TORONTO CITY CLERK

Consolidated Clause in Policy and Finance Committee Report 7, which was considered by City Council on July 19, 20, 21 and 26, 2005.

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2004 Annual General Meeting - Toronto Hydro Corporation; and Annual Audited Financial Statements of Toronto Hydro

City Council on July 19, 20, 21 and 26, 2005, adopted this Clause without amendment.

The Policy and Finance Committee recommends that City Council:

(1) adopt the staff Recommendation contained in the Recommendation Section of the report (July 4, 2005) from the City Solicitor, entitled "2004 Annual General Meeting - Toronto Hydro Corporation"; and

(2) receive, for information, the report (June 29, 2005) from the Deputy City Manager and Chief Financial Officer, entitled "Annual Audited Financial Statements of Toronto Hydro".

The Policy and Finance Committee submits the report (July 4, 2005) from the City Solicitor, entitled "2004 Annual General Meeting - Toronto Hydro Corporation":

Purpose:

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

Financial Implications and Impact Statement:

There are no financial implications which would result from the adoption of this report.

Recommendation:

It is recommended that the recommendations embodied in the attached Toronto Hydro Corporation report (June 23, 2005) be adopted.

Background:

In order to comply with the requirements of the *Business Corporations Act* (Ontario) ("OBCA"), an annual meeting of the shareholders must be held. The last annual shareholder meeting for Toronto Hydro Corporation was held on May 18, 19 and 20, 2004.

Conclusion:

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

Contact:

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

Attachment: - Toronto Hydro Corporation Report (June 23, 2005)

Report dated June 23, 2005, addressed to the Policy and Finance Committee, from Mr. Lawrence D. Wilde, General Counsel and Corporate Secretary, Toronto Hydro Corporation

2004 Annual General Meeting – Toronto Hydro Corporation Report

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 May 18, 19 and 20, 2004.

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.

Recommendations:

It is recommended that:

(1) City Council, as the sole shareholder of THC, hold an annual shareholder meeting;

(2) approve and adopt the shareholder resolutions attached in Appendix A to this report;

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

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

Background:

City Council, by the amendment and adoption of Clause 1 of Report 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

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 was merged with Toronto Hydro Energy Services Inc. in April 2005.

2004 Annual General Meeting

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

(1) audited financial statements for the 2004 completed financial year and the auditor's report for that period, and the unaudited financial statements for the first quarter ended March 31, 2005;

(2) re-appointment of the incumbent auditors for the 2005 financial year and re-authorization of the THC board of directors to fix their remuneration for this period; and

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

Comments:

(1) Audited financial statements for 2004 completed financial years, and related auditor's reports, as well as the unaudited financial statements for the first quarter ended March 31, 2005 have been delivered by THC and reviewed by the Deputy City Manager and 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.

(2) 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 2005 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.

(3) 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.

Contact:

Lawrence D. Wilde, VP, General Counsel and Corporate Secretary,
Toronto Hydro Corporation, Tel: (416) 542-2896; Fax: (416) 542-2540;
e-mail: lwilde@torontohydro.com

List of Attachments:

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

Appendix A
Toronto Hydro Corporation
(the "Corporation")

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

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 ___________, 2005

City of Toronto

____
per: Joesph Pennachetti
Deputy City Manager and
Chief Financial Officer

____
per: Ulli Watkiss
City Clerk

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

Authorized by Clause ____ of Policy & Finance Committee Report No. ____ adopted by Council at its meeting of _____, 2005.

____
per: Ulli Watkiss
City Clerk

____

Appendix B

(Communication dated May 20, 2005 addressed to the
Policy and Finance Committee from Clare R. Copeland,
Chairman of the Board entitled "Toronto Hydro Corporation ("THC")
- 2004 Report to the Shareholder")

Recommendation:

It is recommended that this report be received for information.

Purpose:

This report highlights our key achievements for 2004. We take pride that our core business distributing electricity – is a necessity of life. The Board of Directors of Toronto Hydro Corporation reports that 2004 was a successful year of operation. Initiatives undertaken in 2004 have strengthened the operational, environmental, customer, employee and financial elements of the company leading to enhanced shareholder value. We remained focused on customer service, reliability, workplace safety, operational excellence, sound financial management and Conservation and Demand Management ("CDM") initiatives.

