

Consolidated Clause in Policy and Finance Committee Report 5, which was considered by City Council on June 27, 28 and 29, 2006.

12

**City Electricity Purchase and Results for
Expressions of Interest (REOI) 9119-06-7107**

City Council on June 27, 28 and 29, 2006, amended this Clause by adding the following:

“That Council adopt the following staff recommendations contained in the Recommendations Section of the report (June 23, 2006) from the Deputy City Manager and Chief Financial Officer:

‘It is recommended that:

- (1) Council authorize the Deputy City Manager and Chief Financial Officer to provide financial guarantee(s) of the financial obligations of Toronto Hydro Energy Services Inc. (“THESI”) to Toronto Hydro-Electric System Limited, relating to the purchase of the electricity by the City and some or all of its Agencies, Boards, and Commissions:*
 - (i) in the event that they are necessary in support of a potential arrangement for the provision of consolidated billing services by THESI to the City;*
 - (ii) in support of the obligation of THESI as a retailer under the Ontario Retail Settlement Code, to pay to Toronto Hydro-Electric System Limited as a distributor, all charges for competitive and non-competitive electricity services settled through the distributor) for electricity consumed by the City and its agencies, boards, commissions;*
 - (iii) for an amount not to exceed \$ 50 million; and*
 - (iv) on terms and conditions that are satisfactory to the Deputy City Manager and Chief Financial Officer, and in a form satisfactory to the City Solicitor; and*
- (2) the appropriate City officials be authorized to take any action necessary to give effect thereto.”*

Council also considered additional material, which is noted at the end of this Clause.

The Policy and Finance Committee recommends that City Council adopt the staff recommendations contained in the Recommendations Section of the report (June 2, 2006) from the Deputy City Manager and Chief Financial Officer; and further that City staff be requested to report to the September 18, 2006, meeting of the Policy and Finance Committee on including green power in the City's electricity purchase strategy, inclusive of financial implications, prior to the suppliers bid call in the Fall of 2006.

Purpose:

The purpose of this report is to advise on the results of the Request for Expressions of Interest (REOI) 9119-06-7107, issued for the purposes of establishing a pool of electricity counterparties once the City's current arrangements expire on December 31, 2006; to report on a recommended detailed electricity purchase strategy for the City and its Agencies, Boards, Commissions, and Corporations, and to seek related authorizations; and to adopt a Statement of Policies and Goals relating to the use of electricity commodity financial hedging arrangements to address commodity pricing and costs.

Financial Implications and Impact Statement:

The total estimated annual cost of electricity, for fiscal 2007, based on current usage and market pricing for the City and its Agencies, Boards, Commissions and Corporations, is \$180 million (\$127 million for commodity costs and \$53 million for distribution and other charges), including \$87 million for the City alone (\$61 million for commodity and \$26 million for distribution and other charges). The 2007 operating budget submissions for the City and its Agencies, Boards, and Commissions will include provision for electricity costs.

Recommendations:

It is recommended that:

- (1) Council adopt the Statement of Policies and Goals relating to the use of electricity commodity financial price hedging agreements to address commodity pricing and costs attached as Schedule "A" to this Report;
- (2) Council authorize the City's Deputy City Manager and Chief Financial Officer to negotiate and execute on behalf of the City Master Agreements with Coral Energy Canada Inc., Direct Energy Business Services, Ontario Power Generation Inc., Powerex Corp., WPS Energy Services of Canada Corp being the five highest scoring respondents of REOI 9119-06-7107, on terms and conditions that are:
 - (a) in accordance with Council direction of January 31, February 1, 2, 2006 (Policy and Finance Committee Report 1, Clause 5);
 - (b) satisfactory to the Deputy City Manager and Chief Financial Officer;

- (c) in compliance with the Statement of Policies and Goals recommended in this report; and
 - (d) in a form that is satisfactory to the City Solicitor;
- (3) Council authorize the City's Chief Corporate Officer to negotiate and execute on behalf of the City related agency agreements as required with the City's Agencies, Boards, Commissions, and Corporations, on terms and conditions satisfactory to the Chief Corporate Officer and in form satisfactory to the City Solicitor;
 - (4) Council authorize the Chief Corporate Officer to negotiate and execute on behalf of the City an agreement with Toronto Hydro Energy Services Inc. for the use or purchase of their electricity consolidated billing program, and/or their consolidated billing services, or services to maintain the current enrolment of the City's electricity accounts, on terms and conditions satisfactory to the Chief Corporate Officer and in form satisfactory to the City Solicitor;
 - (5) all administrative costs relating to this exercise, including any consulting costs, consolidated billing costs and account enrolment costs, be shared proportionately with all City, Agency, Board, Commission, and Corporation end users participating in the program;
 - (6) the Chief Corporate Officer or his designate be authorized to execute electricity commodity price hedging transactions for the period January 1, 2007 to December 31, 2009 that result from price quotations received from the approved pool of electricity supply counterparties;
 - (7) the Deputy City Manager and Chief Financial Officer be authorized to report directly to Council with a supplementary report, as required, on additional matters that may arise relating to the negotiation of the various agreements and/or arrangements as recommended in this report;
 - (8) Council authorize the Chief Corporate Officer to request the Province (Ministry of Energy) to amend Ontario Regulation 95/05 under the Ontario Energy Board Act, 1998 as outlined in this report in order to facilitate City Designated Accounts opting out of the Regulated Price Plan; and
 - (9) the appropriate City officials be authorized to take any action necessary to give effect thereto.

