

1 OPERATING ENVIRONMENT

2
3 Toronto Hydro-Electric System Limited (“Toronto Hydro”) is the electricity distributor
4 licensed (ED-2002-0497) by the Ontario Energy Board (“OEB”) to serve the City of
5 Toronto. Toronto Hydro is the successor to the six former hydro-electric commissions of
6 the municipalities which amalgamated on January 1, 1998 to form the City of Toronto.
7 For information about Toronto Hydro’s Corporate Structure and Governance, please refer
8 to Exhibit 1C, Tab 2.
9

10 Toronto Hydro is the second largest municipal electrical distribution utility in North
11 America and serves the largest city in Canada. In 2013, Toronto Hydro distributed 24.4
12 terawatt-hours of electricity representing approximately 18 percent of the electricity
13 consumed in the province of Ontario, and served a peak demand of 4,914 megawatts.
14

15 Toronto Hydro services two distinct customer demographic areas: an urban center in
16 downtown Toronto, and a suburban area around downtown Toronto, which is often
17 referred to as the Horseshoe area. In total, Toronto Hydro has a total of approximately
18 730,000 customers in various classes, ranging from residential to general service and
19 large use.¹
20

21 The utility’s service area includes some of Canada’s largest banks, stock exchanges,
22 major manufacturers, and other large customers that are sensitive to service interruptions.
23 This includes data centres, manufacturing facilities, numerous hospitals, healthcare and
24 long-term care facilities, schools, colleges and universities. Toronto Hydro also supplies
25 electricity to Ontario’s Provincial Legislature and Ministries, as well as Toronto’s
26 municipal government.

¹ Toronto has over 2,900 high-rise multi-residential condominium and apartment building accounts, many of which are “bulk-metered”. Taking these bulk-metered multi-residential buildings into account, Toronto Hydro’s effective customer count exceeds 1 million customers.

Toronto Hydro's distribution system consists of a mix of overhead, underground, secondary network and stations infrastructure. These systems operate at voltages of 27.6kV, 13.8kV, or 4.16kV, and distribute power through a complex network of approximately 175,000 poles, 60,600 distribution transformers, 16,000 primary switches, 15,000 km of overhead conductors and 11,200 km of underground cables. This network is composed of assets of varying vintages and types, reflective of the historical standards employed by the six pre-amalgamated utilities.

1. SERVICE TERRITORY

The City of Toronto is bounded by Lake Ontario to the South, Steeles Ave to the North, Mississauga (mainly Highway 427) to the West, and Scarborough/Pickering Townline to the East. A service territory map is filed at Exhibit 1C, Tab 1, Schedule 2.

2. NEIGHBOURING UTILITIES

Toronto Hydro's neighbouring electric distribution utilities are:

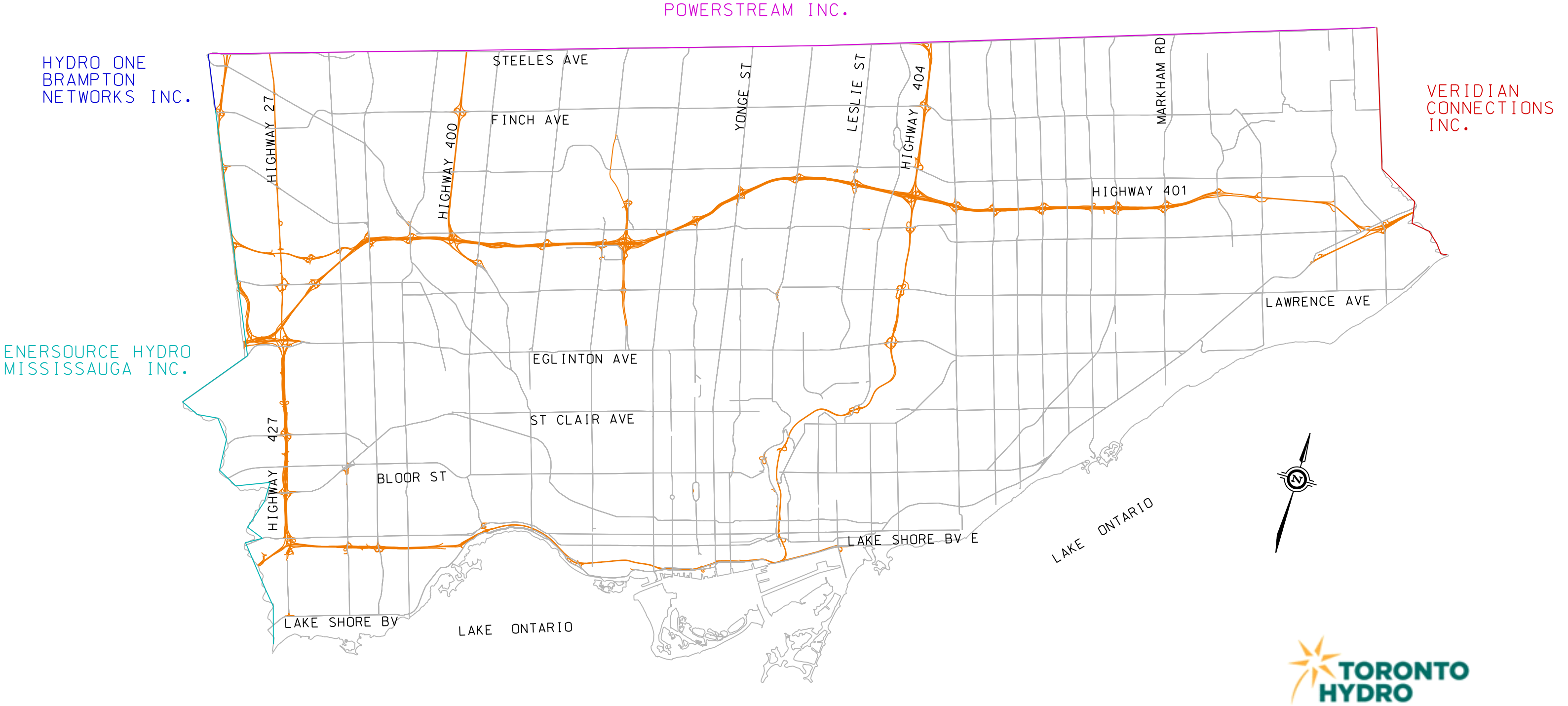
- To the west, Enersource Hydro Mississauga;
- To the north-west, Hydro One Brampton;
- To the north, PowerStream Inc.; and
- To the east, Veridian Connections Inc.

Toronto Hydro is not a host utility and there are no embedded utilities in Toronto Hydro's distribution service area.

3. TRANSMISSION ASSETS DEEMED DISTRIBUTION ASSETS

Toronto Hydro owns two transmission system terminal stations (one operational, one under construction) that have been deemed distribution assets, namely Cavanagh TS and Copeland TS, respectively. Toronto Hydro is not proposing any additional assets to be deemed as distribution assets as part of this application.

TORONTO HYDRO SERVICE TERRITORY



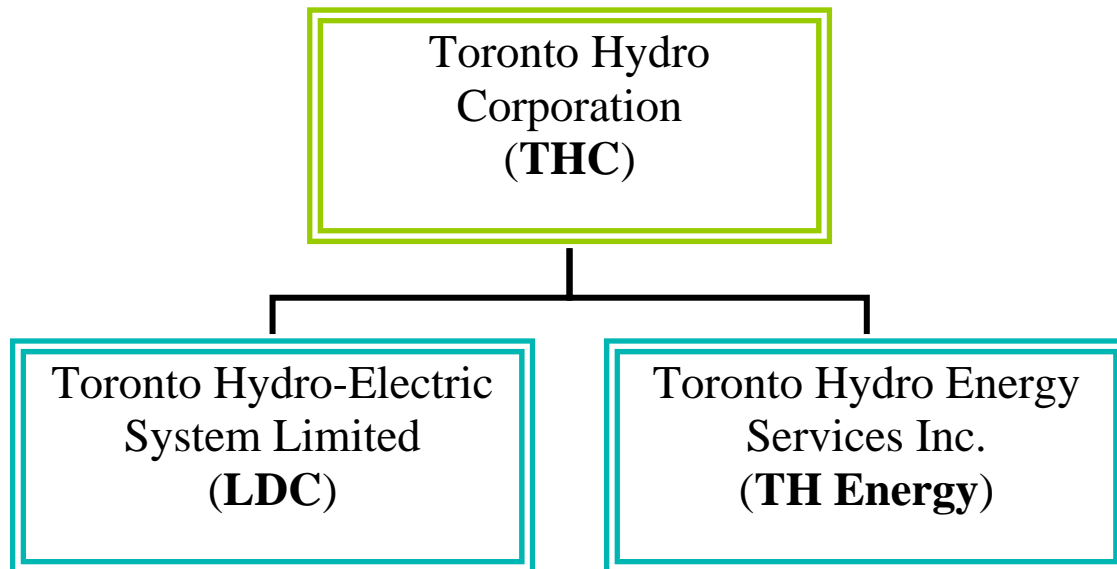
CORPORATE STRUCTURE AND GOVERNANCE

In accordance with s. 2.4.5 of the OEB's Filing Requirements for Electricity Distribution Rate Applications (July 17, 2013) (the "Filing Requirements"), this schedule provides information about Toronto Hydro's corporate structure organization and corporate governance framework. The schedule includes the following appendices:

- Appendix A: City of Toronto Shareholder Direction
- Appendix B: Mandate of the THC Board of Directors
- Appendix C: Mandate of the LDC Board of Directors
- Appendix D: Code of Business Conduct
- Appendix E: Audit Committee Charter
- Appendix F: Governance Committee Charter
- Appendix G: Human Resource Committee Charter

1. CORPORATE STRUCTURE

Toronto Hydro Corporation ("THC") is a holding company, the sole shareholder of which is the City of Toronto, and which wholly owns two subsidiaries (Figure 1): Toronto Hydro-Electric System Limited ("LDC"), a local distribution company which distributes electricity and engages in conservation and demand management ("CDM") activities; and Toronto Hydro Energy Services Inc. ("TH Energy"), a company which provides street lighting services in the City of Toronto.



1 **Figure 1: Toronto Hydro Corporate Organization Chart**

2 The principal business of THC and its subsidiaries is the distribution of electricity by the
3 LDC. THC was formed by amalgamation with a wholly-owned subsidiary under the
4 Business Corporations Act (Ontario) ("OBICA") on January 1, 2011. The predecessor
5 corporation to THC was originally incorporated under the OBICA on June 23, 1999.

6

7 LDC owns and operates an electricity distribution system, which delivers electricity to
8 approximately 730,000 customers located in the City of Toronto. LDC is the largest
9 municipal electricity distribution utility in Canada and distributes approximately 18% of
10 the electricity consumed in Ontario. LDC was formed by amalgamation with 1798594
11 Ontario Inc. under the OBICA on January 1, 2012. The predecessor corporation to LDC
12 was originally incorporated under the OBICA on June 23, 1999.

13

14 TH Energy was incorporated under the OBICA on June 23, 1999, and currently holds
15 electricity retailer and generator licences, and provides street lighting and expressway
16 lighting services.

17

1.1. Executive Team

THC'S executive team is comprised of the Executive Vice-President and Chief Financial Officer ("CFO") and Executive Vice-President, Chief Regulatory Officer and General Counsel, both of whom are accountable to the President and Chief Executive Officer ("CEO") of THC. The CEO of THC is also the President and CEO of the LDC and of TH Energy.

The LDC's executive management team consists of the following positions that are overseen directly by the President and CEO:

- Executive Vice-President and Chief Financial Officer, who is also an executive member of THC and of TH Energy;
- Executive Vice-President and Chief Business Development Officer;
- Executive Vice-President and Chief Engineering and Construction Officer;
- Executive Vice-President and Chief Electric Operations and Procurement Officer;
- Executive Vice-President and Chief Information and Risk Officer;
- Executive Vice-President and Chief Customer Care and Conservation Officer;
- Executive Vice-President and Chief Human Resources and Safety Officer; and
- Executive Vice-President, Chief Regulatory Officer and General Counsel, who is also an executive member of THC and of TH Energy.

2. CORPORATE GOVERNANCE

2.1. Securities Law Requirements

As a venture issuer (i.e., a reporting issuer that does not have any of its securities listed or quoted on the TSX or other marketplace), THC must comply with certain corporate governance and public disclosure requirements under applicable securities legislation.

1 These requirements make THC's operations, finances and governance practices subject to
2 scrutiny from both the Ontario Securities Commission ("OSC") and the public.

3
4 THC fulfills and routinely "over" complies with its securities law corporate governance
5 and disclosure obligations. For example, as a venture issuer, THC is exempt from the
6 requirements of Part 3 of National Instrument 52-110, which mandates the composition
7 of an issuer's audit committee. Nonetheless, THC's audit committee meets all of the
8 mandated requirements: it is composed of a minimum of three directors, and every audit
9 committee member is a director of THC, is independent and is financially literate.

10
11 In addition, although THC is not required to file an Annual Information Form ("AIF")
12 under National Instrument 51-102, THC has filed an AIF in respect of the financial years
13 ended December 31, 2004 through December 31, 2013. THC's AIF discloses material
14 information about THC and its business to the public, including information about
15 operations, prospects, risks, governance and other factors that impact business. A copy
16 of THC's 2013 AIF is filed at Exhibit 1C, Tab 4, Schedule 5.

17
18 In addition, to comply with National Instrument 58-101, THC provides extensive
19 corporate governance disclosure in its AIF and annual Management Discussion and
20 Analysis ("MD&A"). Such disclosure includes details about the following:

- 21 1) how the Board of Directors facilitates its exercise of independent supervision over
22 management, including the identity and independence of its directors other
23 reporting issuer directorships that its directors hold;
- 24 2) Board of Directors orientation and continuing education;
- 25 3) the promotion of ethical business conduct;
- 26 4) the process for nominating new directors;
- 27 5) the process of determining CEO and director compensation;
- 28 6) standing committees and their functions; and

1 7) how the Board of Directors assesses whether it is performing effectively.

2

3 The Board of Directors' decision to provide more extensive disclosure than required
4 under securities legislation demonstrates the Board's commitment to providing effective,
5 independent and rigorous oversight of the Company. The enhanced level of disclosure
6 increases the transparency of the Company's operations and affairs, and facilitates
7 effective monitoring of management by the Board and other stakeholders.

8

9 As a financial oversight measure, and to comply with certification requirements in
10 National Instrument 52-109, all of THC's interim financial statements, interim MD&As,
11 AIFs, annual financial statements and annual MD&As are certified by the CEO and CFO.
12 The CEO and CFO certify that the filings do not contain any misrepresentations and
13 fairly present the financial condition, results of operations and cash flows of THC as of
14 the date of and for the periods presented in the filings. The certification process is one
15 example of the Utility's system of internal checks and balances that fosters a culture of
16 accountability amongst senior management.

17

18 **2.2. Shareholder Direction**

19 As the sole shareholder of THC, the City of Toronto (the "Shareholder" or the "City")
20 has adopted a Shareholder Direction (see Appendix A to this schedule) which establishes,
21 amongst other things, the following objectives and fundamental principles that govern the
22 operations of the Company:

- 23 (a) to operate the Company on an efficient and commercially prudent basis;
- 24 (b) to optimize the Shareholder's return on equity and operate the Company with a
25 view to meeting the financial performance objectives of the Shareholder as set out
26 in the Shareholder Direction;
- 27 (c) to provide a reliable, effective and efficient electricity distribution system that
28 supports the electricity demands of residents and businesses in the City;

- 1 (d) to operate the Company in an environmentally responsible manner consistent with
2 the City's energy, climate change and urban forestry objectives and, as
3 appropriate, utilizing emerging green technologies;
4 (e) to ensure that the business is managed in material compliance with all Law; and
5 (f) to engage in recruitment and procurement practices designed to attract employees
6 and suppliers from the City's diverse community.

7
8 The Board of Directors is responsible for determining and implementing the appropriate
9 balance among these principles. Ultimately, the City requires THC to operate on a
10 commercially prudent and profitable basis in compliance with law, and expects the Board
11 of Directors to provide stewardship and independently oversee management and
12 operations in accordance with best corporate governance practices.