2004 was another year of legislative and regulatory changes in the energy industry that THC responded to and managed effectively. We met the Ontario Energy Board ("OEB") customer service standards for the year. We received approval from the OEB for rate increases for the recovery of Regulatory Assets (expenditures related to the opening of the electricity market) and to fund the CDM initiatives.

Properly investing in maintenance and capital work is a vital role that we play for our customers. The Board of THC continues to ensure that this important piece of infrastructure in the City is properly maintained with continuing investments to maintain the expected level of reliability and costs.

In 2004, THC contribution to the City budget through interest and dividends amounted to $115.9 million. The interest on the outstanding City note of $980.2 million amounted to $66.7 million. The payment of dividends relating to 2003 and 2004 results amounted to $49.2 million. Furthermore, in March 2005, the Board of Directors approved the payment of a dividend of $23.7 million in relation with the 2004 financial results (in excess of the $25 million dividend paid previously for 2004 results) and a one-time extraordinary dividend of $19.3 million. These payments were made on March 31, 2005 and were considered by the Board of Directors following exceptional results achieved by the corporation.

Background:

THC 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.

THC operates four major wholly owned affiliates in the electricity distribution, energy management services, telecommunications services and street lighting businesses. Toronto Hydro-Electric System Limited (THESL), our electricity distribution business, holds 98 percent of the fixed assets and accounts for 92 percent of the gross revenue of the company. We serve 594,976 residential customers and 78,244 commercial and industrial customers, for a total of 673,220 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 34 terminal stations located throughout the City. THC distributes the electricity through 16,564 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, as amended October 3, 2002. The Shareholder Direction sets out the City's objectives and principles for THC. The Board of Directors is responsible for determining and implementing the appropriate balance among the objectives and principles, and for causing the Corporation to conduct its affairs accordingly.

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 governs the operations of Toronto Hydro:

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

The Corporation recognizes that it is in the best interests of Toronto Hydro and the community of stakeholders whom the Business affects 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):

(a) THC will maintain a credit rating of A- or higher;
(b) THC will pay dividends based on 50 percent of the consolidated annual net income; and
(c) 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 and its annual audited consolidated financial statements. 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' vision of being one of the best Canadian utility. Our corporate strategy also embeds key elements of the Shareholder Direction in the following strategies:

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

(ii) 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.

(iii) For our customers, a Commitment to Customer Service, targeted community programs, strong shareholder and stakeholder relationships and environmental leadership.

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

(v) 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.

Post Amalgamation Successes

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 years post amalgamation, including the incorporation as an OBCA corporation, THC has successfully:

(i) Improved lost time injury frequency by 93 percent and improved lost time injury severity by 89 percent from1998 to 2004.

(ii) Reduced total costs by 27 percent in our distribution company from a peak of $545.00 per customer to $396.00 per customer through staffing reductions of 36 percent, reduced fleet levels of 50 percent, reduced cost of facilities of 20 percent, reduced external spending and consolidated call center and system operations to one location.

(iii) Responded successfully to a series of provincial and regulatory changes including electricity market opening on May 1, 2002, electricity market restructuring, recovery of regulatory assets and CDM program in 2004.

(iv) Created new subsidiaries focusing on energy management and conservation, electric water heaters, telecommunications services, and street lighting services.

(v) 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.

2004 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 OEB and the OSC. 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.

In December 2003 the government passed the Ontario Energy Board Amendment Act (Electricity Pricing) (tabled as Bill 4) which intended to remove subsidies in electricity commodity pricing and restored much of the OEB’s role in approving distribution rates.

In December 2004, the Province initiated a further restructuring of Ontario’s electricity industry with the passage of the *Electricity Restructuring Act, 2004* (tabled as Bill 100). The restructuring was intended, among other things, to ensure efficient and effective management of electricity, promote the expansion of new electricity supply and capacity, encourage electricity conservation and renewable energy and regulate prices in parts of the electricity sector. Major components of the Act are as follows:

(i) establishment of the Ontario Power Authority ("OPA"), an independent, non-profit, self-financed corporation, with a broad mandate to ensure adequate long-term electricity supply in the Province;

(ii) reorganization of the Independent Electricity Market Operator as the IESO, a non-share corporation, which will continue to administer the wholesale electricity market and be responsible for the operation and reliability of the integrated power system; and

(iii) establishment of a Conservation Bureau within the OPA responsible for assuming a leadership role in planning and coordinating electricity conservation measures and load management in the Province.