Background:

The Ontario electricity market was deregulated on May 1, 2002, when the price of the electricity commodity began to be set by market conditions (i.e., demand and supply), fluctuating hourly, daily, and seasonally. At that time, it became important to effectively manage the City's cost of electricity.

In anticipation of deregulation, at its meetings of February 29, March 1 and 2, 2000 (Policy and Finance Committee Report 3, Clause 6, as amended) and November 6, 7, 8, 2001 (Policy and Finance Committee Report 14, Clause 13, as amended) Council approved the execution of a power purchase agreement (PPA) between the City, all of its Agencies, Boards, Commissions and Corporations (ABCs), and Toronto Hydro Energy Services Inc. (THESI). This agreement was a retail supply arrangement.

Subsequently, the electricity market in Ontario was partly re-regulated, with legislated and, later regulated pricing put into effect for retail and other “designated” consumers. As a result, THESI elected to restructure its energy retailing operations and has ceased offering new electricity retail contracts. However, as THESI had an option to extend certain contractual supply arrangements at favourable pricing until December 31, 2006, it, in turn, offered the City the opportunity to extend its PPA at favourable pricing until that time. At its meeting of April 19, 20, 21, 22, 23, 26, 27 and 28, 2004 (Policy and Finance Committee Report 3, Clause 9), Council approved recommendations authorizing a renewal of the PPA, effective April 1, 2004, for a period expiring on December 31, 2006.

At its meeting of January 31, February 1 and 2, 2006, City Council adopted the recommendations embodied in Policy and Finance Committee Report 1, Clause 5, as amended, including the following:

- (1) the City’s Chief Corporate Officer be authorized to issue a request for proposals in order to select three (3) to five (5) electricity suppliers to enter into Master Electricity Power Purchase Agreements with the City for a three-year period, with:
 - (a) a possible contract extension for an additional three-year period subject to further Council approval;
 - (b) underlying electricity purchase transactions commencing at dates ranging from January 1, 2007 to April 1, 2008, depending on the City’s inclusion of Provincial electricity capped pricing starting January 1, 2007, in its purchasing strategy, as may be deemed to be appropriate by City staff and its advisors; and
 - (c) Toronto Hydro Energy Services Inc. being deemed to be an electricity supplier, either as a counter-party (directly), or as a broker (indirectly), with respect to the City’s electricity supplier pool.

Furthermore, in the same clause, the Policy and Finance Committee also requested:

“ the Deputy City Manager and Chief Financial Officer to submit a report to the Policy and Finance Committee on the feasibility of building into its transactional electricity power purchase arrangements the opportunity to deduct demonstrated peak period savings at the spot market price (or alternatively sell back demonstrated peak period savings) at the actual rate of power saved.”

Ontario Regulation Requirement:

Buyers in the Ontario marketplace who wish to control power price risk must enter into a form of commodity price hedging arrangement, which would be classified as a financial derivative.

As the legal authority to enter into such an arrangement was not previously clear, on December 13, 2005, the Province published Ontario Regulation 635/05 under the *Municipal Act, 2001*. This regulation authorized municipalities to enter into commodity price hedging arrangements, and in order to do so, required that municipalities adopt a statement of policies and goals regarding commodity price hedging agreements.

Comments:

The electricity market in Ontario is currently facing supply challenges due to the insufficient availability of domestic generation resources to satisfy market demand, the anticipated growth in consumer demand, an inconsistent Provincial electricity policy which has done little to encourage private investment in new generation, and a Provincial policy of phasing out coal-fired generation in favour of renewable (often more expensive) resources. All of these factors have contributed to price volatility, and forward market price uncertainty.

The total cost of electricity for the City and its ABCs amounted to approximately \$165 million in fiscal 2005, comprised of a commodity cost of \$107 million, and regulated charges of \$53 million. However, it is estimated that the total annual cost of electricity for the City/ABC group could increase to as much as \$180 million in 2007 as a result of market factors, (\$127 million for commodity costs and \$53 million for other charges). As the City's current contract expires on December 31, 2006, given the complexity, diversity of the user group, volumes involved, and the overall volatility of pricing, it is prudent to secure electricity pricing for the next contract term before the expiry of the current contract.