13 14 **2.3. Board of Directors**

15 THC's Board of Directors consists of 11 directors, all of whom are appointed by THC's
16 sole shareholder, the City. Of the 11 directors, one director is the Mayor of the City (or a
17 member of City Council whom the Mayor recommends as his or her designate and who is
18 appointed by City Council), two are members of City Council, and eight directors are
19 independent residents of the City.

20
21 The LDC's Board of Directors currently consists of two directors. Of those two
22 directors, one is a member of the Board of Directors of THC and one is an individual who
23 is not a member of any affiliate of the LDC, in accordance with the independence
24 requirements set out by the OEB in the Affiliate Relationships Code ("ARC").

25 26 **2.3.1. Nomination of Directors**

27 Pursuant to the Shareholder Direction, the City appoints directors who collectively
28 represent a range of expertise including:

- 1 (a) experience on a public utility commission or board of a major corporation or other
2 commercial enterprise;
3 (b) experience or knowledge with respect to:
4 i. corporate finance;
5 ii. corporate governance;
6 iii. market development;
7 iv. large system operation and management;
8 v. urban energy industries;
9 vi. public policy issues and the law relating to the Company and the
10 electricity industry;
11 vii. environmental matters;
12 viii. labour relations;
13 ix. occupational health and safety issues;
14 (c) commercial sensitivity and acumen;
15 (d) independence of judgment;
16 (e) personal integrity; and
17 (f) at least three directors with financial management expertise.
18

19 The City utilizes a board skills and competencies matrix, as reviewed and recommended
20 to the City by the Board's Chair, in the evaluation of potential THC Board of Directors
21 members. The matrix's design reflects best practices for directors as recommended by
22 the Institute of Corporate Directors.
23

24 THC appoints the LDC's Board of Directors from among the directors of THC and
25 independent residents of the City. When appointing directors of the LDC, THC ensures
26 that the directors have a mix of competencies and skills necessary to enable Toronto
27 Hydro's Board of Directors to properly discharge their responsibilities.
28

1 **2.3.2. Exercise of Independent Judgment**

2 The Board of Directors for each of THC and LDC has a number of practices and policies
3 in place to facilitate its ability to act independently of senior management and to ensure
4 that its behaviour and decision-making processes are objective, responsible and effective.

- 5 • *In Camera Board Meetings:* Each of the Boards of Directors meets regularly in
6 the absence of management to discuss the management of THC and LDC
7 respectively.
- 8 • *Outside Advisors:* Under its mandate, each of the Board of Directors is
9 authorized to retain independent legal counsel and other outside advisors if it
10 considers this appropriate.
- 11 • *Internal Audit Function:* The internal audit department provides each of the
12 Boards of Directors with an objective view of the Company's risk management,
13 governance and internal control systems. The internal audit department's work is
14 overseen by the Audit Committee of the Board of Directors of THC. To facilitate
15 independence, the Director of Internal Audit has unrestricted access to any
16 member of the Board of Directors of THC or LDC, as required. THC's external
17 auditor reviews the competency and work of the internal audit department.
- 18 • *Corporate Governance Committee:* The Corporate Governance Committee of the
19 Board of Directors of THC oversees and evaluates the exercise of independent
20 judgment by the Board of Directors and its committees.

21
22 **2.3.3. Board of Directors Mandate**

23 The Board of Directors for each of THC and LDC has adopted a mandate on August 15,
24 2013 which is reviewed every two years and revised as required. The most recent
25 Mandate of the Board of THC is filed at Appendix B to this schedule, and the Mandate of
26 the Board of LDC is filed at Appendix C.

2.3.4. Schedule of Board of Directors Meetings

The schedule for THC's Board of Directors Meetings is as follows:

2013	2014
January 30, 2013	February 6, 2014
February 28, 2013	March 19, 2014
May 16, 2013	May 15, 2014
June 7, 2013	August 14, 2014
August 15, 2013	November 13, 2014
November 15, 2013	

The schedule for the LDC's Board of Directors Meetings is as follows:

2013	2014
February 28, 2013	March 19, 2014
August 15, 2013	March 24, 2014

2.3.5. Orientation and Continuing Education

Upon joining the Board of Directors of THC and/or LDC, each new director is given a set of materials designed to provide him/her with a summary of the key organizational, financial, regulatory, reporting and operational aspects of the Company. Directors have access to a variety of internal and external resources on topics related to THC's and LDC's businesses, as well as relating to the responsibilities of directors such as fiduciary obligations, issues of confidentiality and privilege, and public disclosure and whistle blowing requirements. Directors also have the opportunity to attend continuing education programs run by outside service providers such as the Institute of Corporate Directors designation program.

2.3.6. Ethical Business Conduct

All employees, officers and directors of THC and LDC are required to comply with the principles set out in the Code of Business Conduct (the "Code"), which is filed as Appendix D to this evidence. The Code was implemented in 2004, and is periodically

1 reviewed and re-approved by the Board of Directors of THC. The Code of Business
2 Conduct is included in new directors' orientation materials and each director signs an
3 acknowledgement that he or she will comply with the Code.

4
5 The Code provides for the appointment of an Ethics Officer and establishes a direct
6 hotline to the Ethics Officer through which perceived violations of the principles set out
7 in the Code may be raised, anonymously or otherwise. The Ethics Officer is accountable
8 to the Audit Committee.

9
10 **2.3.7. Board Committees**

11 THC's Board of Directors has established three standing committees: the Audit
12 Committee, the Corporate Governance Committee, and the Human Resources
13 Committee.

- 14 • The **Audit Committee** oversees the adequacy and effectiveness of financial
15 reporting, accounting systems, internal financial control structures and financial
16 risk management systems. Among other things, the Audit Committee reviews
17 THC's quarterly and annual financial statements (as well as financial statements
18 prepared in connection with securities offerings or required by applicable
19 regulatory authorities), reviews the audit plans of the external auditors, and
20 oversees the internal audit of THC. All of the members of the Audit Committee
21 are independent and financially literate in accordance with sections 1.4 and 3.1 of
22 National Instrument 52-110 on Audit Committees. The Audit Committee Charter
23 is attached as Appendix D to this schedule.
- 24 • The **Corporate Governance Committee** advises the Board of Directors with
25 respect to matters relating to the corporate governance of the Company, including
26 Board and committee composition and mandates, guidelines for assessing the
27 effectiveness of the Board and its committees, and procedures to ensure that the
28 Board functions independently from management. The Corporate Governance

1 Committee also reviews and approves all orientation and education materials and
2 programs for new and current directors undertaken by management. The
3 Governance Committee Charter is attached as Appendix E to this schedule.

- 4 • The **Human Resources Committee** assists the Board with the recruitment,
5 assessment and compensation of the CEO, reviews and approves the
6 compensation of the executive officer, oversees executive compensation
7 disclosure under applicable securities laws, and advises the Board of Directors
8 regarding the compensation structure, benefit plans and programs of Toronto
9 Hydro, as well as collective bargaining and environmental and health and safety
10 matters. The Human Resource Committee Charter is attached as Appendix F to
11 this schedule.