2004 Performance Highlights

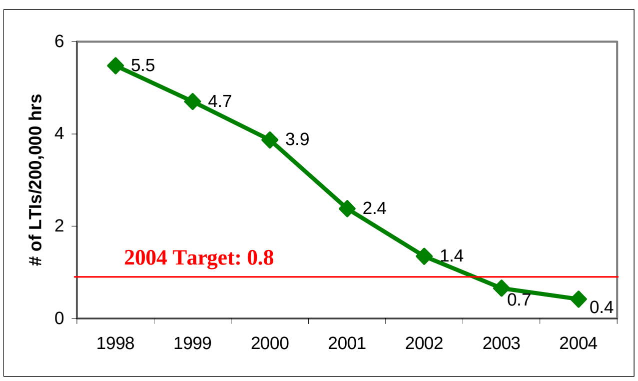
In accordance with the Shareholder Direction and through its corporate strategy, THC and its subsidiary companies performed well in 2004 in the key areas of operations, environment, customer service, employees and financial.

1. Operations:

   (i) Achieved the best performance in safety since amalgamation both in terms of frequency of injuries and severity of injuries. Actual severity of 7.3 days per 100 employees is a 47 percent decrease from 2003 and 27 percent better than the 10.0 target. Actual frequency of 0.40 is a 43 percent reduction from 2003 and a 50 percent improvement versus the goal of 0.8. In 2004, we experienced 7 lost time injuries compared to 11 in 2003.

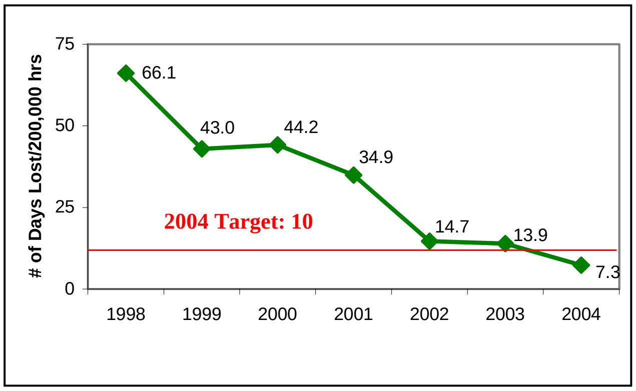
   (ii) Since amalgamation, we have achieved a 93 percent reduction in workplace accidents. The charts below demonstrate this significant achievement that was attained through our effectiveness in accident investigation, implementation of our Early and Safe Return to Work program and with collaboration with CUPE Local One.

Injury Frequency



Number of disabling injuries
Per 100 employees

Injury Severity



No. of days lost per
100 employees

(iii) Implemented key process improvements in the distribution system and most articularly in the material and work scheduling processes. Process improvements increased crew utilization to 66 percent; had materials required for work issued on time and in full 95 percent of the time; enabled full achievement of planned capital and maintenance work.

(iv) Completed $100 million in capital projects on our distribution system and operations. Our highly skilled staff completed this program on schedule and below 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.

(v) Surpassed our target for the distribution system reliability with 66 minutes of outage time per customer. This compares favourably to our 2004 target of 75 minutes and the regulated requirement of 82 minutes.

(vi) Maintained the size of the fleet at 2003 levels while providing an increase vehicle availability rate of 94 percent.

(vii) Improved operations at THESI, our energy management subsidiary, to achieve timely billing and collection results.

(viii) In THESI, continued to grow the energy management value added services to business customers and to manage the portfolio of electricity contracts including signature of a $4.2 million energy efficiency contract with the City.

(ix) Exercised a favorable purchase power option in THESI with a wholesale counterparty and concurrently signed an extension to the City purchase power agreement to December 31, 2006. These transactions along with other related hedging activities provided a contribution of $17.0 million to net income for 2004.

(x) Enhanced the operation and cost structure of the network operations center of THTI, our telecom company by providing extended services through the U-Telco group.

(xi) THSLI, our street lighting company, completed and implemented a Service Level Agreement with the City's Street and Expressway Lighting Department and installed Toronto Maintenance Management System (TMMS) for effective communication with City on street lighting issues.

2. Environment:

(i) THC was in compliance with environmental, health and safety regulations in 2004.