Electricity Purchase Strategy:

(1) Form of Arrangement:

The City's current contract is a retail contract, which is a form of power purchase agreement with a single energy supplier.

The City's electricity consultant, Aegent Energy Advisors Inc. ("Aegent") has recommended that upon expiry of the current contract, that the City move away from a retail type of arrangement with a single energy supplier to an approach that involves entering into a series of financial electricity commodity price hedges with more than one qualified counterparty. (More discussion on the technical aspects of hedging will be presented later on in this report.) The reasoning is that:

- (i) the supply of electricity itself is required to be delivered to the user in Ontario regardless of whether or not it is party to an electricity agreement. The only outstanding factor is price. The optimal method of managing electricity

commodity price risk is to enter into “contract for differences” (CFD), which are a form of financial price hedging arrangements;

- (ii) a key difference between a CFD and a retail arrangement is that under a retail arrangement, the City is limited to one energy supplier for each meter point. Under a CFD arrangement, the City would have the ability to contract with more than one counterparty, thereby establishing an electricity counterparty pool. Under this arrangement, the City would solicit price bids from its electricity counterparty pool at the appropriate times, for the appropriate quantities, terms, and timing (e.g., for on or off-peak hours, seasonality). Pricing arrangements may be set for any block of time during on-peak or off-peak hours, and for terms of up to three years.

Establishing a pool of counterparties would encourage competition among counterparties, thereby ensuring that the City receives optimal pricing for the quantities and terms required, and that there is a hedge available for the quantity and term sought. Furthermore, establishing such a pool would diversify contract risk, thereby minimizing the consequences of poor performance, default, or withdrawal from the market by a single counterparty;

- (iii) as a CFD would allow the City to retain control over the timing and amount of the underlying electricity purchased, this would enhance the City’s ability to manage price risk through the establishment of an optimal portfolio of pricing and terms; and
- (iv) a CFD arrangement would allow for greater price transparency, since a CFD is actually layered on top of electricity spot market pricing. Under a retail arrangement, however, only blended pricing is provided.

A similar purchase strategy is already in place in the City’s natural gas purchasing program, which has been shown to work well. Since natural gas pricing volatility is similar to electricity pricing, City staff anticipate that a CFD arrangement with a pool of electricity supply counterparties will work well.

(2) Options for Price Structuring:

Price risk exposure is a function of how electricity demand is distributed over hours of the day, weekdays/weekends and holidays, and months of the year. Electricity prices are higher and more volatile in on-peak hours, and times of extreme weather conditions (summer and winter).

The City has considered a number of options for securing optimal electricity commodity pricing, commencing January 1, 2007, including the following:

(i) Default to the Regulated Price Plan (RPP):

Under current legislation, the City is considered to be a “designated consumer” (Ontario Regulation 478/05), and therefore has the option of accepting regulated commodity pricing (as set periodically by the Ontario Energy Board). The City could default to the RPP for a large part of its load that falls within the definition of “designated consumer”. However, this option is only available to City divisions, the Toronto Community Housing Corporation (TCHC), and to small volume users (those consuming less than 250,000 kWh/year).

Low consumption City or ABC accounts, or TCHC accounts that have a low “per-suite” consumption, may benefit from the RPP. However, participation in the RPP may result in higher electricity costs since the RPP pricing mechanism currently allocates higher prices to larger users.

Furthermore, as the RPP is amended on a periodic basis, there is less certainty associated with its adoption, and therefore, selection of this option may carry a certain price risk exposure;

(ii) Accept the Hourly Ontario Electricity Spot Price (HOEP):

The HOEP is the default price for “non-designated” accounts above the RPP threshold of 250,000 kWh/year. The HOEP is also the default price for “designated” accounts that opt out of the RPP. The HOEP is set hourly on the Ontario spot market, is influenced by supply and demand, and can be volatile and difficult to predict. Furthermore, following this option can make the determination of an annual budget difficult; and

(iii) CFD Hedge:

A CFD is a financial commodity price hedge arrangement that would allow the City to control and minimize the price of the electricity commodity, and to achieve a higher degree of cost certainty and predictability than by strict reliance on the RPP and HOEP pricing mechanisms.

A CFD is essentially a financial hedge, whereby the City would contract with a financial counterparty for a given price relating to a block of electricity (commodity only) by swapping the HOEP pricing for the fixed pricing. The financial counterparty would in turn hedge its own risk by entering into simultaneous financial hedges with other counterparties.

It should be noted, however, that there is a degree of unpredictability in the Ontario electricity marketplace, in that there is no guarantee that the HOEP will be greater than a particular hedge amount during the entire term of its agreement, whether for a limited period, or for a prolonged period of time.

