Toronto Hydro Corporation – Annual General Meeting and 2013 Audited Financial Statements

Date:       June 17, 2014
To:         Executive Committee
From:       City Manager
Wards:      City-wide
Reason for Confidential Information: This report relates to the security of property of the municipality or one of its agencies, boards and commissions and includes personal information about identifiable individuals
Reference Number: 

SUMMARY

This report contains recommendations pertaining to the actions necessary to comply with the requirements of the Business Corporations Act (Ontario), R.S.O. 1990, c.B.16 ("OBCA") for holding the Annual General Meeting of the Shareholder of Toronto Hydro Corporation ("THC") including receipt of THC's audited annual consolidated financial statements for 2013 and appointment of the auditor for THC for 2014.

This report also recommends for receipt at the Annual General Meeting of the Shareholder of THC, other reports provided by THC as required by the Amended and Restated Shareholder Direction Relating to THC ("Shareholder Direction") which, in addition to the OBCA requirements, include:

- THC's annual report;
- THC's fourth quarter report to the Shareholder, internal financial statements and financial statements for its subsidiaries; THC has advised the City that Attachments 3, 7, 8 and 9 are confidential due to (a) the security of the property of the City, and (b) securities requirements arising from THC's status as an offering corporation under the OBCA, THC's status as a reporting issuer under the Securities Act (Ontario), R.S.O. 1990, c.S.5, and the application by the Ontario Securities Commission of National Instrument 51-102;
- THC's Annual Information Form which is a public document published annually as required by the Ontario Securities Commission from THC as a public debt issuer;
- THC's disclosure of executive compensation in two parts, with the part in Attachment 11(b) being confidential as it includes personal information about identifiable individuals; and
- THC's report on environmental performance in relation to City objectives.

**RECOMMENDATIONS**

**The City Manager recommends that:**

1. City Council consider that portion of the Council meeting at which this Report is being considered as the Annual General Meeting of the Shareholder for Toronto Hydro Corporation by:

   a. Approving the "Toronto Hydro Corporation 2013 Annual Shareholder Meeting, Resolution of the Sole Shareholder – City of Toronto, Re-appointing Auditor" forming Attachment 1 to this Report in order to re-appoint KPMG LLP, Chartered Accountants as the auditor for Toronto Hydro Corporation for 2014, and to authorize the Board of Directors of Toronto Hydro Corporation to fix the auditor's remuneration;

   b. Receiving the "Toronto Hydro Corporation 2013 Annual Report, The Measure of Our Commitment", forming Attachment 2 to this Report;

   c. Receiving the "Toronto Hydro Corporation Fourth Quarter 2013 Report to the Shareholder December 31, 2013", forming Confidential Attachment 3 to this Report;

   d. Receiving the "Toronto Hydro Corporation 2013 Annual Financial Report December 31, 2013", including the "Toronto Hydro Corporation Consolidated Financial Statements December 31, 2013 and 2012", the "Toronto Hydro Corporation Ontario Securities Commission Form, Certification of Filings – CFO and CEO", and the "Toronto Hydro Corporation First Quarter Report March 31, 2014", forming Attachments 4, 5 and 6 respectively to this Report; and

   e. Receiving the "Toronto Hydro Corporation December 31, 2013 Internal Financial Statements", the "Financial Statements Toronto Hydro-Electric System Limited December 31, 2013", and the "Financial Statements Toronto Hydro Energy Services Inc. December 31, 2013", forming Confidential Attachments 7, 8 and 9 respectively to this Report; and

2. City Council direct that Confidential Attachments 3, 7, 8 and 9 remain confidential in their entirety due to the security of the property of the City and securities requirements arising from Toronto Hydro Corporation's status as an offering corporation under the Business Corporations Act (Ontario), R.S.O. 1990, c.B.16,

3. City Council receive the "Toronto Hydro Corporation Annual Information Form for the Year Ended December 31, 2013" forming Attachment 10 to this Report.