(ii) Launched a Conservation and Demand Management (CDM) program that targets a 5 percent reduction of 250 megawatts in Toronto Hydro's 2007 peak demand. The CDM program, approved by the OEB, will entail spending $39.8 million in the areas of customer energy conservation, power distribution system loss reduction, load displacement and stand-by generators.

(iii) A key component of our CDM strategy is the coordination we have established with Hamilton Utilities Inc; Hydro Ottawa; PowerStream Utilities; Enersource Hydro Mississauga; and Veridian. Together, we will deliver conservation programs to 1.4 million customers in key urban markets, representing an investment of more than $70 million over three years in electricity saving programs, new energy efficiency technologies and distribution system upgrades to decrease line losses. Included in the cooperative strategy are plans to install smart meters in a coordinated way, and to ensure that the process is as seamless as possible to customers.

(iv) A Green THC team maximized the environmental efforts of the Corporation in areas such as energy efficiency, use of alternate energy and recycling. Total waste diversion at THC reached an all-time high at 83 percent. A 36 kilowatt solar panel system was installed at 500 Commissioners Street in order to supplement building lighting. The photovoltaic system produces enough electricity to power four to five homes or to illuminate 2,796 compact fluorescent lights. The solar panels will prevent an estimated 37.8 tones of carbon dioxide from being released into the atmosphere. The solar panels have generated over 10,000 kilowatt-hours of energy in 2004, after going on-line in August. This initiative won the 'Solar Photovoltaic Project of the Year Award' from the Canadian Solar Industries Association and the Electricity Distributors Association's Environmental Award of Excellence'.

(v) 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;

(vi) Progress was made in reducing vehicle emissions from our fleet. Most of our vehicles are now operating on an alternative fuel such as biodiesel, ethanol blended gasoline, compressed natural gas or hybrid technology (gas/electric). Taking the lead in biodiesel application, Toronto Hydro participated in many communication opportunities with the City and through media (CBC, City TV, CFMT, Town and Country Ontario and Global TV), and is recognized as the industry leader in this field.

(vii) 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 $250,000.00 to this program.

(viii) The urban forest in proximity to our distribution lines is managed by an internal team of certified arborists who work closely with the City of Toronto to develop sustainable urban forestry practices.

(ix) 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 $150,000.00 to LEAF since 1998;

3. Customer:

(i) To help our customers manage their electricity bills more effectively, we introduced a simplified invoice in 2004, and customer response has been very favourable. The old bill required two pages, but now 95 percent of the bills rendered are only one page in length and much easier to read. The two-tiered rates that were introduced in April are clearly illustrated in a bar chart on the bill to provide a strong visual conservation aid to consumers.

(ii) Communications to customers centered on the introduction of the federal government's new *Protection of Personal Privacy Act*, and changes to our advance deposit policy.

(iii) Significant attention was paid to revenue protection and recovery. As a result, more than $700,000.00 was recovered in 2004. This is more than double our forecast and reflects funds recovered from intentional theft of power as well as unintentional energy diversions.

(iv) Our Customer Care group is the most active customer touch point for Toronto Hydro-Electric System Limited and we meet or exceed OEB service levels consistently. While speed in answering customer calls is very important, our focus in 2004 was to enhance the quality of the customer service transaction. Call volumes can be high, and customers often look to Toronto Hydro's service representatives for information about changes in the electricity industry or in their billing information. Improving call quality while meeting high service level standards is a challenging, but important piece of our customer service commitment.

(v) Managed 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.

(vi) Responded to 85 percent of all customer telephone calls within 30 seconds (OEB target: 65 percent).

(vii) Provided written responses to customer letters 97 percent of the time within 5 days (OEB target: 80 percent).

(viii) Provided emergency response 89 percent of the time within 99 minutes (OEB target: 80 percent).

(ix) Kept 94 percent of customer appointments on time (OEB target: 90 percent).

(x) Provided cable locate services 94 percent of the time within 5 days (OEB target: 90 percent).

(xi) Provided 4,303 customer connections for low voltage services within 5 days 98 percent of the time (OEB target: 90 percent).

(xii) Provided 213 customer connections for high voltage services within 10 days 100 percent of the time (OEB target: 90 percent).

4. Employees:

(i) completed leadership training for managers, 94 days for Crew Leaders, 158 days for Supervisors, 34 days for Managers and 139 days for Professionals. Financial management training was also completed for all Managers.