In the absence of entering into a pricing arrangement, the City would fall under the RPP, and those ABCs that are ineligible as designated consumers, such as the Toronto Transit Commission would default to the HOEP.

Aegent has recommended that the City implement a CFD arrangement. However, elements of each of the RPP and HOEP will be incorporated in order to derive an optimal purchase strategy with the goal of receiving optimal pricing points and enhancing cost predictability.

The optimum amount of electricity to be hedged by the City through a CFD arrangement will be determined for each major user group, taking into account electricity usage, risk management objectives, and the degree to which “default” price-risk coverage is available through Provincial price rebate mechanisms, and regulated pricing might offset the City’s risk. As the default price-risk coverage mechanisms act as limited price-hedges, the City would only be required to manage its “residual” risk. It is important to note that hedging a greater amount than is required could result in an over-hedged condition, whereby price risk is actually increased rather than reduced.

Default price-risk coverage is currently available through two Provincial mechanisms: the “OPG Rebate” and the “Global Adjustment”. The OPG Rebate is a mandated price cap on the average unit revenue on power generated by certain facilities owned by Ontario Power Generation (OPG), and it covers approximately 20 percent of the energy in the electricity marketplace. The Global Adjustment is essentially a price regulation applied to another 45 percent of the energy in the electricity market, representing power from OPG’s base-load facilities and some non-utility generation contracts.

These two mechanisms apply to approximately 65 percent of the Province’s electricity generation facilities, thereby providing the City with a default hedge that applies to approximately 65 percent of its consumption. Therefore, the above-noted residual price risk relates to approximately 35 percent of the City’s consumption.

There are no fixed costs associated with the use of a CFD. The estimated pricing associated with using a CFD will be a function of the amount hedged, the pricing quoted by one or more counterparties and the HOEP during the term of the transaction.

Implementing the CFD Arrangement:

Opting Out of the RPP:

Under Ontario Regulation 95/05, the City must actually “opt out” of the RPP in order to implement a CFD arrangement, but may only do so for the portion of the electricity load that is interval metered (metered by time of use). Although most of the City’s load is already interval metered, this requirement is restrictive.

To date there have been some efforts on behalf of other designated consumers to persuade the Ministry of Energy to amend or remove the restrictions in O. Reg. 95/05 relating to opting out of the RPP.

This report recommends that Council endorse the position of asking the Province to amend O. Reg. 95/05 to eliminate the requirement for an interval meter, and to allow larger energy-metered customers to opt out of the RPP by simply notifying their local electricity distribution company. A suggestion made by Aegent, and supported by City staff, is that there be an annual lower consumption limit of 50,000 kWh on energy-metered accounts that wish to opt out. There is optimism that this step will be taken in the near term, but it cannot be considered a certainty at this point.

In the event that such an amendment is not forthcoming, the City may use the services of a retailer to facilitate opting out of the RPP. Under this process, for a small fee, a retailer would “enrol” the City’s energy-metered accounts and thereby be considered as the City’s “energy supplier”. The retailer would simply pass through the spot market price. The City would then manage the price risk by also entering into CFD hedges with financial counterparties. The section below outlines the REOI process that was used to select these counterparties.

REOI 9119-06-7107 (Electricity Price Hedging Agreements):

Respondents’ scores by criteria and a staff analysis of the evaluation results can be provided in an in-camera presentation if requested by Committee Members.

Thirteen (13) firms were invited to submit responses, with this requirement advertised on the City’s internet website. The responses were opened on April 18, 2006, and seven (7) responses were received from the following firms:

- (1) Coral Energy Canada Inc.;
- (2) Direct Energy Business Services;
- (3) Ontario Power Generation Inc.;
- (4) Powerex Corp.;
- (5) WPS Energy Services of Canada Corp.;
- (6) Constellation New Energy Canada; and
- (7) Toronto Hydro Energy Services Inc. (THESI).

(A discussion of the arrangements specific to THESI will be discussed later on in this report given that Council has already deemed THESI as one of the City's suppliers.)

In the terms of reference of the REOI, minimum credit rating requirements were set for respondents or by guarantors of those respondents (whose contractual obligations will be guaranteed by an affiliated guarantor) of not less than a BBB credit rating from Standard & Poors, BBB from DBRS or Baa2 from Moody's. The City will enhance its risk protection by requiring electricity counterparties, during the terms of the relevant agreements, to post security collateral, in the form of either cash, or letters of credit, in an amount related to the contracted amounts, and to the counterparty's credit rating.

These responses were evaluated based on criteria included in the REOI document which included credit rating, performance capabilities, contract terms and conditions, experience and references. The evaluation team consisted of City staff, including Toronto Water staff, Toronto Transit Commission staff, Toronto Community Housing Corporation staff, and Aegent. The overall scores ranged from 63 to 85 points.

