

VAUGHAN AND RICHMOND HILL HYDRO DISTRIBUTION COMPANIES – FOR PROFIT

Recommendation

The Commissioner of Finance & Corporate Services recommends:

That the City of Vaughan Council affirms its position that Hydro Vaughan Distribution Inc. should continue as a corporation under section 142(1) of the Electricity Act 1998 and to operate on a for-profit basis;

That the City of Vaughan Council affirms its position that Richmond Hill Hydro Inc. should continue as a corporation under section 142(1) of the Electricity Act 1998 and to operate on a for-profit basis;

That the attached Resolution of the Council of the Corporation of the City of Vaughan (Attachment No. 1) be approved; and

That the Town of Markham be notified of the City of Vaughan's decision.

Purpose

To advise Council that as a municipal shareholder the City must pass a resolution by March 9, 2003 indicating they want to operate Hydro Vaughan Distribution Inc. and Richmond Hill Hydro Inc. on a for-profit basis. If a resolution is not passed, each utility automatically must operate on a not-for-profit basis.

Background - Analysis and Options

In 1998, the Provincial government passed Bill 35, the *Energy Competition Act*, to restructure Ontario's electricity system and to introduce competition. Municipal Electric Utilities were required to incorporate under the Ontario Business Corporations Act (OBCA) by November 7, 2000 and were required to be licensed as electricity distributors by the Ontario Energy Board.

In recognition of the requirements in the *Energy Competition Act*, the City of Vaughan passed a transfer by-law that transferred substantially all of the assets and liabilities of the Vaughan Hydro-Electric Commission to Hydro Vaughan Distribution Inc., which is wholly owned by the City of Vaughan.

As part of Hydro Vaughan's original rate filing, due May 1, 2000, the City of Vaughan as the "shareholder" of Hydro Vaughan Distribution Inc. provided direction with respect to the rate filing as follows:

"That the Vaughan Hydro-Electric Commission's regulatory rate filing be prepared based on earning up to the maximum rate of return (9.88%) to the regulated distribution business to the extent permitted by the Ontario Energy Board (OEB) pursuant to the OEB Act; and

That the Vaughan Hydro-Electric Commission establish distribution rates for the regulated distribution business which are competitive with similar electric utilities in neighbouring areas and as permitted under the OEB Act and are intended to enhance the value of the utility."

In addition, the City of Vaughan in a 50/50 partnership with the Town of Markham, acquired Richmond Hill Hydro Inc. from the Town of Richmond Hill on December 27th, 2001 for approximately \$143.2 million (purchase price less cash equivalents). The business was purchased on the basis that it was a viable "for profit" electricity distribution company. Each municipality subsequently transferred its shares to their respective electricity distribution company.

With respect to Richmond Hill Hydro Inc., the following was included in the Shareholders Agreement dated May 31, 2002 under Objectives and Guiding Principles:

"The Corporation will be a for-profit corporation, with the objective of providing a maximum rate of return and maximizing shareholder value. Subject to OEB approval, the maximum rate of return sought by the Corporation will be achieved by way of a phase-in of rate increases over the period of first generation Performance Based Rates."

On November 25, 2002, The *Electricity Pricing, Conservation and Supply Act, 2002* (Bill 210) was introduced by the Province of Ontario. Bill 210 requires shareholder municipal councils to either pass a resolution to confirm their original decision to commercialize their respective local electricity distribution company (LDC), or to operate them on a not-for profit basis if no resolution is passed. Municipalities which own or control electricity distribution companies may pass a council resolution within 90 days of section 159.1 (1) of Bill 210 coming into force, affirming that their distribution companies continue as OBCA companies. The wording of the resolution has not been mandated by the Province, however the Province has mandated the form of certificate, which must be filed with such resolution in regulation 430/02. Bill 210 received Royal Assent December 9, 2002, therefore, Council must pass the required resolution by March 9th 2003 should they wish to continue operating Hydro Vaughan Distribution Inc. and Richmond Hill Hydro Inc. as OBCA companies on a for profit basis.