CITY OF TORONTO

AMENDED AND RESTATED SHAREHOLDER DIRECTION RELATING TO TORONTO HYDRO CORPORATION

**July 1, 1999 as amended and restated as of October 3, 2002,
as further amended as of October 1, 2004 , as further amended and restated as of June 27,
2006; and as further amended and restated as of October 23, 2007; and as further amended
and restated as of May 7, 8, 9 and 10, 2013**

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SHAREHOLDER DIRECTION

WHEREAS *Toronto Hydro* Corporation (the "**Corporation**") is a corporation existing under the *Business Corporations Act* (Ontario);

AND WHEREAS the *City of Toronto* (the "**Shareholder**") is the beneficial owner of all of the issued shares of the *Corporation*;

AND WHEREAS the *Corporation* and the *Subsidiaries* (together, "*Toronto Hydro*") are the successors to the business of Toronto Hydro Electric Commission;

AND WHEREAS *Toronto Hydro's* business (the "**Business**") is integral to the well-being and infrastructure of the City of Toronto;

AND WHEREAS the *Business* is subject to the provisions of the *Electricity Act, 1998* and the *Ontario Energy Board Act, 1998*, as such statutes may be amended or re-enacted from time to time;

AND WHEREAS the *Corporation* is a reporting issuer subject to *Securities Rules* (as herein defined);

AND WHEREAS the *Shareholder* wishes to establish certain principles of governance relating to *Toronto Hydro*;

NOW THEREFORE THIS SHAREHOLDER DIRECTION IS HEREBY AMENDED AND RESTATED AND WITNESSES AS FOLLOWS:

ARTICLE 1 INTERPRETATION

1.1 Definitions

In this *Shareholder Direction*, in addition to the terms defined in the recitals, the following terms will have the meanings set out below:

"Affiliate Relationships Code" means the *Ontario Energy Board* Affiliate Relationships Code For Electricity Distributors and Transmitters, as amended from time to time;

"Associate" means a *Person* that is associated with the *Corporation* or any *Subsidiary* as such relationship is defined in the *OBCA*;

"Auditor General" means the *City of Toronto's* Auditor General or his/her designate or any *Person* acting in that capacity;

"Board" means the board of directors of the *Corporation*;

"Body Corporate" means a firm, partnership, unincorporated association, joint venture, body corporate, corporation, bank, trust, pension fund, union, governmental agency, board, tribunal, ministry or commission or other legal entity of any kind whatsoever, but excludes an individual or natural person;

"Business Plan" means the business plan referenced in Section 9.1

"Chair" means the Chair of the *Board*;

"Citizen Directors" means the citizen directors referenced in Section 5.1;

"City Authorized Representative" means the City authorized representative referenced in Section 9.3;

"City CFO" means the *City of Toronto's* Deputy City Manager and Chief Financial Officer or the *Person* acting in that capacity or his/her designate;

"City Chief Corporate Officer" means the *City of Toronto's* Chief Corporate Officer or the *Person* acting in that capacity or his/her designate;

"City Council" means the Council of the *City of Toronto* when exercising its authority in its capacity as a municipal government or as the *Shareholder* of the *Corporation*;

"City Council Directors" means the *City Council* directors as referenced in Section 5.1;

"City Liaison" means the City officer or delegated staff member referenced in Section 8.2;

"City of Toronto" means the municipal corporation continued under the *City of Toronto Act, 2006*;

"City Manager" means the *City of Toronto's* City Manager or the *Person* acting in that capacity or his/her designate;

"Directed by Council" means a direction from *City Council*, acting on behalf of the *City of Toronto* in its capacity as *Shareholder*, to the *Corporation*, which direction shall be in the form of a recommendation or resolution adopted by *City Council* which directs the *Corporation* as it applies to the *Corporation* or any of its *Subsidiaries*, and subject to *Law*, in making any direction *City Council* shall take into consideration the objectives and principles set out in Section 2.2.2 herein;

"Distribution Company" means any one or more *Subsidiaries* licensed to own or operate an electricity distribution system under the *Ontario Energy Board Act, 1998*;

"Energy Services" means Toronto Hydro Energy Services Inc.;

“Executive Compensation Information” means, for all of the officers of the *Corporation*, the same executive compensation information as is required to be disclosed by the *Corporation* for its Named Executive Officers in the Summary Compensation Table of its Annual Information Form pursuant to Form 51-102F6 (Statement of Executive Compensation) issued under the National Instrument 51-102 (Continuous Disclosure Obligations);

“Financial Statements” means, for any particular period, the audited or unaudited (as stipulated in this *Shareholder Direction*), consolidated or unconsolidated (as stipulated in this *Shareholder Direction*), comparative financial statements of the *Corporation* or its *Subsidiaries*, as applicable, consisting of not less than a balance sheet, a statement of income and retained earnings, a statement of changes in financial position, a report or opinion of the auditor (in the case of audited *Financial Statements*) and such other statements, reports, notes and information prepared in accordance with accounting principles as permitted at *Law*;

“Governmental Authority” means a federal, provincial, state, regional, municipal or local government, domestic or foreign, including any entity, *Person*, court or other body or organization exercising executive, legislative, judicial, regulatory or administrative functions of, or pertaining to, any such government;

“Law” means any statute, law, ordinance, rule, regulation, restriction, code, regulatory policy or guideline or order of any *Governmental Authority*, including without limitation all *Securities Rules* and all applicable by-laws or rules of any *Regulator*;

“Lien” means any mortgage, hypothec, assignment, encumbrance, lien or security interest, regardless of form, that secures the payment of any indebtedness or liability or the observance or performance of any obligation;

“OBCA” means the *Business Corporations Act* (Ontario), as amended or re-enacted from time to time;

“Ontario Energy Board” or ***“OEB”*** means the Ontario Energy Board, or its successor;

“Ontario Energy Board Act, 1998” or ***“OEB Act”*** means the *Ontario Energy Board Act, 1998* (Ontario), as amended or re-enacted from time to time;

“Person” means an individual, limited liability company, unincorporated syndicate, unincorporated organization, *Body Corporate* or *Governmental Authority*;

“Receiving Party” means the receiving party as referenced in Sections 4.4 and 6.3;

“Regulator” means the *Ontario Energy Board*, the Ontario Securities Commission and each other *Governmental Authority* having jurisdiction over *Toronto Hydro* or the *Business*, and any successor(s) thereto;

"Securities Rules" means all statutes, laws, ordinances, rules, regulations, restrictions, instruments, codes, regulatory policy or guidelines applicable to the *Corporation* as a reporting issuer under the *Securities Act* (Ontario), as amended from time to time;

"Shareholder" means the *City of Toronto* as the beneficial owner of all of the issued shares of the *Corporation*, exercising its authority as *Shareholder* through *City Council*;

"Shareholder Direction" means this Shareholder Direction Relating to Toronto Hydro Corporation dated as of July 1, 1999, as amended and restated from time to time; and

"Subsidiary" means, with respect to the *Corporation*, any *Body Corporate* of which more than 50% of the outstanding securities of any class carrying exercisable voting rights are beneficially owned, directly or indirectly, by the *Corporation*, and includes any *Body Corporate* in like relation to a *Subsidiary*.

1.2 City Authorized Representative, City Council, City of Toronto and Shareholder

- a) Wherever there is a reference to a *City Authorized Representative* in this *Shareholder Direction*, that reference shall be deemed to include any individual acting in that capacity or any successor *City Authorized Representative* duly appointed or designated by the *City of Toronto* as being responsible for that office.
- b) In this *Shareholder Direction* the use of the terms *City Council*, *City of Toronto* and *Shareholder* shall be interpreted to reflect the actions or authority of the municipal government, municipal corporation or the corporate shareholder as reasonably indicated by the context.

1.3 Calculation of Time

In this *Shareholder Direction*, a period of days will be deemed to begin on the first day after the event which began the period and to end at 5:00 p.m. (Toronto time) on the last day of the period. If, however, the last day of the period does not fall on a business day, the period will terminate at 5:00 p.m. (Toronto time) on the next business day.

1.4 Regulatory Matters

In the event of any conflict between any approval or matter *Directed by Council* or other requirement of the *Shareholder* under this *Shareholder Direction* and any decision, order or policy of any *Regulator*, the decision, order or policy of the *Regulator* shall govern and *Toronto Hydro* will at all times comply with any decision, order or policy of the *Regulator* whether or not an approval or matter *Directed by Council* has first been given in respect thereof by the *Shareholder* under this *Shareholder Direction*. For greater certainty, *Toronto Hydro* will not seek any order from any *Regulator* for any matter that would require the approval of the *Shareholder* under this *Shareholder Direction* without first giving notice of its intention to seek such an order to the *Shareholder*.

ARTICLE 2 OBJECTIVES AND PRINCIPLES

2.1 Purposes

The purposes of this *Shareholder Direction* are as follows:

- a) subject to the *Board's* authority to manage or supervise the management of the business and affairs of the *Corporation*, to provide the *Board* with the *Shareholder's* fundamental principles regarding the *Business*;
- b) to inform the residents of the *City of Toronto* of the *Shareholder's* fundamental principles regarding the *Business*; and
- c) to set out the accountability, responsibility and relationship between the *Board* and the *Shareholder*.