Under this evaluation, Coral Energy Canada Inc., Direct Energy Business Services, Ontario Power Generation Inc., Powerex Corporation and WPS Energy Services of Canada Corporation obtained the highest scores.

The Fair Wage Office has reported that the recommended firms have indicated that they reviewed and understand the Fair Wage Policy and Labour trades requirements and have agreed to comply fully.

Master Agreements:

This report recommends that the City negotiate and enter into master electricity price hedging agreements ("the Master Agreements") with the successful respondents, as well as with THESI. The City has retained the outside legal expertise of Stikeman Elliot LLP to assist in this regard.

Once the Master Agreements are in place, these firms will form the City's pool of electricity counterparties, and will be given the opportunity to provide electricity pricing quotations as required and requested by the City during the contract term. Electricity pricing transactions will then be entered into from time to time by the City, by selecting optimal price quotations, and an optimal mix of long and short term purchasing positions. Furthermore, as indicated in the REOI, the City will require that electricity counterparties, upon request from time-to-time, provide indicative pricing, strictly as a means to monitor the electricity market.

The Master Agreement itself does not obligate the parties to do anything or pay anything, unless and until a specific transaction is completed. The Master Agreement commonly has no defined term, and lasts at least as long as any transaction is in effect.

Agency Agreements:

The City's ABCs have been invited to participate in the City's electricity price procurement arrangements. This report recommends that the City's Chief Corporate Officer negotiate and enter into agency agreements with those ABCs that wish to participate. The intention is for the Chief Corporate Officer, through the Energy and Waste Management Office of the Facilities and Real Estate Division act as agent for those ABCs in respect of these arrangements.

International Swap Dealers Association (ISDA) Master Agreement:

Each of the proponents have agreed to use the 1992 International Swap Dealers Association (ISDA) Master Agreement (Multicurrency-Bilateral) and the Schedule thereto, governed by Ontario law, and the New York Form of Credit Support Annex thereto (also to be governed by Ontario law) in each such case as appropriately modified following advice of the City's outside legal counsel.

CFD Hedge Transactions:

The quantities that the City will wish to hedge will be determined by examining the load analysis model in the context of the forward prices available at the time the transaction is to be done. The hedge quantities will also take into account electricity demand response and demand reduction programs the City is participating in order to maximize the benefits of these programs as applicable.

When the time comes to implement a transaction, the City will canvass its counterparty pool in order to obtain price offers for the appropriate hedge (e.g., on-peak, baseload), quantity, and term. Electricity markets, like all commodity markets, have the potential for significant price movements in a short period of time. For this reason, electricity counterparties are generally unwilling to allow a price offer to remain valid for a significant period of time. The City will therefore institute a timely and efficient process for determining the price offered by each of its counterparties, deciding on the preferred transaction, and confirming that transaction with the supplier. Furthermore, due to the necessity of responding quickly, this report recommends that the Chief Corporate Officer or his designate be authorized to accept, and transact on the optimal quotations.

There is a desire for the City to manage year-to-year price changes which will require a process of buying beyond the pending year, so as to accumulate a series of multi-year contracts. The net result will be a power price that tends to rise and fall more slowly than the market price. To accomplish this "laddering" approach will be used to balance year to year portfolio risk, and would include hedges of

varying terms to maturity. This approach is similar to the City's natural gas strategy (a portfolio approach).

THESI Response:

THESI submitted an alternative response to the REOI, suggesting instead that the City consider entering into a full brokerage service arrangement with THESI. Under this proposed arrangement, THESI would also maintain its status as the City's retailer and consolidated billing service provider.

As previously discussed, enrolling the City's accounts with a retailer would enable the City to opt out of the RPP. Therefore, it may be appropriate for THESI to remain the City's retailer. Furthermore, it may be prudent for the City to continue its arrangement with THESI for the provision of consolidated billing services. In order to do so, it is preferable for THESI to be the City's retailer, since this is the most expedient way for THESI to gain access to the City's electricity invoices.

For the reasons previously discussed in this report, it would be prudent for the City to pursue its strategy of arranging for CFD hedges to manage its price risk instead of entering into a full service brokerage service arrangement with THESI. Using brokerage services would not only layer on an added dimension of cost, but it would preclude the City from following the strategy as recommended by Aegent and outlined in this report, and would disallow the City from diversifying its financial and contract risk by spreading electricity price hedge agreements among multiple counterparties.

Consolidated Billing:

To date, THESI has provided the City with consolidated billing services, whereby the City has received one electronic bill on a monthly basis, requiring one electronic payment. The alternative is for the City to begin to receive about 4,000 paper bills in each month (as in the past). Consolidated billing has provided the City with significant savings in terms of staff time and administration of bill payment. Therefore, this arrangement should be continued.