4. City Council receive the report "Executive Compensation Disclosure Toronto Hydro Corporation 2013", forming Attachment 11(a) and Confidential Attachment 11(b) to this Report, and direct that Confidential Attachment 11(b) remain confidential in its entirety as it deals with personal information about identifiable individuals.

5. City Council receive the "Toronto Hydro Annual Report 2013 Environmental Performance", forming Attachment 12 to this Report.

6. City Council refer the "Toronto Hydro Corporation Consolidated Financial Statements December 31, 2013 and 2012", included as part of Attachment 4 to this report, to the Audit Committee for information.

7. City Council authorize and direct the appropriate City Officials to take the necessary actions to give effect thereto.

Financial Impact

THC paid the City $43 million in dividends in 2013 and, in accordance with the City’s Shareholder Direction to THC, is expected to pay the City dividends of $60.6 million in 2014 based on 50% of 2013 net income of $121.2 million. The City budgeted $55.0 million for THC dividends in 2014.

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact information.

DECISION HISTORY

City Council authorized the incorporation of THC by adoption of Strategic Policies and Priorities Committee Report No. 10, Clause 1, as amended, at its meeting held on June 9-11, 1999.

At the Annual General Meeting of the Shareholder of THC on April 12-13, 2011, City Council in EX4.8 requested the Corporation to circulate its Annual Information Form, detailing senior executive compensation, to Council each year with its annual financial statements.

Toronto Hydro AGM and 2010 Audited Financial Statements

At the Annual General Meeting of the Shareholder of THC on July 11-13, 2012, City Council in EX21.2 requested the THC Board of Directors to report on options for
capping executive salaries, bonuses, retirement allowances and other perquisites of office and request the Chair of the THC Board of Directors to present the current policy for executive compensation.

**Toronto Hydro AGM and 2011 Audited Financial Statements**

Also at its meeting of July 11-13, 2012, City Council in EX21.19 adopted recommendations that among other things requested that individual variable pay remuneration (one-time lump sums) not exceed 25% of an executive employee's base salary.

**Executive Compensation for City Agencies and Corporations**

At its meeting of November 27-29, 2012, City Council in EX25.4 received for information the report from THC regarding executive compensation policies and practices.

**Toronto Hydro Executive Compensation**

At its meeting of May 7-10, 2013, City Council in EX31.7 approved the Amended and Restated Shareholder Direction Relating To THC.

**THC Shareholder Direction**

**ISSUE BACKGROUND**

Subsection 154 (1) of the OBCA requires that the Shareholder receive THC's audited annual financial statements and the report of the auditor thereon at the annual meeting of the Shareholder, and Subsection 94 (1) requires that the directors of THC call an annual meeting of its Shareholder by no later than fifteen months after holding the last preceding annual meeting, which was held by City Council at its meeting of July 16-19, 2013.

Section 149 (2) of the OBCA requires that the THC's Shareholder at each annual meeting appoint one or more auditors to hold office until the close of the next annual meeting, and allows the Shareholder to authorize the directors to fix the auditor remuneration.

Section 9.7 of the THC Shareholder Direction requires THC to deliver its audited consolidated annual financial statements for THC and its active Subsidiaries to the Shareholder within three months after the end of each fiscal year.

Section 9.8 of the THC Shareholder Direction requires THC to deliver an annual report detailing THC’s accomplishments, Business Plan status, performance data, executive compensation information, and the financial statements noted above.

THC's audited consolidated annual financial statements for 2013 are included as part of Attachment 4 to this report and are filed with the City Clerk’s office, posted on THC’s website and posted on the SEDAR website for Canadian public securities documents. The consolidated statements are public documents upon their release.

[www.torontohydro.com](http://www.torontohydro.com)
[www.sedar.com](http://www.sedar.com)
The Annual Information Form ("AIF") is a public document published annually by THC as a public debt issuer in accordance with Ontario Securities Commission requirements. The 2013 AIF is filed with the City Clerk’s office, posted on THC's website and posted on the SEDAR website for Canadian public securities documents.

