



## STAFF REPORT ACTION REQUIRED

### Legislative Changes Required to allow Auditor General Review of Toronto Hydro Corporation

<b>Date:</b>	May 9, 2011
<b>To:</b>	Executive Committee
<b>From:</b>	City Solicitor
<b>Wards:</b>	All
<b>Reference Number:</b>	

#### SUMMARY

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City Council has previously resolved to allow the City's Auditor General access to the books and records of Toronto Hydro Corporation in cases where City Council has first issued a separate direction to the Auditor General in relation to a perceived breach by Hydro of the provisions of the Shareholder Direction, with such access limited to those books and records relating to the perceived violation.

Subject to any cautions set out in this report, should Council wish to allow the Auditor General access to the books and records of Toronto Hydro under different terms, an amendment to the Shareholder Direction would be required, and possibly an amendment to the Municipal Code.

#### RECOMMENDATIONS

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**The City Solicitor recommends that:**

1. City Council receive this report for information.

#### FINANCIAL IMPACT

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There is no financial impact.

## **DECISION HISTORY**

This matter arose during City Council's consideration of the Auditor General's 2011 Audit Work Plan at its meeting held on March 8 and 9, 2011 as Item AU1.9 when Council requested the City Manager to report to the May 24, 2011 meeting of the Executive Committee on any legislative changes required to allow the Auditor General to conduct any review with respect to Toronto Hydro he may deem appropriate. The City Manager referred this matter to the City Solicitor for report given the nature of Council's request.

## **ISSUE BACKGROUND**

The Auditor General's access to the books and records of Toronto Hydro Corporation was previously considered by City Council at its meeting held on February 5, 6, 7 and 8, 2007 as Item EX2.3 as part of implementation of the new *City of Toronto Act, 2006*.

Previously, City Council adopted Clause 6, Report 4 of the Audit Committee at its meeting held on December 5, 6 and 7, 2005 which recommended that the City Solicitor review the existing shareholders' agreements with Toronto Hydro, TEDCO and TCHC with a view to amending the agreements to provide the Auditor General the same level of access to records as is provided to the Deputy City Manager and Chief Financial Officer, and that consideration be given to further amending the agreement to include a provision enabling the Auditor General to conduct specific audit work only in circumstances, where in Council's opinion, the interests of the City are being compromised.

## **COMMENTS**

### **Shareholder Direction**

Article 6.3 of the City's Shareholder Direction to Toronto Hydro Corporation states that:

"The duly appointed representatives of the Shareholder (as approved by report to the Council of the City of Toronto from time to time) shall have unrestricted access to the books and records of the Corporation and the Subsidiaries during normal business hours. Such representatives shall treat all information of Toronto Hydro with the same level of care and confidentiality as any confidential information of the Shareholder."

The Shareholder Direction also provides that THC provide an annual report addressing certain matters (s.6.7), its audited annual financial statements (s.6.6) and quarterly reports (s.6.2) to the City's Finance Department reporting on:

- (a) quarterly unaudited consolidated and unconsolidated financial statements,
- (b) such explanations, notes and information as is required to explain and account for any variances between the actual results from operations and the budgeted amounts set forth in the current Business Plan, including any material variances in

- the projected ability of any business activity to meet or continue to meet the financial objectives of the City;
- (c) information that is likely to materially affect the City's financial objectives or energy policies;
  - (d) information that is likely to materially affect customers' perceptions or opinions regarding Toronto Hydro;
  - (e) information regarding any matter, occurrence or other event which is a material breach or violation of any law; and
  - (f) any such additional information as the City may specify from time to time.

### **Securities Legislation**

THC is a reporting issuer under applicable securities legislation because it has sold over \$1.4 billion in bonds to the public. THC, as a reporting issuer, is under the jurisdiction of the Ontario Securities Commission (OSC) with respect to how certain aspects of its business and financial reporting are conducted. Securities legislation prohibits a reporting issuer and any person or company in a special relationship with a reporting issuer, from informing any person of a material fact before that material fact has been broadly disclosed to the investing public (tipping provision). Disclosure is generally accomplished through the issuance of a press release or by filing documents on SEDAR, the public securities registry. Tipping is an issue because it creates opportunities for insider trading and damages investor confidence in the fairness and integrity of capital markets. However, the tipping provision is usually not engaged in circumstances such as the THC providing information to the Auditor General "in the necessary course of business".

In situations where THC may be directed by the City to provide the City's Auditor General with access to its books and records which contain non-public material information relating to THC, care must be taken by the Auditor General and his staff not to disclose such information in order to comply with securities legislation.