Furthermore, the consolidated billing service as currently provided by THESI is no longer offered by any other retailer or wholesale power marketer as a competitive service. The only alternative solution would be to implement a custom-made solution. However, this would be costly, and take some time to develop. Since THESI already provides consolidated billing services to the City and having already incurred the associated capital costs, it makes sense to negotiate an agreement with THESI to continue its consolidated billing services to the City.

Authority:

Under Ontario Regulation 635/05, municipalities may enter into financial arrangements for the purpose of hedging commodity prices for commodities used in the normal operation of the municipality, to enhance price protection and add stability to the budgeting process. As such, a municipality is authorized to enter into one or more financial agreements for the purpose of minimizing the cost or financial risk associated with securing the commodity.

Section 6 of the regulation requires Council to first adopt a Statement of Policies and Goals relating to the use of financial electricity price commodity hedging agreements to address commodity pricing issues.

This report recommends that Council adopt the proposed Statement of Policies and Goals relating to the use of Electricity Commodity Price Hedging Agreements as provided in Schedule “A” to this report. This statement was prepared in accordance with the requirements of the regulation, which requires that consideration be given to the various risk and cost issues that have been outlined in this report, as follows:

“6. (2) The council of the municipality shall consider the following matters when preparing the statement of policies and goals:

- (1) the types of projects for which commodity price hedging agreements are appropriate;
- (2) the fixed costs and estimated costs to the municipality resulting from the use of such agreements;
- (3) whether the future price or cost to the municipality of the applicable commodities will be lower or more stable than they would be without the agreements;
- (4) a detailed estimate of the expected results of using such agreements;
- (5) the financial and other risks to the municipality that would exist with, and without, the use of such agreements; and
- (6) risk control measures relating to such agreements, such as:
 - (i) credit exposure limits based on credit ratings and on the degree of regulatory oversight and the regulatory capital of the other party to the agreement,
 - (ii) standard agreements, and

- (iii) ongoing monitoring with respect to the agreements.
O. Reg. 653/05, s. 6 (2).”

Section 7 of the regulation also requires that:

If a municipality has any subsisting commodity price hedging agreements in a fiscal year, the treasurer of the municipality is required to prepare and present to the municipal council once in that fiscal year, or more frequently if the council so desires, a detailed report on all of those agreements. The report must contain the following information and documents:

- (1) a statement about the status of the agreements during the period of the report, including a comparison of the expected and actual results of using the agreements;
- (2) a statement by the treasurer indicating whether, in his or her opinion, all of the agreements entered during the period of the report are consistent with the municipality’s statement of policies and goals relating to the use of financial agreements to address commodity pricing and costs;
- (3) such other information as the council may require; and
- (4) such other information as the treasurer considers appropriate to include in the report.

Conclusion:

This report outlines a detailed electricity purchase strategy for the City once its current arrangements expire on December 31, 2006. The strategy involves the City entering price hedge agreements with a pool of electricity counterparties in order to manage its price risk and to negotiate a service agreement with THESI for account enrolment and consolidated billing services as required. These counterparties were selected under REOI No. 9119-06-7107, issued in April 2006. This report also recommends the adoption of a Statement of Policies and Goals relating to the use of financial hedging agreements to address commodity pricing and costs.

Contacts:

Gwen Manderson, Acting Director, Purchasing and Materials Management
Tel: (416) 392-7312, E-mail: gmanders@toronto.ca

Bruce Bowes, P.Eng., Chief Corporate Officer
Tel: (416) 397-4156; Fax: (416) 397-4007; E-mail: bbowes@toronto.ca

Chuck Donohue, P.Eng., Executive Director, Facilities and Real Estate Division
Tel: (416) 397-5151; Fax: (416) 392-4828; E-mail: cdonohue@toronto.ca

Jodie Parmar, Director, Business and Strategic Innovation, Facilities and Real Estate Division;
Tel: (416) 338-1295 ; Fax: (416) 392-4828 ; E-mail: jparmar@toronto.ca

Jim Kamstra, Manager, Energy and Waste Management, Facilities and Real Estate Division
Tel: (416) 392-8954; Fax: (416) 392-4828; E-mail: jkamstra@toronto.ca

Schedule “A”

City of Toronto
Statement of Policies and Goals
relating to the use of Electricity Commodity Price Hedging Agreements

Electricity commodity price hedging agreements (“the hedging arrangements”) may be employed by the City when securing pricing for electricity supply for:

- (i) facilities owned by City or City Agencies, Boards, Commissions, or Corporations that are subject to the Hourly Ontario Energy Price (HOEP) (currently these are defined as entities that are not “designated consumers” under relevant provincial regulation; and accounts that are not serviced by an interval meter); and/or
- (ii) City facilities that may be considered to be “designated consumers”, which would also benefit by hedging a portion of their electricity requirements.