COMMENTS

1. APPOINTMENT OF AUDITOR

The auditor is selected by THC based on a competitive process, subject to Shareholder approval. Under the OBCA the auditor must be appointed annually by the Shareholder at the annual general meeting of the corporation. The auditor so appointed holds office until the close of the next annual general meeting of the Shareholder, or until a successor is appointed.

Based on a formal RFP process conducted for fiscal year 2011, THC selected KPMG, Chartered Accountants, for an initial period of 5 years. The initial appointment of KPMG as the auditor for THC was approved by City Council in early 2011.

It is recommended that City Council, acting as Shareholder, approve the Shareholder Resolution forming Attachment 1 to this Report to re-appoint KPMG, Chartered Accountants, as the auditor for THC for 2014 and to authorize the Board of Directors of THC to fix the auditor's remuneration.

2. KEY THC ACHIEVEMENTS IN 2013


Key achievements by THC in 2013 include the following:

- Delivered net income of $121 million compared to $86 million in 2012.
- Paid $43 million in dividends to the City of Toronto in 2013.
- Maintained strong credit rating with ratings of "A (high)" by DBRS Limited and "A" by Standard & Poor's.
- Among the leading local distribution companies in the delivery of conservation and demand management (CDM) programs to help customers conserve energy, save money and help the environment.
- Recognized by Infrastructure Health & Safety Association for achieving 3.5 million hours without a lost time injury.
- Started construction on the new Clare R. Copeland Transformer Station, the first underground station in downtown Toronto, which will help increase electricity capacity.
- Participated in the Centre for Urban Energy at Ryerson University, a research and technology demonstration centre devoted to the discovery and commercialization of innovative solutions to urban energy issues.
- Continued to work with Hydro One Inc. to refurbish the existing 115 kilovolt transmission infrastructure serving midtown to help improve service and reliability.
- Facilitating a number of expansion and streetscape improvements including construction of the air rail link to help prepare for the Pan Am Games.
- Relocated and upgraded aging infrastructure as part of Waterfront Toronto's initiative to revitalize the waterfront.
- Named one of Canada's Top 100 Employers as selected by editors of the Canada's Top 100 Employers project, organized by Mediacorp Canada Inc.
- Recognized for Corporate Social Responsibility efforts by the Electricity Distributors Association.
- Supported Trees Across Toronto, Leslieville Tree Festival and Local Enhancement and Appreciation of Forests through tree planting initiatives and education programs.

3. SUMMARY – TORONTO HYDRO CORPORATION 2013 AUDITED CONSOLIDATED FINANCIAL STATEMENTS

2013 Audited Consolidated Financial Results

The City's Finance staff have reviewed THC's 2013 audited consolidated financial statements. THC's financial statements have been prepared to consolidate the operations of the following two wholly-owned subsidiaries: Toronto Hydro-Electric System Limited ("THESL"), and Toronto Hydro Energy Services Inc. ("THESI"). The principal business of THC is the distribution of electricity by THESL. THESI provides street lighting services to the City of Toronto and has only a minor impact on the consolidated figures.

The "Toronto Hydro Corporation Consolidated Financial Statements December 31, 2013 and 2012" are included as part of the "Toronto Hydro Corporation 2013 Annual Financial Report December 31, 2013" forming Attachment 4 to this Report. Attachment 5 to this Report contains Ontario Security Commission forms certifying THC filings. THC's internal financial statements, including unconsolidated statements relating to its subsidiary companies and the holding company, and THC's 2013 Report to the Shareholder are included in Confidential Attachments 3, 7, 8 and 9 to this Report.

Below is a summary of comparable financial data for 2013 and 2012.
Gross revenues reflect all billed electricity charges, including those collected for the electricity commodity, transmission debt reduction and street lighting. Gross margin is THC revenue collected for its own activities, almost entirely electricity distribution. The increase in gross margin is primarily a result of revenue recognition related to the disposition of the 2008-2010 smart meter deferral account balances.