(ii) Communicated the new Code of Conduct to all employees.

(iii) Ensured that all employees were in compliance with the OEB Affiliate Relationships Code.

(iv) In response to an aging workforce, continued the Trades Training School with 16 students, 8 to become Certified Power Linepersons, and 8 to become Underground Cable Splicers.

(v) Completed an average of 5.4 days training per employee meeting exceeding our target of 5 days.

(vi) Conducted Employee Satisfaction Survey where significant improvements were noticed in clarity of corporate goals and objectives despite transition in several key executive positions.

Financial:

(i) Met financial targets on the corporate scorecard with operating expenses at $185.1 million; capital expenditures at $109.6 million and exceeded financial target for net income at $97.3 million.

(ii) Maintained strong credit ratings throughout 2004 at an A(low) from Dominion Bond Rating Service and A- from Standard & Poors.

(iii) Increased cash flow to the City by paying dividends to the City of $49.2 million with respect to 2003 and 2004 consolidated results.

(iv) Restated 2002 and 2003 financial statements to reflect the error in the wholesale metering and revenue cost of power model, providing incremental net income of $10.5 million and $1.5 million respectively.

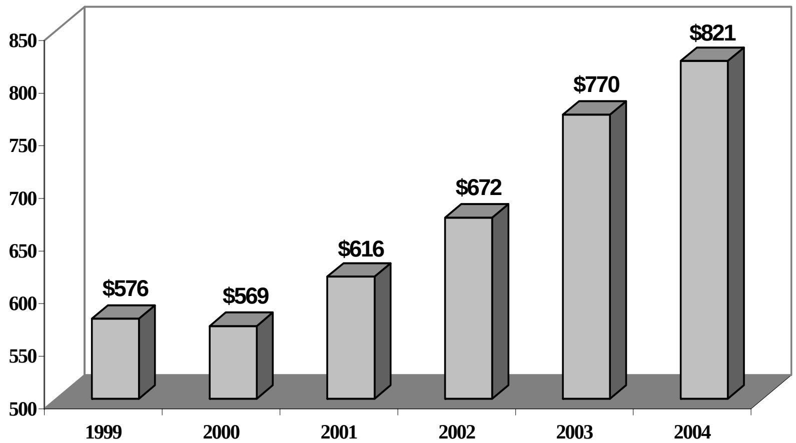
(v) Increased consolidated cash balance to $386.6 million from $287.7 million in 2003. The excess operating cash will be used to fund future investments in electricity distribution system over the next few years. According to the current long-term asset plan, capital spending will increase significantly in the future to maintain the current level of reliability as a result of an aging asset base.

(vi) Adopted new accounting policy regarding hedging of financial derivatives and asset retirement obligations.

(vii) Maintained disclosure and compliance requirements that provided for public filings of THC financial results as required by the OSC.

(viii) Increased shareholder equity by $51 million or 6.6 percent from 2003 and by $245 million or 42.5 percent since incorporation in 1999.

$ millions



Conclusions:

The Board of Directors of THC is pleased to report that, in 2004, THC has operated within the Shareholder Direction in a balanced manner by making financial contributions to the City of $115.9 million, continuing to improve on safety, operational processes, costs containment, services to customers and environmental issues.

Our employees are an integral part of THC's success and management has continued to spearhead the continuing necessary changes and improvements in the operation of the company's regulated and unregulated lines of business.

The recent financial success was due to strong stable results from the regulated business sector and to one-time gains from the electricity retailing business. As THESI is exiting the electricity retail business due to market constraints, this exceptional contribution to the City will not likely prevail after 2006. Accordingly, the level of assistance provided to the City through dividends will decrease after 2007.

2005 is a year of transition for the Toronto Hydro Board of Directors and continuing efforts will be made to ensure the achievement of all business goals and objectives. The main focus of the Board of Directors for 2005 will be to provide ratepayers of the City of Toronto with a necessity of life, safely and reliably, while meeting the expectations of the City as Shareholder.

The Policy and Finance Committee also submits the report (June 29, 2005) from the Deputy City Manager and Chief Financial Officer entitled "Annual Audited Financial Statements of Toronto Hydro Corporation":

Purpose:

To provide the Shareholder with the annual audited financial statements of Toronto Hydro Corporation to the Shareholder for the year ended December 31, 2004, and the unaudited financial statements for the first quarter ended March 31, 2005.