The purpose for employing the hedging arrangements is to receive optimal electricity commodity pricing, and to reduce the volatility of the pricing for the municipal user group whereby the future pricing, or cost of electricity to the municipality will be more stable than it would be without the electricity commodity price hedges.

From time to time, City staff will solicit bids for hedging arrangements, for the appropriate quantities of electricity, at the appropriate terms and timing, from an established pool of electricity counterparties, thereby ensuring that the City receives optimal pricing for the quantities and terms required.

The optimum amount of electricity to be hedged by the City through a hedging arrangement will be determined for each major electricity user group, taking into account electricity usage, risk management objectives, and the degree to which “default” price-risk coverage may be available through Provincial price rebate mechanisms and/or regulated pricing.

The City’s Deputy City Manager and Chief Financial Officer will be responsible for managing credit risk relating to the use of Electricity Commodity Price Hedging Agreements by addressing, among other matters, credit ratings of counterparties, transaction values and collateral support requirements.

City Council – June 27, 28 and 29, 2006

Council also considered the following:

- *Report (June 23, 2006) from the Deputy City Manager and Chief Financial Officer [Communication 18(a)]:*

Subject: Financial Guarantee for City Electricity Purchase Consolidated Billing

Purpose:

This report seeks authority for the City to provide a financial guarantee to Toronto Hydro in the event that it is required to contain the cost of a consolidated billing arrangement between the City and Toronto Hydro Energy Services Inc. This report is to be read in conjunction with a report of the Policy and Finance Committee, concurrently before Council, entitled “City Electricity Purchase and Results of Request for Expressions of Interest (REOI) 9119-06-7107”.

Financial Implications and Impact Statement:

This report recommends that the City be authorized to provide a financial guarantee to Toronto Hydro of up to \$50 million in support of a potential arrangement for the provision of consolidated billing services. This guarantee would result in the City promising payment for its electricity purchase, and would only be provided in the event that it would aid in containing the cost associated with consolidated billing.

Should the City provide such a financial guarantee, there would be no associated up-front cost to the City, although it would be carried as a contingent liability on the City’s balance sheet. Furthermore, this guarantee would be separate and apart from any requirement for credit support that could be required (depending on the magnitude of arrangements with one counterparty) under the various financial electricity price hedge arrangements to which the City may be party.

Recommendations:

It is recommended that:

- (1) *Council authorize the Deputy City Manager and Chief Financial Officer to provide financial guarantee(s) of the financial obligations of Toronto Hydro Energy Services Inc. (“THESI”) to Toronto Hydro-Electric System Limited, relating to the purchase of the electricity by the City and its some or all of its Agencies, Boards, and Commissions:*
 - (i) *in the event that they are necessary in support of a potential arrangement for the provision of consolidated billing services by THESI to the City,*
 - (ii) *in support of the obligation of THESI as a retailer under the Ontario Retail Settlement Code, to pay to Toronto Hydro-Electric System Limited as a distributor, all charges for competitive and non-competitive electricity services*

settled through the distributor) for electricity consumed by the City and its agencies, boards, commissions,

- (iii) for an amount not to exceed \$ 50 million; and*
 - (iv) on terms and conditions that are satisfactory to the Deputy City Manager and Chief Financial Officer, and in a form satisfactory to the City Solicitor; and*
- (2) the appropriate City officials be authorized to take any action necessary to give effect thereto.*

Background:

This report is to be read in conjunction with a report of the Policy and Finance Committee (meeting of June 20, 2006), concurrently before Council, entitled "City Electricity Purchase and Results of Request for Expressions of Interest (REOI) 9119-06-7107". The former report outlines a detailed electricity purchase strategy for the City, commencing January 1, 2007, involving the City negotiating and entering into a service agreement with Toronto Hydro Energy Services Inc. ("THESI") for account enrolment and consolidated billing services, as required, and managing electricity price risk by entering into hedge agreements with a pool of electricity counterparties.

The following recommendations were included in the above-mentioned report:

- "(4) Council authorize the Chief Corporate Officer to negotiate and execute on behalf of the City an agreement with Toronto Hydro Energy Services Inc. for the use or purchase of their electricity consolidated billing program, and/or their consolidated billing services, or services to maintain the current enrolment of the City's electricity accounts, on terms and conditions satisfactory to the Chief Corporate Officer and in form satisfactory to the City Solicitor;*
- (7) the Deputy City Manager and Chief Financial Officer be authorized to report directly to Council with a supplementary report, as required, on additional matters that may arise relating to the negotiation of the various agreements and/or arrangements as recommended in this report;"*

Comments:

Council is currently considering a concurrent report of the Policy and Finance Committee, relating to the implementation of an electricity purchase strategy for the City, and its agencies, boards, and commissions ("ABC"), once current arrangements expire on December 31, 2006. The strategy includes the City negotiating and entering into service arrangements with THESI for continued account enrolment and consolidated billing services.