For the fiscal year ended December 31, 2013, THC generated a consolidated net income of $121.2 million as compared with $86.0 million in 2012, an increase of $35.2 million (or 40.9%). Higher gross margins in 2013 were offset by higher operating expenses and depreciation so that the increase in net income was primarily due to one-time restructuring costs in 2012 and lower financing charges in 2013.

Capital expenditures increased substantially in 2013 due to planned spending on overhead infrastructure ($52.2 million), Copeland Station ($41.3 million), underground infrastructure ($24.4 million), customer connections ($22.4 million), and network infrastructure and equipment ($13.5 million).
Significant Events

Smart Meters

The smart and stranded meters regulatory asset accounts relate to the Province's decision to install smart meters throughout Ontario. In connection with this initiative, the Ontario Energy Board ("OEB") ordered that all expenditures and revenues related to this initiative be recorded. In late 2013, the OEB approved the recognition of costs and recoveries for smart meters since 2008 resulting in net revenue of $25.2 million in 2013. The net recovery is comprised of increases in smart meter revenues of $57.5 million, partially offset by increased operating expenses related to smart meters of $7.1 million and increased depreciation costs for smart meters of $25.7 million in 2013.

Ice Storm

In December 2013, an ice storm caused damage to the above-ground infrastructure of THC's electricity distribution system. Approximately 300,000 customers lost power for periods of up to eight days.

THC, in consultation with City officials, implemented a large scale outreach and recovery effort. As a result, THC incurred incremental costs consisting of overtime of its own employees, time and equipment costs of other utilities that provided mutual aid, tree clearing services and the replacement of damaged assets. The total costs incurred amounted to $13.8 million in 2013. In addition, potential distribution revenue of approximately $0.9 million was lost due to the power outage. THC was able to absorb these impacts from the other favourable variances described above.

Subsequent Events

In accordance with Section 10.4 of the Shareholder Direction for THC, the City expects to receive dividends of $60.6 million in 2014 based on 50% of 2013 net income of $121.2 million. The City budgeted $55.0 million for THC dividends in 2014.

On May 15, 2014, Toronto Hydro released its unaudited financial results for the first quarter of 2014 (Attachment 6 to this Report). For the quarter ended March 31, 2014, THC generated a consolidated net income of $22.5 million, compared with $18.5 million for the same period in 2013.
The favourable variance in net income for the three months ended March 31, 2014 was primarily due to higher distribution revenue ($5.6 million) and lower operating expenses ($0.4 million). These favourable variances were partially offset by higher net financing charges ($0.8 million) and higher income tax expenses resulting from the increased distribution revenue ($1.3 million).

4. **HIGHLIGHTS – 2013 ANNUAL INFORMATION FORM**

THC’s Annual Information Form for the year ended December 31, 2013, forms Attachment 10 to this Report. The AIF is published annually by THC as a public debt issuer according to Ontario Securities Commission requirements.

**Employees**

On February 13, 2014, CUPE One ratified collective agreements governing inside and outside employees of THC for a four year period expiring January 31, 2018. The collective agreements implemented a wage increase of 1.5% on February 1, 2014 and provide for general wage increases of 1.75%, effective on each of February 1, 2015 and February 1, 2016, respectively, and 2% effective February 1, 2017. The collective agreements also contain cost of living escalator clauses that provide for wage adjustments corresponding to the percentage change in the Consumer Price Index.

**Executive Compensation**

Executive compensation for Named Executive Officers (NEOs) is set out in the AIF in Attachment 10 (table at page 54 of AIF). The executive compensation reported for NEOs includes base salary, performance-based incentive compensation, personal benefits and perquisites, retirement benefits, retirement allowances and termination payments.

In addition to the executive compensation reported through the AIF, City Council as the Shareholder has also directed that executive compensation, including compensation for executives other than NEOs, be disclosed annually to City Council as permitted by law.
This information is provided in two parts in Attachment 11(a) and Confidential Attachment 11(b) to this Report to present public and confidential information separately. The compensation disclosure for NEOs, which is already public information through the AIF, forms Attachment 11(a) to this Report. Reporting of additional executive compensation information includes personal information about identifiable individuals and this information is contained in Confidential Attachment 11(b) to this Report.