CONSEQUENCES OF NOT PASSING A RESOLUTION

The following consequences will occur should a council resolution confirming the for profit status of the LDCs not be passed within the 90 day timeline:

- No dividends can be declared by the LDC
 - The LDC cannot sell, lease or dispose of all or substantially all of its assets or liabilities
 - The LDC shall not dismiss all or substantially all of its employees.
 - The LDC cannot increase its debt obligation to its municipal shareholder
 - The LDC cannot enter into new agreements for goods or services with affiliates or the shareholder (e.g. no further agreements for joint electricity-water billing arrangements)
 - Deemed 0% return on equity in the LDC's rate application with the OEB
- Municipal Shareholders are restricted in disposing of their interests in the LDC

FINANCIAL CONSIDERATIONS:

After extensive analysis of the issues, the City of Vaughan made the decision to retain each LDC as a for-profit company. Operating Hydro Vaughan Distribution Inc. on a for-profit basis will enhance the value of the corporation as an investment and provide financial benefits to the City of Vaughan taxpayers. The City of Vaughan acquired 50% of Richmond Hill Hydro Inc. for the same reasons; however an external loan was required to complete the purchase of Richmond Hill Hydro Inc. The interest payments on the loan were to be paid with the dividends earned from Richmond Hill Hydro, which dividends will be eliminated if Richmond Hill Hydro is operated on a not-for-profit basis.

The failure to pass the resolution will have severe financial consequences for Hydro Vaughan and Richmond Hill Hydro. The Dominion Bond Rating Agency (DBRS) advised January 31, 2003, that the credit rating of the Pooled Bond offering has been downgraded. It can be expected that credit ratings for individual utilities will be downgraded if they choose to operate on a not for profit basis. If the credit ratings are downgraded, future borrowing costs and IMO prudential requirements will be increased.

The value of Hydro Vaughan and Richmond Hill Hydro as investments for the City will also decrease significantly if the proposed resolution is not passed. A common method of valuation is the net present value of its future cash flows. Cash flows are directly affected by distribution rates. The City will still have the responsibilities of a shareholder, but will receive no return on its investment.

The City will also not be able to sell its investment if the resolution is not passed. The 33% transfer tax on sales still applies, however if in the future the Province of Ontario decides to establish another transfer tax holiday, the City will not be able, under Bill 210, to take advantage of that opportunity should it wish to sell the utility.

For Richmond Hill Hydro, both Vaughan and Markham must pass the resolution for it to remain for profit. Bill 210 requires that the resolution be passed by municipal shareholders holding a majority of the voting shares. Because of the 50-50 ownership, both shareholders of Richmond Hill Hydro must pass this resolution. Staff have been coordinating with the Town of Markham. Markham has passed a for profit resolution for Markham Hydro and Richmond Hill Hydro.

CERTIFICATE AND RESOLUTION

The form of the Certificate is attached. The Certificate requires the projected rate of return on equity to be stated as well as the details of all financial arrangements involving the local distribution company and the municipality. This would include interest on promissory notes and may include joint service arrangements and rent.

Conclusion

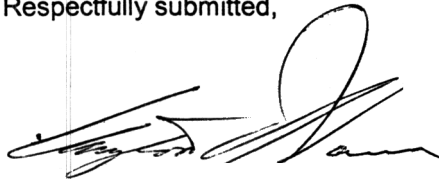
Staff recommends that the City affirm its commitment to the for-profit operation of Hydro Vaughan Distribution Inc. and Richmond Hill Hydro Inc. in order to protect the investment of taxpayer/ratepayer monies.

Attachments

Attachment No. 1 – Resolution of the Council of the City of Vaughan

Attachment No. 2 – Form of Certificate of Passing of Resolution under Section 159.1 of the Electricity Act, 1998

Respectfully submitted,



Clayton D. Harris, CA
Commissioner of Finance & Corporate Services

**RESOLUTION OF THE COUNCIL OF THE
CORPORATION OF THE CITY OF VAUGHAN**

WHEREAS Section 142 of the *Electricity Act, 1998*, required municipalities to convert their existing hydro-electric commissions into corporations incorporated under the *Business Corporations Act (Ontario)* before November 7, 2000.

AND WHEREAS Hydro Vaughan Distribution Inc., Hydro Vaughan Energy Corporation and Hydro Vaughan Holdings Inc., were incorporated under the *Business Corporations Act, (Ontario)*, pursuant to Section 142 of the *Electricity Act, 1998*.