City and THESI staff are in the process of exploring the potential for a continued consolidated billing arrangement, under which the City would continue to receive one consolidated bill that it pays electronically, subsequently dividing it into component accounts and sending the appropriate charges on to their respective City divisions and ABCs for reimbursement. There

are approximately 4,000 separate user accounts in total, 1,500 of which belong to City divisions. The consolidated billing arrangements have been beneficial in that they significantly reduce the City/ABC staff time required to administer payment.

While there have been multiple providers of consolidated billing services in the past, the service as currently provided by THESI is no longer offered by any other retailer or wholesale power marketer as a competitive service.

The alternative to consolidated billing would be to revert to the historical method of receiving and paying one paper bill for each account. Under this alternative, it is the local electricity distribution companies, such as Toronto Hydro-Electric System Limited ("THESL"), which invoice electricity customers. The City could then supplement the receipt of paper bills with its own custom-made solution. However, a custom-made solution would take some time to develop, and there would be an associated cost.

City and THESI staff are in the process of exploring the potential for a continued consolidated billing arrangement. However, early indications are that continuation of such arrangements may be cost prohibitive. Therefore, staff have been investigating methods for reducing the cost, such as the City, rather than THESI, providing financial guarantees to THESL relating to the City/ABC purchase of electricity. To date, Toronto Hydro Corporation has provided parental guarantees to THESL on behalf of THESI, at a cost to THESI. (Under current legislation/regulation, THESL is required to treat THESI no differently than other electricity retailers, regardless of the fact that they are affiliated entities.)

The amount of financial guarantee provided by Toronto Hydro Corporation to THESL on behalf of THESI as it relates to the City/ABC electricity purchase has been approximately \$50 million. This report seeks authority for the City to provide a replacement financial guarantee to THESL, of up to the same amount, in support of a potential consolidated billing arrangement between THESI and the City. (Given the City's credit rating, it may be possible for THESL to accept a financial guarantee of a lesser amount.) A financial guarantee would only be provided in the event that it helps to contain the associated costs by eliminating the cost to THESI of the guarantee.

A financial guarantee from the City would essentially be a promise to pay, and would not be supported by any other collateral. Therefore, should the City provide such a financial guarantee, there would be no associated up-front cost to the City, although it would be carried as a contingent liability on the City's balance sheet. This guarantee would be separate and apart from any requirement for credit support (depending on the magnitude of arrangements with one counterparty) under the various financial electricity price hedge arrangements to which the City may become party.

While the City does not make a practice of providing such financial guarantees to third parties, in this case, Toronto Hydro Corporation is wholly-owned by the City, the guarantee would involve an assurance that the City will pay its own (City and ABC) electricity bill, and the City would only provide such a guarantee in the event that it would be helpful in containing the cost associated with consolidated billing.

Conclusions:

This report is to be read in conjunction with a report of the Policy and Finance Committee, entitled “City Electricity Purchase and Results of Request for Expressions of Interest (REOI) 9119-06-7107”, concurrently before Council. The former report outlines a detailed electricity purchase strategy for the City, commencing January 1, 2007, involving the City negotiating and entering into a service agreement with Toronto Hydro Energy Services Inc. (“THESI”) for account enrolment and consolidated billing services, as required, and managing price risk by entering into hedge agreements with a pool of electricity counterparties.

This report seeks authority for the City to provide a financial guarantee to Toronto Hydro of up to \$50 million in support of a potential arrangement for the provision of consolidated billing services. This guarantee would only be provided in the event that it would be helpful in containing the associated cost to the City.

Contacts:

Len Brittain, Director, Corporate Finance

Tel: (416) 392-5380 ; fax : (416) 397-4555 ; e-mail: lbrittai@toronto.ca

Bruce Bowes, P.Eng., Chief Corporate Officer;

Tel: (416) 397-4156; fax: (416) 397-4007; e-mail: bbowes@toronto.ca

Chuck Donohue, P.Eng., Executive Director, Facilities & Real Estate Division

Tel: (416) 397-5151; fax (416) 392-4828; e-mail: cdonohue@toronto.ca

Jodie Parmar, Director, Business & Strategic Innovation, Facilities and Real Estate Division

Tel: (416) 338-1295 ; fax: (416) 392-4828 ; e-mail: jparmar@toronto.ca

Jim Kamstra, Manager, Energy & Waste Management, Facilities and Real Estate Division

Tel: (416) 392-8954; fax: (416) 392-4828; e-mail: jkamstra@toronto.ca