2.2 Shareholder Objectives and Principles

2.2.1 Subject to *Law*, the *Corporation* shall and shall direct its *Subsidiaries* to conduct their affairs and govern their operations in accordance with such rules, policies, directives or objectives as *Directed by Council* from time to time.

2.2.2 The following objectives and principles shall govern the operations of *Toronto Hydro*:

- a) to operate *Toronto Hydro* on an efficient and commercially prudent basis;
- b) to optimize the *Shareholder's* return on equity and operate *Toronto Hydro* with a view to meeting the financial performance objectives of the *Shareholder* as set out in this *Shareholder Direction*;
- c) to provide a reliable, effective and efficient electricity distribution system that supports the electricity demands of residents and businesses in the *City of Toronto*;
- d) to operate *Toronto Hydro* in an environmentally responsible manner consistent with the *City of Toronto's* energy, climate change and urban forestry objectives and, as appropriate, utilizing emerging green technologies;
- e) to ensure that the *Business* is managed in material compliance with all *Law*; and
- f) to engage in recruitment and procurement practices designed to attract employees and suppliers from the *City of Toronto's* diverse community.

- 2.2.3 The *Board* is responsible for determining and implementing the appropriate balance among the objectives and principles in Section 2.2.2 and for causing *Toronto Hydro* to conduct its affairs in accordance with the same.

ARTICLE 3 BUSINESS OF TORONTO HYDRO

3.1 Business of Toronto Hydro

Subject to *Law* and the ongoing ability of the *Corporation* and the *Subsidiaries* to meet the financial objectives of the *Shareholder* set out in this *Shareholder Direction* and the ability of the *Board* to demonstrate the same, the *Corporation* may engage in, and may authorize the *Subsidiaries*, to engage in, any of the business activities permitted by the *Ontario Energy Board Act, 1998*, as may be amended from time to time. Without limiting the foregoing, and for ease of reference, an extract of the relevant provisions of the *Ontario Energy Board Act, 1998* is attached as Appendix A to this *Shareholder Direction*.

ARTICLE 4 BOARD OF DIRECTORS

4.1 Responsibilities of the Board of Directors

Subject to *Law* and any matters requiring approval of the *Shareholder* pursuant to this *Shareholder Direction*, the *Board* is responsible for supervising the management of the business and affairs of the *Corporation*, including the following specific matters:

- a) establishing sound financial principles and performance objectives;
- b) approving any dividend payment or distribution of capital;
- c) appointing the officers of the *Corporation*;
- d) approving the overall business strategy and related *Business Plan*;
- e) approving the financing strategy, including the selection of financial institutions and related banking authorities;
- f) directing labour and employee relations matters; and
- g) approving the financial statements in accordance with the requirements of the *OBCA*.

4.2 Committees of the Board

The *Board* may form committees and delegate such decision making or other responsibilities to the committees, as permitted by *Law*, from time to time.

The committee of the *Board* responsible for compensation related matters shall include at least one *City Council Director*.

4.3 Conflict of Interest Policy

The directors and officers of the *Corporation* will strictly abide by the requirements of the *OBCA* and the *Corporation* in respect of conflicts of interest, including any requirements in respect of disclosure and abstention from voting.

4.4 Confidentiality

The *Shareholder* and the directors and officers of the *Corporation* will ensure that no confidential information of the *Shareholder* or *Toronto Hydro* is disclosed or otherwise made available to any *Person*, except to the extent that:

- a) disclosure to a *Receiving Party's* employees or agents is necessary for the performance of any *Receiving Party's* duties and obligations under this *Shareholder Direction*;
- b) disclosure is required in the course of any legal or regulatory proceedings or actions or pursuant to any *Law*; or
- c) the confidential information becomes part of the public domain (other than through unauthorized disclosure by the *Receiving Party*).

ARTICLE 5 BOARD STRUCTURE

Without restricting the rights of the *Shareholder*, this article provides information regarding *City Council's* "Public Appointments Policy" and "Policy on Board Governance Structures" as amended from time to time.

5.1 Composition of the Board

5.1.1 The *Board* will be composed of eleven (11) directors comprising:

- a) the Mayor of the *City of Toronto* or a member of *City Council* whom the Mayor recommends as his/her designate and who is appointed by *City Council*;

- b) two (2) members of *City Council* (together with the Mayor or Mayor's Designate, the "*City Council Directors*"); and
- c) eight (8) residents of Toronto who are not elected officials or employees of the *City of Toronto* or any of its agencies or corporations ("*Citizen Directors*"), one of whom shall be the *Chair*.

5.1.2 The *Shareholder* shall appoint all members of the *Board* of the *Corporation*.

5.1.3 The *Chair* of the *Board* shall be appointed by the *Board* upon the nomination of the *Shareholder* from time to time.

5.2 Qualifications of Directors

In addition to the general eligibility requirements as set out at *Law* (including without limitation the *OBCA* and *Securities Rules*) and in the *City of Toronto's* "Public Appointments Policy" and "Policy on Board Governance Structures", as amended by *City Council* from time to time, *Board* members should collectively represent a range of expertise including:

- a) experience on a public utility commission or board of a major corporation or other commercial enterprise;
- b) experience or knowledge with respect to:
 - i. corporate finance;
 - ii. corporate governance;
 - iii. market development;
 - iv. large system operation and management;
 - v. urban energy industries;
 - vi. public policy issues and the *Law* relating to Toronto Hydro and the electricity industry;
 - vii. environmental matters;
 - viii. labour relations;
 - ix. occupational health and safety issues
- c) commercial sensitivity and acumen;
- d) independence of judgment;
- e) personal integrity; and
- f) at least three directors with financial management expertise.

5.3 Vacancies

If a member of the *Board* ceases to be a director for any reason, the *Shareholder* will fill the vacancy created thereby as soon as reasonably possible.

5.4 Term

- a) The term for *City Council Directors* shall be two (2) years. Incumbent *City Council Directors* may be reappointed by the *Shareholder*, for such consecutive terms as the *Shareholder* may determine, in its discretion.
- b) The term for *Citizen Directors* shall be two (2) years. Incumbent *Citizen Directors* may be reappointed by the *Shareholder*, at its discretion, for an additional term without a formal *Citizen Director* recruitment process. Where any *Citizen Director* has served for two (2) consecutive terms, or a total of four (4) consecutive years, then the *Shareholder* shall proceed with a formal *Citizen Director* recruitment process prior to reappointing an incumbent director for that position. The maximum number of consecutive two (2) year terms for any *Citizen Director* shall be four (4) terms for a maximum term of eight (8) consecutive years as a *Citizen Director*.
- c) Notwithstanding any of the foregoing, all directors are appointed at the pleasure of the *Shareholder* and the *Shareholder* may elect, in its discretion, to replace any appointed director at any time and for any reason. All directors shall continue to serve on the *Board* past the end of their term until such time as such successors are appointed by the *Shareholder*.

ARTICLE 6 SUBSIDIARIES

6.1 Boards of Directors of Subsidiaries

- a) Subject to *Law* and any matters requiring approval of the *Shareholder* pursuant to this *Shareholder Direction*, the *Corporation* shall cause the business and affairs of the *Subsidiaries* to be managed or supervised by their respective boards of directors.
- b) The *Board* will appoint the directors of the *Subsidiaries* from among the directors of the *Corporation*, provided however that the appointment of the directors of the *Distribution Company* shall be subject to and meet all requirements for independence as may be set out by the *Ontario Energy Board's Affiliate Relationships Code* as amended from time to time. Without limiting the foregoing, and for ease of reference, an extract of the relevant section of the *Affiliate Relationships Code* is attached as Appendix B to this *Shareholder Direction*.
- c) The *Chair* shall notify the *City Manager* of the names of, remuneration to be paid to, and the process used to select, any independent directors as required by the *OEB* from time to time.

6.2 Conflict of Interest Policy

The *Corporation* will cause the directors and officers of each *Subsidiary* to strictly abide by the requirements of the *OBCA* and the *Corporation* in respect of conflicts of interest, including any requirements in respect of disclosure and abstention from voting.

