initial public debt in May 2003 offering of $225 million at 6.11 percent for 10 years with 50 different investors and (ii) obtaining an increased working capital line of credit to $500 million with a syndicate of five Schedule 1 banks;

(f) beginning in June 2003, implemented disclosure and compliance requirements that provided for public filings of THC financial results as required by the Ontario Securities Commission; and

(g) increased shareholder equity by $107 million or 13.6 percent from 2002 and by $193 million or 30.6 percent since incorporation in 1999.

Shareholder's Equity
(millions)



Conclusions:

The Board of Directors of THC are pleased to report that, in 2003, THC has operated within the Shareholder Direction in a balanced manner by making financial contributions to the City of almost $100 million, continuing to improve our on the job safety, continuing to improve operating processes to contain costs; continuing to improve our service to customers particularly when an outage occurs, and continuing to improve our impacts on the environment. Our employees are an integral part of THC's success and management has continued to spearhead the continuing changes and improvements in the operation of the company.

The Board looks forward to 2004 as a year of continuing contribution of THC to the City as shareholder as well as the ratepayers of the City of Toronto by providing a necessity of life, safely and reliably, while maintaining a focus on operational excellence.

Clare R. Copeland
Acting Chief Executive Officer
Chairman, Toronto Hydro Corporation

The Policy and Finance Committee also submits the following report (April 26, 2004) from the Chief Financial Officer and Treasurer, entitled "Financial Statements of Toronto Hydro Corporation":

Purpose:

To provide the annual audited financial statements of Toronto Hydro Corporation for the two years ended December 31, 2003 to the Shareholder.

Financial Implications and Impact Statement:

There are no financial implications of this report.

Recommendations:

It is recommended that this report be received for information.

Background:

Disclosure of Financial Results:

Toronto Hydro Corporation was incorporated as at July 1, 1999, with the City of Toronto as sole shareholder. As at that date, the Shareholder Direction relating to Toronto Hydro Corporation ("the Corporation") became effective. At its meeting of October 1, 2, 3, 2002, Council adopted an amended and restated Shareholder Direction.

- Section 6.6 of the Shareholder Direction requires the Corporation to deliver the audited consolidated statements of the Corporation to the Shareholder within 120 days of its fiscal year end.

- Section 6.2 of the Shareholder Direction requires the Corporation to submit its unaudited quarterly financial statements to the Finance Department of the City within 60 days after each fiscal quarter.

In addition, the Ontario Business Corporations Act ("OBCA") (s.94) requires that an annual meeting of shareholders be called no later than 18 months after the Corporation comes into existence and subsequently not later than 15 months after the last preceding annual meeting.

Shareholders are to consider several items at an annual general meeting including the financial statements for a fiscal period ending not more than six months prior to an annual meeting of the shareholders. This report reviews the annual audited financial statements for the two years ended December 31, 2003.

A report from the City Solicitor concerning the annual general meeting of the Corporation is presented in a separate report before this Committee.

Business Environment

The electricity market in Ontario opened to competition on May 1, 2002, causing the commodity of electricity to become traded on a Provincial electricity market, with pricing to be determined by supply and demand. At that time, the Corporation and its subsidiaries became taxable entities, liable for the payments in lieu of income taxes (PILs) to the Province that are equivalent to corporate taxes normally levied on corporations by both Federal and Provincial levels of government.

On December 9, 2002, the Province enacted Bill 210: the *Electricity Pricing, Conservation and Supply Act, 2002*, thereby altering the landscape of the competitive electricity market in Ontario by capping the price of the electricity commodity at 4.3 cents/kwh for certain customers retroactively to market opening, and precluding any applications to the Ontario Energy Board (OEB) for distribution rate increases after November 11, 2002, except for under special circumstances.

At the time of market opening, the Corporation's retail subsidiary had been engaged in the retailing of natural gas and electricity purchased wholesale from suppliers. However, as a result of the implementation of Bill 210, the Corporation elected to curtail its energy retailing activities by:

(i) ceasing to enter into new electricity retail contracts as of November 2002;
(ii) electing to manage existing electricity retail contracts until their expiry (most expire April 30, 2005); and
(iii) selling off its natural gas contracts to a third party (completed in July 2003).

Subsequent Events:

On December 18, 2003, the Province enacted Bill 4: the *Ontario Energy Board Amendment Act*, increasing the price cap price to 4.7 cents/kWh for the first 750 kWh/month, and a 5.5 cents thereafter, effective April 1, 2004 - April 30, 2005 (at the latest), with the OEB to then assume responsibility for setting commodity pricing to replace the price cap.