Any review of THC by the Auditor General should be mindful of the authority of the OSC to regulate certain business, financial, operational and other aspects of THC and the Auditor General, if authorized to conduct his own reviews of THC, should not recommend changes which could conflict with the OSC oversight and regulation.

### **Business Corporations Act (Ontario)**

THC is incorporated under the *Business Corporations Act (Ontario)* ("OBCA"). The OBCA sets out the rights, and restrictions on rights, of a shareholder in a corporation incorporated under the OBCA. The City, as a shareholder, must comply with the provisions of the OBCA, and should not take on the management or operation of THC in

order to avoid taking on the obligations and liabilities of the Board of Directors. However, under the OBCA, the City can exercise control over THC by amending the Shareholder Direction to allow the Auditor General to conduct any review of THC as he deems appropriate.

It should also be noted that Hydro's financial affairs are already audited by:

- (a) THC's independent external auditor, KPMG, LLP, Chartered Accountants who are appointed by City Council as THC's sole shareholder;
- (b) the Ontario Energy Board's periodic audits of THC's primary subsidiary, Toronto Hydro Electric System Limited ("THESL"), as part of its recurring rate applications as well as other periodic audits of THESL that it considers appropriate;
- (c) THC's legislatively mandated Audit Committee which operates under strict regulations (with the potential of sanctions for wrongdoing) imposed by the OSC and other securities regulators, and
- (d) THC's own internal auditor.

### **Rate Setting Regulation**

Under the provisions of the *Ontario Energy Board Act, 1998*, as part of the Ontario Energy Board's (OEB) supervisory oversight of electricity distribution companies, the OEB is charged with approving the distribution rates for electricity. In order to satisfy the application requirements for the establishment of new or different rates, electricity distribution companies, such as THESL, have to adhere to the requirements of the Electricity Distribution Rate Handbook (amongst other things) approved for use by the OEB. That Handbook details the components of the application and schedules, establishes the test year and adjustments, the rate base, the cost of capital, distribution expenses, taxes/PILS, revenue requirement, cost allocation, rates and charges, specific service charges, other regulated charges, mitigation, comparators and cohorts and service quality regulation.

Any review of THC by the Auditor General should be mindful of the authority of the OEB to regulate certain business, financial, operational and other aspects of THESL, and the Auditor General, if authorized to conduct his own reviews of THC, should not recommend changes which could conflict with the OEB oversight and regulation.

### **Council's Previous Action and Conclusion**

City Council at its meeting held on February 5, 6, 7 and 8, 2007, when considering how to allow the Auditor General access to THC's books and records for audit purposes while also addressing the risk and the cost of an unlawful disclosure of material information or

potentially taking upon itself the obligations and liabilities of a director under the OBCA (Item EX2.3) decided to:

"... designate the Auditor General to be the City's representative under the shareholder direction for Toronto Hydro Corporation (THC) with the representative's role being limited to where staff has not been able to obtain the necessary information to evaluate its concern through the Shareholder Direction reporting mechanisms or through inquiries to officers or staff or through a request from City Council to the directors of THC and further, that the access right not be exercised until City Council has first issued a separate direction to the Auditor General in relation to a perceived breach by THC of the provisions of the Shareholder Direction and with such access right being limited to those books and records relating to the perceived violation." Municipal Code, Chapter 3, Accountability Officers, Article II, Auditor General was amended to reflect this Council resolution.

Accordingly, no legislative changes are required to allow the Auditor General access to the books and records of Toronto Hydro. Should Council wish to allow the Auditor General access to the books and records of Toronto Hydro under different terms and conditions, such access should be directed by City Council by means of an amendment to the Shareholder Direction, and if necessary, an amendment to the Municipal Code, subject to the cautions set out in this report.

The City Manager's Office and Toronto Hydro were consulted in the preparation of this report.

## **CONTACT**

Lorraine Searles-Kelly  
Solicitor  
Legal Services Division  
Tel: 416-392-7240, Fax: 416-397-5624  
Email: [lsearles@toronto.ca](mailto:lsearles@toronto.ca)

Joe Borowiec  
Corporate Management & Policy Consultant  
Strategic and Corporate Policy Division, City Manager's Office  
Tel: 416-397-9110, Fax: 416-696-3645  
E-mail: [jborowie@toronto.ca](mailto:jborowie@toronto.ca)

## **SIGNATURE**

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Anna Kinastowski  
City Solicitor