6.3 Confidentiality

The *Corporation* will cause the directors and officers of each *Subsidiary* to ensure (the *Shareholder* and the directors and officers of each *Subsidiary* are hereinafter referred to as a "*Receiving Party*"), that no confidential information of the *Shareholder* or *Toronto Hydro* is disclosed or otherwise made available to any *Person*, except to the extent that:

- a) disclosure to a *Receiving Party's* employees or agents is necessary for the performance of any *Receiving Party's* duties and obligations under this *Shareholder Direction*;
- b) disclosure is required in the course of any legal or regulatory proceedings or actions or pursuant to any *Law*; or
- c) the confidential information becomes part of the public domain (other than through unauthorized disclosure by the *Receiving Party*).

6.4 Vacancies

If a member of the *Board* of directors of any *Subsidiary* ceases to be a director for any reason, the *Corporation* will cause the vacancy to be filled by another director of the *Corporation* as soon as reasonably possible.

ARTICLE 7 BOARD REMUNERATION AND EXPENSE REIMBURSEMENT

7.1 Remuneration

- a) The *Chair* will receive remuneration in the amount of \$75,000 per annum; and
- b) Each director of the *Corporation*, other than the *Chair*, will receive remuneration in the amount of \$12,500 per annum plus:
 - (i) \$1,000 for each meeting of the *Board* attended;
 - (ii) \$1,000 for each meeting of the board of a *Subsidiary* attended, provided the meeting is other than on a day when there is a meeting of the *Board*; and
 - (iii) \$1,000 for each meeting of a committee of the *Board* attended, provided the meeting is other than on a day when there is a meeting of the *Board* and subject to an aggregate annual maximum of \$5,000 for meetings of committees of the *Board*.

- c) Notwithstanding any of the foregoing, *City Council Directors* will receive no remuneration and the maximum aggregate remuneration for a director other than the *Chair* is \$30,000 per annum.
- d) The remuneration of the directors of the *Corporation* for their respective services as directors will be as determined by the *Shareholder* under *City Council's* Board remuneration policy as amended from time to time.

7.2 Reimbursement Policy

The *Board* shall establish an expense reimbursement policy to provide for the reimbursement of out-of-pocket expenses for *Board* members while conducting *Board* business. Such policy shall require that the *Board* pre-approve the amount and reason for all major expenses for directors.

ARTICLE 8 SHAREHOLDER MATTERS

8.1 Decisions of the Shareholder

- a) Where the *Corporation* wishes or is required to obtain an approval or decision from the *Shareholder* pursuant to this *Shareholder Direction* or otherwise, the *Corporation* shall submit a written request to the appropriate *City Liaison* for the approval or decision which includes all information necessary for the *Shareholder* to make an informed decision.
- b) Where possible and permitted by *Law*, the *Corporation* shall submit its request and supporting information in a timely manner that enables the *City Liaison* to comply with deadlines for submission to *City of Toronto* Committees and *City Council*. The *City Manager* or the *City CFO*, as appropriate, shall determine how a particular matter for which approval or decision has been requested will proceed.

8.2 Liaison with the City

- a) For corporate governance matters requiring the *Shareholder's* approval, as set out in this *Shareholder Direction* or pursuant to the *OBCA*, and for all other day-to-day matters with respect to corporate governance, the designated *City Liaison* is the *City Manager*.
- b) For financial matters requiring the *Shareholder's* approval, as set out in Article 9 and Article 10, and for all other day-to-day financial matters, the designated *City Liaison* is the *City CFO*.
- c) For program matters concerning the *Corporation's* operations, and for all other day-to-day operational matters, the designated *City Liaison* is the *City Chief Corporate Officer*.

8.3 Matters Requiring Shareholder Approval under the OBCA

In accordance with the provisions of the *OBCA*, the *Corporation* shall not, and shall ensure that each *Subsidiary* does not, without the approval of the *Shareholder*:

- a) amend its articles or make, amend or repeal any by-law;
- b) amalgamate (except for an amalgamation with one or more *Subsidiaries*), apply to continue as a *Body Corporate* under the *Law* of another jurisdiction, merge, consolidate or reorganize, or approve or effect any plan of arrangement, in each case whether statutory or otherwise;
- c) take or institute proceedings for any winding up, arrangement, reorganization or dissolution;
- d) create new classes of shares or reorganize, consolidate, subdivide or otherwise change its outstanding securities;
- e) sell or otherwise dispose of, by conveyance, transfer, lease, sale and leaseback, or other transaction, all or substantially all of its assets or undertaking;
- f) change the auditor;
- g) make any change to the number of directors comprising the *Board*; or
- h) enter into any transaction or take any action that requires *Shareholder* approval pursuant to the *OBCA*.

8.4 By-Laws

Subject to *Law*:

- a) The *Board* may, by resolution, make, amend, or repeal any of its by-laws and the changes take effect at such time as the *Board* approves.
- b) Where the *Board* makes, amends or repeals a by-law, the *Board* shall submit the by-law, amendment or repeal to the *Shareholder* as soon as possible and by no later than the next *City Council* meeting, and the *Shareholder* may confirm, reject or amend the by-law, amendment or repeal.
- c) Where a by-law is made, amended or repealed by the *Board* under Section 8.4 (a), the by-law, amendment or repeal is effective from the date of the resolution of the *Board* until it is confirmed, confirmed as amended or rejected by the *Shareholder* under Section 8.4 (b) or until it ceases to be effective under Section 8.4 (d) and, where the by-law is confirmed or confirmed as amended, it continues in effect in the form in which it was so confirmed.
- d) If a by-law or an amendment or repeal of a by-law is rejected by the *Shareholder*, or if the *Board* does not submit the by-law, amendment or repeal to the *Shareholder* as required under

Section 8.4 (b), the by-law, amendment or repeal ceases to be effective on the date of such rejection or on the date of the meeting of the *Shareholder* at which it should have been submitted, as the case may be, and no subsequent resolution of the *Board* to make, amend or repeal a by-law having substantially the same purpose or effect is effective until it is confirmed or confirmed as amended by the *Shareholder*.

8.5 Other Matters Requiring Shareholder Approval

- a) Unless the *Shareholder* approves otherwise, the *Corporation* shall ensure that the *Distribution Company* does not:
 - (i) provide any financial assistance, whether by loan, guarantee or otherwise, to any *Person* other than in accordance with this *Shareholder Direction*;
 - (ii) create any *Lien* on its assets other than:
 - (1) any *Lien* in favour of the *Shareholder*;
 - (2) *Liens* securing purchase money obligations, trade debts or other liabilities incurred in the ordinary course of business (other than in relation to the borrowing of money) if the aggregate principal amount of such obligations does not exceed \$10,000,000 at any time;
 - (3) *Liens* securing credit facilities created or incurred for the purpose of providing operating financing for day-to-day working capital requirements of the *Distribution Company* if the aggregate principal amount of such credit facilities does not exceed \$100,000,000 at any time; or
 - (4) *Liens* held by any *Governmental Authority* that have not at the time been filed or registered against the title to the *Distribution Company's* assets or served upon the *Distribution Company* pursuant to *Law* or that relate to obligations of the *Distribution Company* that are not due or delinquent;
- b) unless the *Shareholder* approves otherwise, the *Corporation* shall not, and shall ensure that the *Subsidiaries* do not:
 - (i) provide any financial assistance, whether by loan, guarantee or otherwise, to any director or officer of the *Corporation* or of any *Subsidiary* or *Associate*;
 - (ii) invest funds in publicly-traded securities other than government debt, Canadian chartered bank or Canadian corporate securities rated less than A/R-1 (low) (or its equivalent) by Standard & Poor's, Dominion Bond Rating Service Limited; or Moody's;
 - (iii) acquire any interest in the distribution system, undertaking or securities of a distributor (as defined in the *Electricity Act, 1998*) operating outside of the municipal boundaries

of the *Shareholder* other than in accordance with Section 8.6 of this *Shareholder Direction*; and

- (iv) subject to Section 8.5, enter into any agreement, commitment or investment that provides recourse to the assets of the *Corporation* or the *Distribution Company* in favour of any third party in such assets;
- c) unless the *Shareholder* approves otherwise the *Corporation* shall not, and shall ensure that the *Distribution Company* does not:
 - (i) provide any financial assistance, whether by loan, guarantee or otherwise, to or make any investments, whether by loan, equity or otherwise, in any *Subsidiary* other than the *Distribution Company*, other than:
 - (1) trade payables incurred in the ordinary course of business on customary terms;
 - (2) that portion of any investment in any *Subsidiary* attributable to the value of the assets, property and undertaking of the business of the *Distribution Company* transferred by the *Distribution Company* to the *Subsidiary*;
 - (3) financial assistance to a *Subsidiary* provided to replace financial assistance provided to the *Distribution Company* in respect of a business of the *Distribution Company* transferred by the *Distribution Company* to the *Subsidiary*; and
 - (4) in accordance with this *Shareholder Direction*;

unless, after giving effect to the investment or financial assistance, the aggregate amount of all investments in and financial assistance to such *Subsidiaries* does not exceed 12% of *Shareholder's* equity in the *Distribution Company*, as shown on its most recent *Financial Statements*, and unless the investment or financial assistance is included in the *Business Plan*; provided that, in the case of the *Distribution Company*, the *Distribution Company* does not contravene the *Affiliate Relationships Code*.