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.

(a) 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.
(b) 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 *Business Corporations Act*, Ontario ("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. The last annual general meeting of the Corporation was held at the Council meeting of May 18, 2004, (Policy and Finance Committee Report 4, Clause 14).

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 therefore reviews the annual audited financial statements for the year ended December 31, 2004, along with the unaudited financial statements for the first quarter ended March 31, 2005.

A report from the City Solicitor concerning the annual general meeting of the Corporation, as well as reports from the City Manager concerning nominations for the Toronto Hydro Board of Directors, and Board compensation, are presented concurrently to this Committee.

Business Environment:

The electricity market in Ontario opened to competition on May 1, 2002, causing the electricity commodity to become traded on a Provincial electricity market, with pricing to be determined by supply and demand. Subsequently, on December 9, 2002, the Province enacted the *Electricity Pricing, Conservation and Supply Act, 2002*, thereby re-regulating the sale of the electricity commodity for certain customers retroactively to market opening.

The Corporation's retail subsidiary had been engaged in the retailing of electricity, however, as a result of the second legislation, the corporation elected to curtail its energy retailing activities by ceasing to enter into new electricity retail contracts, and electing to manage existing electricity retail contracts until their expiry (most expired on April 30, 2005).

Finally, on December 18, 2003, the Province enacted the *Ontario Energy Board Amendment Act*, with the Ontario Energy Board (OEB) to assume responsibility for setting commodity pricing after April 30, 2005. Furthermore, electricity distribution rate increase applications to the OEB were 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 phased-in over a four-year period that began March 1, 2004.

Subsequent Events:

The OEB published its updated Distribution Rate Handbook on May 11, 2005. As of May 1, 2006, new parameters will be in place for electricity distribution companies, including reducing the maximum allowable return on equity to 9.0 percent.

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 held by the City 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:

(a) 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 Ac*t; and
(b) 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.

Comments:

City staff received the annual audited consolidated financial statements of the Corporation for the year ended December 31, 2004, and the unaudited consolidated financial statements of the Corporation for the first quarter ended March 31, 2005, in accordance with the Shareholder Direction. These documents are on file with the City Clerk's office.

2004 Audited Annual Consolidated Financial Statements:

For the fiscal year ended December 31, 2004, the Corporation generated a consolidated net income of $97.3 million, declining only slightly over fiscal 2003 ($98.4 million). This decline was due primarily to a decline in consolidated revenues of $2.2 billion in comparison to the fiscal 2003 ($2.4 billion), as a result of:

(i) a milder winter and cooler summer, resulting in a reduced demand for electricity;
(ii) restructured operations to phase-out the retailing of electricity; and
(iii) the implementation of hedge accounting practices in accordance with CICA (Canadian Institute of Chartered Accountants) guidelines, affecting the method of revenue recognition. However, the hedge accounting practices also had the effect of improving the gross margin for the retail subsidiary.

During fiscal 2004, the Shareholder received interest payments of $67 million, and dividend payments of $49.2 million.

Unaudited Consolidated Financial Statements for the first quarter ended March 31, 2005:

For the first three months ended March 31, 2005, the Corporation generated a net income of $20.8 million, a slight decrease over the previous comparable fiscal period ($24.3 million), primarily as a result of a flat gross profit combined with increased operating expenses, increased depreciation and amortization expenses, and an increase in the provision for payments in lieu of income taxes (a proxy tax) to the Province.

During the first fiscal quarter of 2005, the Shareholder received interest payments of $16.7 million, and a dividend payment of $49 million, consisting of:

(i) a $6 million first quarterly dividend instalment as required under the Shareholder Direction;
(ii) a $23.7 million adjustment to dividends relating to fiscal 2004, paid after having received the annual audited financial results; and
(iii) a $19.3 million "one time" additional dividend, paid in response to a Shareholder request.

Subject to the approval of the Board of Toronto Hydro Corporation, the City anticipates receipt of another $19 million in dividends during the 2005 year.

Conclusion:

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 2004 fiscal year, and its unaudited financial statements for the first fiscal quarter ended March 31, 2005. The financial statements are on file with the City Clerk's office. This report reviews and highlights key results.

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(A copy of the Consolidated Financial Statements – Toronto Hydro Corporation, March 31, 2005, referred to in the aforementioned report is on file in the Office of the City Clerk, City Hall.)