2014 Rate Application

In August 2013, THESL filed their IRM/ICM (Incentive Regulation Mechanism / Incremental Capital Module) application regarding its 2014 work program and in December 2013 received approval for their capital program spending request of $398.8 million for 2014.

Conservation and Demand Management (CDM)

In 2011, THC entered into an agreement with the Ontario Power Authority to deliver CDM programs for three years in a total amount of $50.0 million. As at the end of 2013, THC has received $45.9 million for the delivery of CDM programs. The time period has subsequently been extended to December 31, 2015.

Risk Factors

The AIF provides a description of various potential risks to the performance of the business, including regulatory risk, asset reliability, IT systems dependency, labour relations, electricity consumption variability, market/credit risk, and exposure to natural or other unexpected occurrences.

5. ENVIRONMENTAL PERFORMANCE

Attachment 12 to this report contains THC's Annual Report 2013 Environmental Performance. In summary, highlights of THESL's operations include:

- In 2013, total greenhouse gas ("GHG") emissions were 30% lower relative to 2012 (Scope 1 and Scope 2 emissions as defined in the THC report).
- 87% of emissions are attributed to line losses.
- Office relocations are planned which will reduce driving time, fuel use/costs and GHG emissions.
- A Pool Vehicle Program was initiated in 2013 to make better use of specialty equipment and reduce emissions.
- In 2013, THESL's CDM programs led to an estimated energy savings of 109,828MWh, reducing customer GHG emissions by 10,673 tCO2e.
- In 2013, over 9.5MW of solar photovoltaic power was connected to the Toronto Hydro grid, consisting of 155 microFIT projects and 43 FIT projects.
• THESL conducted 9 separate training sessions in Emergency Preparedness in 2013 for staff with a key role during an emergency.
• THESL conducted research on climate change, and in 2014 will undertake further work on climate change risk assessment of electrical distribution infrastructure.

CONTACT

Martin Herzog, Strategic and Corporate Policy Division
Tel: 416-392-5491, Fax: 416-696-3645; Email: mherzog@toronto.ca

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

Rob Hatton, Director, Strategic Initiatives & Intergovernmental Finance
Tel: (416) 392-9149; Fax: (416) 397-4555; E-mail: rhatton@toronto.ca

SIGNATURE

_______________________________
Joseph P. Pennachetti
City Manager
ATTACHMENTS

Attachment 1  Toronto Hydro Corporation 2013 Annual Shareholder Meeting, Resolution of the Sole Shareholder – City of Toronto, Re-appointing Auditor

Attachment 2  Toronto Hydro Corporation 2013 Annual Report, The Measure of Our Commitment

Confidential Attachment 3  Toronto Hydro Corporation Fourth Quarter 2013 Report to the Shareholder December 31, 2013

Attachment 4  Toronto Hydro Corporation Annual Financial Report December 31, 2013
Including: Toronto Hydro Corporation Consolidated Financial Statements December 31, 2013 and 2012

Attachment 5  Toronto Hydro Corporation Ontario Securities Commission Form, Certification of Annual Filings – CFO and CEO

Attachment 6  Toronto Hydro Corporation First Quarter Report March 31, 2014

Confidential Attachment 7  Toronto Hydro Corporation December 31, 2013 Internal Financial Statements

Confidential Attachment 8  Financial Statements Toronto Hydro-Electric System Limited December 31, 2013 and 2013

Confidential Attachment 9  Financial Statements Toronto Hydro Energy Services Inc. December 31, 2013

Attachment 10  Toronto Hydro Corporation Annual Information Form for the Year Ended December 31, 2013

Attachment 11(a)  Executive Compensation Disclosure, Toronto Hydro Corporation 2013

Confidential Attachment 11(b)  Executive Compensation Disclosure, Toronto Hydro Corporation 2013

Attachment 12  Toronto Hydro Annual Report, 2013 Environmental Performance