For greater certainty, in this Section 8.5, the term "financial assistance" does not include remuneration paid in the normal course of business to directors, officers or employees, including honoraria, wages, salaries or bonuses, or any reimbursement for expenses arising from such *Person's* duties.

8.6 Acquisition of Distributor under Certain Conditions

The *Corporation* is authorized, and shall authorize the *Distribution Company*, to acquire any interest in the distribution system, undertaking or securities of a distributor (as defined in the *Electricity Act, 1998*) operating outside of the municipal boundaries of the *Shareholder*, provided that:

- a) the *Corporation* or the *Distribution Company*, as the case may be, has determined that the proposed acquisition presents a reasonable opportunity to create additional value in *Toronto Hydro* for the *Shareholder*;
- b) the *Shareholder's* dividend will not be adversely affected by the proposed acquisition, either in the immediate or long term;
- c) there is no dilution of the *Shareholder's* shareholding in the *Corporation*;
- d) if it is necessary to place *Liens* on any assets of the *Distribution Company* to effect the acquisition, the *Liens* are placed on the assets or securities of the distributor being acquired;
- e) the *Corporation* provides the *Shareholder* with a quarterly update on its acquisition activity and the acquisition activity of the *Distribution Company*, indicating the bids that have been submitted, commentary on successful bids and commentary on unsuccessful bids indicating any underlying reasons for the lack of success; and
- f) where an acquisition has been successful, the *Corporation* reports to the *Shareholder* at the next meeting of *City Council* after the acquisition with particulars of the acquisition, including financing information which details how each of the conditions set out in Subsections 8.6 (a), (b), (c) and (d) have been satisfied.

8.7 Provision of Financial Assistance

Despite Section 8.5,

- a) the *Corporation* is authorized to provide financial assistance to the *Subsidiaries* by guarantees, letters of credit, direct loans or otherwise, for the purposes of enabling them to carry on their business, including in the case of the *Distribution Company*, for the purposes of satisfying the prudential requirements of the Independent Electricity System Operator (or its successor) which form part of the market rules to ensure the uninterrupted supply and payment of electricity.
- b) subject to the terms and conditions of the *Affiliate Relationships Code*, the *Corporation* shall authorize the *Distribution Company* to provide financial assistance to other *Subsidiaries* by guarantees, letters of credit, direct loans or otherwise for the purposes of enabling them to carry on their business.

provided that such financial assistance does not exceed an aggregate amount of \$500 million. For the purposes of this Section 8.7 only, except in the case of the *Distribution Company*, "*Subsidiary*" means a wholly-owned *Subsidiary* of the *Corporation*.

ARTICLE 9 REPORTING

9.1 Business Plan

Not later than the end of each fiscal year, the *Board* will approve and the *Chair* shall submit to the *City CFO* a business plan for the next three (3) fiscal years (the "*Business Plan*"). The *Business Plan* will be prepared on a consistent basis with the *Business Plan* then in effect. The *Corporation* will carry on its business and operations in accordance with the *Business Plan* which will include, in respect of the period covered by such *Business Plan*.

- a) the strategic direction, key objectives, priorities and business initiatives that the *Corporation* proposes to undertake;
- b) the metrics for monitoring the accomplishments and financial performance of the *Corporation* in the previous fiscal year, including the *Corporation's* liquidity and debt coverage, and the *Corporation's* then current return on equity;
- c) an operating and capital expenditure budget for the *Corporation* and each of the *Subsidiaries* for the next fiscal year and corresponding operating and capital expenditure projections for each fiscal year thereafter, including the anticipated resources necessary to implement the *Business Plan*;
- d) the projected annual revenues and profits for each fiscal year for the *Corporation* and each of the *Subsidiaries*;
- e) projected dividend payments to the *Shareholder*;
- f) an acquisition budget setting forth the nature and type of capital expenditures proposed to be made by the *Corporation* and its *Subsidiaries* in the following fiscal year, supported by explanations, notes and information upon which the budget was based;
- g) energy conservation programmes and environmental plans, including the level of commitment to renewable energy and co-generation;
- h) any material variances in the projected ability of any business activity to meet or continue to meet the financial objectives of the *Shareholder* as set out in this *Shareholder Direction* or as *Directed by Council* from time to time;
- i) any material variances from the *Business Plan* then in effect; and
- j) any such additional information as the *City CFO* may request of the *Chair* in writing from time to time.

9.2 Quarterly Reports

Within 60 days after the end of each fiscal quarter, the *Board* will approve (on a consistent basis with the previous fiscal quarter) and the *Chair* shall submit to the *City CFO* a quarterly report. The quarterly report will include, in respect of the immediately preceding fiscal quarter:

- a) quarterly *Financial Statements*;
- b) such explanations, notes and information as is required to explain and account for any variances between the actual results from operations and the budgeted amounts set forth in the current *Business Plan*, including any material variances in the projected ability of any business activity to meet or continue to meet the financial objectives of the *Shareholder*;
- c) information that is likely to materially affect the *Shareholder's* financial objectives or the *City of Toronto's* energy policies; applicable to the *Corporation*, as *Directed by Council* from time to time;
- d) information that is likely to materially affect customers' perceptions or opinions regarding *Toronto Hydro*;
- e) information regarding any matter, occurrence or other event which is a material breach or violation of any *Law*; and
- f) any such additional information as the *City CFO* may request of the *Chair* in writing from time to time.

9.3 Access to Records

- a) Subject to *Law*, the *Shareholder* may at any time duly appoint, in its discretion, any staff of the *City of Toronto* as one or more *City Authorized Representatives* in addition to the currently appointed *Auditor General*, *City Manager*, *City CFO* and *City Chief Corporate Officer*.
- b) The *Corporation* shall provide any *City Authorized Representative* with access to the books and records of the *Corporation* and its *Subsidiaries* during normal business hours as *Directed by Council*.
- c) The access by the *City Authorized Representative* to the *Corporation's* books and records is limited to situations where the *City Authorized Representative* has been specifically appointed by *City Council* to gain access to the *Corporation's* books and records for a specific purpose or project and where the *City Authorized Representative* has not been able to obtain the necessary information through the *Shareholder Direction* reporting mechanisms, through inquiries to senior management of the *Corporation*, or through a request from *City Council* to the *Chair* of the *Corporation*.

- d) The *City Authorized Representative* shall treat all information of *Toronto Hydro* with the same level of care and confidentiality as any confidential information of the *Shareholder* and shall be deemed to be subject to, and shall at all times comply with all *Law* with respect to such information.

9.4 Audit of Financial Statements

The *Corporation's* consolidated *Financial Statements* and the *Financial Statements* of all active Subsidiaries will be audited.

9.5 Internal Audit

The *Corporation* shall have an internal auditor who is independent of management and reports directly to the *Board* or a committee of the *Board* and who has the authority to undertake financial and performance audits, as may be requested by the *Board* or committee of the *Board* from time to time, and make recommendations to the *Board* or committee of the *Board*, as applicable, concerning all departments, offices, activities and programs of the *Corporation*.

9.6 Accounting

Subject to *Law*, the *Corporation* will, in consultation with its external auditor, adopt and use such accounting policies and procedures which may be approved by the *Board* from time to time.

