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February 28, 2012

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
PO Box 2319
2300 Yonge St, Suite 2700
Toronto, ON M4P 1E4

Via mail and email

Dear Ms. Walli:

Re: Request for Deferral Account for Accounting Differences Resulting from the Implementation of United States of America Generally Accepted Accounting Principles ("U.S. GAAP")

Toronto Hydro-Electric System Limited (the "Corporation" or "THESL") formally received its decision from the Ontario Securities Commission ("OSC") on July 21, 2011, allowing it to utilize U.S. GAAP for external financial reporting and securities filing purposes instead of International Financial Reporting Standards ("IFRS") effective January 1, 2012.

The use of a consistent financial accounting framework for external financial reporting and regulatory reporting allows the Corporation to preserve the existing link between the audited consolidated financial statements and the documentation that it will utilize in its rate applications and regulatory reports. Given that U.S. GAAP Accounting Standards Codification ("ASC") 980 – *Regulated Operations*, allows for the recognition of rate regulation, the impacts of certain Ontario Energy Board ("OEB") rate decisions and ratemaking practices can be reflected as regulatory assets and liabilities. It is beneficial to the OEB, the Corporation, and other stakeholders to be able to compare financial information in regulatory filings to the Corporation's audited consolidated financial statements. This provides all participants with assurance of the integrity of financial information.

THESL has determined that it will transition to U.S. GAAP on January 1, 2012 for external financial reporting purposes. As noted in THESL's letter dated August 19, 2011 to the OEB and its 2012 Cost of Service application (EB-2011-0144 Exhibit C1, Tab 2, Schedule 1, Appendix D), THESL has notified the OEB that it intends to use U.S. GAAP for regulatory accounting purposes, consistent with the guidance provided in the OEB's *Report of the Board (EB-2008-0408)* and the subsequent Addendum to this report.

Based on THESL's review of the differences between Canadian and U.S. GAAP at this time, there are specific areas of difference in accounting treatment, including the treatment of other post-employment benefits.

The Board has made certain findings and provided direction to utilities with respect to analogous accounting differences that exist between CGAAP and IFRS. For example, in the Addendum, the Board stated at page 14:

> The Board will not approve the creation of a generic account for IFRS related impacts on P&OPEB accounts occurring at the date of transition. As acknowledged by the

CLD, the impacts are anticipated to be significant for only a few large utilities. The option remains for these utilities to seek an individual account if they can demonstrate the likelihood of a large cost impact upon transition to IFRS.

Following these developments, and pursuant to the Board's direction set out above with respect to IFRS related impacts, THESL requests that the OEB establish a parallel deferral account to record certain accounting differences between Canadian Generally Accepted Accounting Principles ("CGAAP") and U.S. GAAP, effective January 1, 2012 with 2011 comparatives. As noted above, these differences pertain to post-employment benefits. The requested deferral account would record these accounting differences resulting from both the transition to and the implementation of U.S. GAAP. An explanation of these differences and their impacts on utility revenue requirements and ratemaking is set out below.

Illustrative example under CGAAP

Under CGAAP, the excess of the net actuarial gains or losses which exceed 10% of the accrued benefit obligation is amortized into expense over the average remaining service period of active employees to full eligibility. Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

Liability section of the Balance Sheet	$
Accrued benefit obligation	**(100)**
Less: unamortized actuarial losses[1]	**20**
Less: unamortized past service costs[1]	**10**
Post-retirement benefits liability	**(70)**

Illustrative example under U.S. GAAP

In accordance with ASC 715-60, *Defined Benefits Plans, Other Postretirement*, all actuarial gains and losses and prior service costs are fully recognized in Accumulated Other Comprehensive Income ("AOCI") under U.S. GAAP. This results in the full recognition of the benefit obligation (or the funded status) as a liability on the balance sheet.

Liability section of the Balance Sheet	$
Accrued benefit obligation[2]	**(100)**
Post-retirement benefits liability[2]	**(100)**

Equity section of the Balance Sheet	$
Actuarial losses	**20**
Prior service costs	**10**
Accumulated other comprehensive income	**30**

The net impact to the Balance Sheet is the same as the illustrative example under CGAAP of -$70. The U.S. GAAP difference is a matter of location and no measurement differences are expected.

[1] Not all actuarial gains or losses are recognized on the balance sheet. The excess of the net actuarial gains or losses over the 10% corridor, and the past service costs are amortized into expense as noted above.
[2] The accrued benefit obligation is equal to post-retirement benefits liability since there is no adjustment for the actuarial losses and prior service costs. Instead, they are fully recognized in AOCI.

Illustrative example for rate-regulated entities under U.S. GAAP

ASC 980-715-25-5 specifically allows for the recognition of a regulatory asset for post-retirement benefit differences under THESL's circumstances. The facts considered include the assumption that it is probable for the amount to be recovered in the future and THESL's post-retirement benefits liability has been accounted for on an accrual basis.

Asset section of the Balance Sheet	$
Regulatory asset[3] *(proposed deferral account)*	**30**

Liability section of the Balance Sheet	$
Accrued benefit obligation	**(100)**
Post-retirement benefits liability	**(100)**

Equity section of the Balance Sheet	$
Actuarial losses	**20**
Prior service costs	**10**
Reclassified to regulatory assets	**(30)**
Accumulated other comprehensive income	—

As illustrated above, this is solely a difference in location on the balance sheet and no impact is expected in profit and loss. Accordingly, THESL does not expect any rate impact as a result of the recognition of this deferral account. The fluctuation within this deferral account is driven by the actuarial determination of actuarial gains and losses and prior service costs for the period. Under U.S. GAAP, recoveries of the amounts in this deferral account happen in the same manner as they do currently under CGAAP, as the amount in AOCI (reclassified to a regulatory asset) is amortized through profit and loss in the current service cost. Accordingly, the establishment of this deferral account will not impact rates for rate payers.

THESL's post-retirement benefit difference between CGAAP and U.S. GAAP is estimated to be approximately $30 million as at January 1, 2011. Given that CGAAP is no longer available beyond December 31, 2011, a transition to a different accounting standard is externally imposed on THESL and clearly outside of management's control. The establishment of a deferral account to manage U.S. GAAP differences is justified and consistent with the OEB's principles governing the transition to a different regulatory accounting standard.

THESL is therefore requesting establishment of a deferral account to accumulate the differences between Canadian and U.S. GAAP.

Please direct any correspondence on this matter by regular mail or by e-mail to regulatoryaffairs@torontohydro.com.

Yours truly,

[original signed by]

JS Couillard
Chief Financial Officer

[3] The impact to AOCI is reclassified to a regulatory asset. The net impact to the Balance Sheet remains at -$70.