Under Bill 4, electricity distribution rate increase applications to the OEB will be permitted in order to allow the Distribution Subsidiary:

(i) to achieve the third phase of a "market-based" rate of return, to a maximum of 9.88 percent return on equity, beginning March 1, 2005, although the proceeds of any rate increase will be required to be reinvested in demand side management initiatives for a period of one year; and
(ii) to recover "regulatory assets" relating to expenditures associated with market opening on May 1, 2002, with such recovery expected to be phased-in over a four-year period beginning March 1, 2004.

Capital Structure of the Corporation

At incorporation, the capital structure of Toronto Hydro Electric-System Limited (the "Distribution Subsidiary") comprised 35 percent equity and 65 percent debt, including a promissory note of $980 million held by the City, with an attached interest rate of 6.8 percent per annum, translating to a yearly interest payment of $67 million to the City.

On May 8, 2003, the Corporation completed its initial public commercial debt issuance of $225 million, with an attached interest rate of 6.11 percent. During this exercise, the promissory note of the Distribution Subsidiary obligation was assumed by the Corporation, and was revised to include commercial terms. The promissory note continues to have an attached interest rate of 6.8 percent, allowing the City to continue to receive a yearly interest payment of $67 million. The revised promissory note includes the following terms:

(i) a maximum term of ten years, ending in 2013, in accordance with Ontario Regulation 265/02, which amended O.Reg 438/97 (Eligible Investments) under the *Municipal Act*; and
(ii) a call feature restricting any repayment of principal to a maximum of $330 million in each 12 month period, subject to a 90 day notice period.

<u>Comments</u>:

City staff received the annual audited financial statements of the Corporation for the year ended December 31, 2002 (received March 2003), and for the year ended December 31, 2003 (received March 2004) in accordance with the Shareholder Direction. These documents are on file with the City Clerk's office. It should be noted that at the time of the last annual general meeting of the Corporation (February 4, 2003, Policy & Finance Report No 1, Clause 8) , although the 2002 annual audited financial statements were unavailable, the unaudited financial statements for the third Quarter ended September 30, 2002 were made available.

2002 Audited Annual Financial Statements:

For the fiscal year ended December 31, 2002, the Corporation generated earnings of $45.5 million, equivalent to a return on equity of approximately 6.9 percent, and demonstrating an improvement over the previous year's earnings of $11.4 million, due to:

(i) an OEB-approved distribution rate increase of 2 percent in March 2002, since Distribution Subsidiary operations represent the majority of the business of the Corporation; and
(ii) increased consumption of electricity during 2002 as a result of extreme weather conditions.

However, the increase in profitability was tempered by extraordinary expenses of $17.3 million relating primarily to business write-offs as a result of the cessation of energy retailing activities, including deferred business development and marketing costs, fixed assets, lease cancellation costs, and severance payments.

During fiscal 2002, the Shareholder received interest payments of $67 million, and no dividend payments.

2003 Audited Annual Financial Statements:

For the fiscal year ended December 31, 2003, the Corporation generated earnings of $95.6 million, equivalent to a return on equity of approximately 12.7 percent, and representing a 10.1 percent increase over the previous fiscal year's earnings, due to:

(i) the inclusion of the March 2002, OEB-approved 2 percent distribution rate increase for the full fiscal period;
(ii) the retention of a portion of Provincially mandated electricity commodity price rebates by the Retail subsidiary (as previously negotiated under existing contracts); and
(iii) reduced operating expenses.

During fiscal 2003, the Shareholder received interest payments of $67 million, and dividend payments of $5 million.

Subsequent Events:

Upon receipt of its annual audited financial statements, the Board of the Corporation declared additional dividends to the Shareholder of $24.2 million, relating to the 2003 fiscal year.

Conclusions:

As required by the Shareholder Direction relating to Toronto Hydro Corporation, the Corporation has provided the Shareholder with its audited annual consolidated financial statements for the 2002 and 2003 fiscal years. This report has highlighted key financial results of the Corporation for these fiscal periods.

Contact:

Len Brittain, Director, Corporate Finance Division, Finance Department
Tel: (416) 392-5380, Tax: (416) 397-4555
E-mail: lbrittai@toronto.ca

(A copy of the Annual Audited Financial Statements of Toronto Hydro Corporation referred to in the aforementioned report (April 26, 2004) from the Chief Financial Officer and Treasurer, is on file in the office of the City Clerk, City Hall.)