AND WHEREAS subsequent to the formation of Hydro Vaughan Distribution Inc. and with the approval of the Ontario Energy Board, Hydro Vaughan Distribution Inc. and Markham Hydro Distribution Inc. each purchased fifty (50) percent of the shares of Richmond Hill Hydro Inc. from the Town of Richmond Hill effective December 27, 2001.

AND WHEREAS HVDI and RHHI have obtained external third party financing.

AND WHEREAS Hydro Vaughan Distribution Inc. and Richmond Hill Hydro Inc. continue to operate as highly efficient electricity distributors for the benefit of the electricity customers of Vaughan and Richmond Hill.

AND WHEREAS on December 9, 2002 Bill 210, the *Electricity Pricing, Conservation and Supply Act, 2002* ("the Act") received third reading, Royal Assent and came into force.

AND WHEREAS the Act amends the *Electricity Act, 1998*, by adding Section 159.1, which provides that each municipality that beneficially owns or controls a corporation incorporated under Section 142 of the *Electricity Act, 1998*, and that is licensed under the *Ontario Energy Board Act, 1998* to distribute electricity, may within 90 days after Section 159.1 comes into force, pass a resolution affirming that the corporation should continue to be incorporated as provided in Section 142(1) of the *Electricity Act, 1998*.

AND WHEREAS the Act also provides several consequences of failure to pass the required resolution and submit the necessary certificate certifying the passing of the resolution, which consequences include a prohibition against declaring or paying dividends for the benefit of any person; a prohibition against any disposition of the assets or liabilities of the electricity distribution corporation; prohibitions against entering into certain contractual arrangements; and an application being deemed to have been made to the Ontario Energy Board for a rate order that incorporates a 0% return on common equity which effectively converts the distribution corporation into a not-for-profit business.

AND WHEREAS Hydro Vaughan Distribution Inc. is a licensed electricity distributor that was incorporated as provided in Section 142(1) of the *Electricity Act, 1998* and is directly owned by the City of Vaughan.

AND WHEREAS Richmond Hill Hydro is a licensed electricity distributor that was incorporated as provided in Section 142(1) of the *Electricity Act, 1998* and is 50% owned by the City of Vaughan through its direct ownership of Hydro Vaughan Distribution Inc.

AND WHEREAS Hydro Vaughan Distribution Inc. and Richmond Hill Hydro Inc. have consistently ensured that the electricity customers of Vaughan and Richmond Hill receive efficient electrical services at competitive rates.

NOW THEREFORE BE IT RESOLVED THAT:

- 1 The Council of the Corporation of the City of Vaughan affirms that Hydro Vaughan Distribution Inc., an electricity distributor licensed under the *Ontario Energy Board Act, 1998*, and Richmond Hill Hydro Inc. an electricity distributor licensed under the *Ontario Energy Board Act, 1998*, which is 50 percent owned by Hydro Vaughan Distribution Inc., should each continue to be incorporated as a corporation under the *Business Corporations Act (Ontario)* as provided in Subsection 142(1) of the *Electricity Act, 1998* and to operate on a for-profit basis.
2. The Mayor and Clerk are authorized to prepare and file with the Minister of Energy the necessary certificate required under Section 159.1 of the *Electricity Act, 1998* as provided for in the Act.

December 20, 2002

**CERTIFICATE OF PASSING OF RESOLUTION
UNDER SECTION 159.1 OF THE ELECTRICITY ACT, 1998**

Name of Municipality _____

Name of Local Distribution Company _____

Direct and Indirect Beneficial Ownership of and Voting Rights in Local Distribution Company. Specify shareholders and % of ownership at each level of the corporate structure (see subsection 159.1 (3) of Act). If there is insufficient space on this form, attach additional page(s).

Attached is a copy of the resolution passed by the municipality affirming that the local distribution company should continue to operate on a for-profit basis.

The municipality affirms that the projected return on common equity to be earned by the local distribution company, on which the rates approved by the Ontario Energy Board are based, is _____%.

Provide details of all financial arrangements involving the municipality and the local distribution company. If there is insufficient space on this form, attach additional page(s).

Date of Arrangement	Description of Arrangement	Term	Principal Amount	Annual Interest Payable

Name of Mayor

Signature of Mayor _____
Date

Name of Clerk

Signature of Clerk _____
Date