9.7 Annual Financial Statements

The *Board* will deliver to the *City Manager* and the *City CFO*, as soon as practicable and in any event within three (3) months after the end of each fiscal year, the annual audited consolidated *Financial Statements* of the *Corporation* and its active *Subsidiaries*, and information concerning its *Subsidiaries*, equity interests and joint ventures as *Directed by Council*, for consideration by the *Shareholder*.

9.8 Annual Report

Together with the annual audited consolidated *Financial Statements* noted in Section 9.7 above, the *Board* will deliver to the City Executive Committee through the *City Manager's* office and the *City CFO* an annual report outlining:

- a) the *Corporation's* accomplishments during the fiscal year along with explanations, notes and information required to explain and account for any variances between the *Corporation's* actual results and the *Business Plan* in effect for the year;
- b) the progress made, using quantifiable performance data, towards accomplishing the principles set forth in Section 2.2.2 d);
- c) the *Executive Compensation Information*, as permitted by *Law*, which the *Shareholder* agrees it will receive and use in accordance with all *Law* including all applicable privacy law;

- d) a copy of the *Corporation's* Annual Information Form; and
- e) an annual report detailing the total remuneration and expenses paid by the *Corporation* for each member of the *Board*.

ARTICLE 10 FINANCIAL PERFORMANCE

10.1 Financial Performance

The *Board* will use its best efforts to ensure that *Toronto Hydro* meets the financial performance standards set out in this Article 10.

10.2 Credit Rating

The *Corporation* shall obtain and maintain, and, if necessary for financing purposes, shall cause the *Distribution Company* to obtain and maintain, a rating of A- or higher (or its equivalent rating, depending on the credit rating agency) on its senior debt securities, as rated by two (2) accredited credit rating agencies in Ontario (which credit rating agencies include Standard & Poor's, DBRS and Moody's).

10.3 Debt Financing

The *Corporation* shall optimize, and, if necessary for financing purposes, shall cause its *Subsidiaries* to optimize, its debt financing in accordance with the provisions of this *Shareholder Direction*.

10.4 Dividend Policy

Subject to any restrictions imposed by *Law* and this *Shareholder Direction*, the *Board* of the *Corporation* shall declare aggregate dividends with respect to each fiscal year in the amount of:

- a) 50% of the *Corporation's* prior fiscal year's annual consolidated net income,
- b) with a minimum annual amount of \$25 million, payable to the *Shareholder* in equal instalments of \$6.25 million payable on the last day of each fiscal quarter of the year (March 31, June 30, September 30 and December 31), and
- c) with the balance of the annual dividend, if any, payable within ten (10) days from the date of approval by the *Board* of the *Corporation's* annual audited consolidated *Financial Statements*.

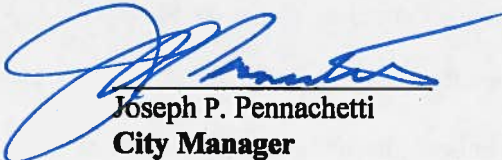
ARTICLE 11 AMENDMENTS

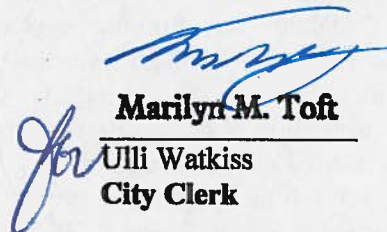
11.1 Amendments

This *Shareholder Direction* may be amended solely at the discretion of the *Shareholder*. The *Shareholder*, if possible, will provide prior written notice to the *Board* of any proposed amendments to this *Shareholder Direction*.

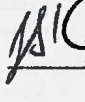
DATED at Toronto as of this 21st day of May, 2013.

CITY OF TORONTO


Joseph P. Pennachetti
City Manager

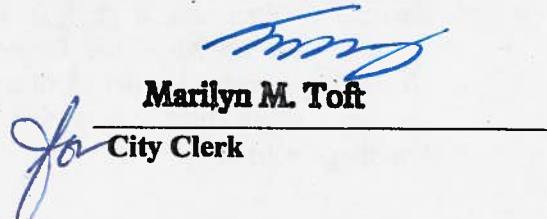

Marilyn M. Toft
Ulli Watkiss
City Clerk

Approved as to Form

 For: Anna Kinastowski
City Solicitor

 Authorized by Clause 14 of Policy and Finance Committee Report No. 13, adopted by Council at its meeting on October 1, 2 and 3, 2002, as amended by:

- Clause 24 of Policy and Finance Committee Report No. 7, adopted by Council at its meeting on September 28, 29, 30 and October 1, 2004;
- Clause 7 of Policy and Finance Committee Report No. 4, adopted by Council at its meeting of May 23, 24 and 25, 2006;
- Clause 7 of Policy and Finance Committee Report No. 5, adopted by Council at its meeting on June 27, 28 and 29, 2006;
- Executive Committee Item EX12.3 as amended and adopted by Council at its meeting on October 22 and 23, 2007, and
- Authorized by Executive Committee Item EX 31.7, as amended and adopted by Council at its meeting on May 7, 8, 9 and 10, 2013.


Marilyn M. Toft
City Clerk

APPENDIX A

Ontario Energy Board Act, 1998 – Permitted Activities

Note: The following extract is being provided as an appendix to this *Shareholder Direction* for reference purposes only and the reader is cautioned to review the *Ontario Energy Board Act, 1998* and its regulations for any updates or revisions, from time to time.

a) Restriction on business activity

71. (1) Subject to subsection 70 (9) and subsection (2) of this section, a transmitter or distributor shall not, except through one or more affiliates, carry on any business activity other than transmitting or distributing electricity. 2004, c. 23, Sched. B, s. 12.

Exception

(2) Subject to section 80 and such rules as may be prescribed by the regulations, a transmitter or distributor may provide services in accordance with section 29.1 of the *Electricity Act, 1998* that would assist the Government of Ontario in achieving its goals in electricity conservation, including services related to,

- (a) the promotion of electricity conservation and the efficient use of electricity;
- (b) electricity load management; or
- (c) the promotion of cleaner energy sources, including alternative energy sources and renewable energy sources. 2004, c. 23, Sched. B, s. 12.

Exception

(3) Despite subsection (1), a distributor may own and operate,

- (a) a renewable energy generation facility that does not exceed 10 megawatts or such other capacity as may be prescribed by regulation and that meets any criteria that may be prescribed by the regulations;
- (b) a generation facility that uses technology that produces power and thermal energy from a single source and that meets any criteria that may be prescribed by the regulations; or
- (c) a facility that is an energy storage facility and that meets any criteria that may be prescribed by the regulations. 2009, c. 12, Sched. D, s. 11; 2011, c. 1, Sched. 4, s. 1.

b) Municipally-owned distributors

73. (1) If one or more municipal corporations own, directly or indirectly, voting securities carrying more than 50 per cent of the voting rights attached to all voting securities of a corporation that is a distributor, the distributor's affiliates shall not carry on any business activity other than the following:

- 1. Transmitting or distributing electricity.
- 2. Owning or operating a generation facility that was transferred to the distributor pursuant to Part XI of the *Electricity Act, 1998* or for which the approval of the Board was obtained under section 82 or for which the Board did not issue a notice of review in accordance with section 80.
- 3. Retailing electricity.

4. Distributing or retailing gas or any other energy product which is carried through pipes or wires to the user.
5. Business activities that develop or enhance the ability of the distributor or any of its affiliates to carry on any of the activities described in paragraph 1, 3 or 4.
6. Business activities the principal purpose of which is to use more effectively the assets of the distributor or an affiliate of the distributor, including providing meter installation and reading services, providing billing services and carrying on activities authorized under section 42 of the *Electricity Act, 1998*.
7. Managing or operating, on behalf of a municipal corporation which owns shares in the distributor, the provision of a public utility as defined in section 1 of the *Public Utilities Act* or sewage services.
8. Renting or selling hot water heaters.
9. Providing services related to the promotion of energy conservation, energy efficiency, load management or the use of cleaner energy sources, including alternative and renewable energy sources.

Limitation

(2) In acting under paragraph 7 of subsection (1), the distributor's affiliate shall not own or lease any works, pipes or other machinery or equipment used in the manufacture, processing or distribution of a public utility or in the provision of sewage services.

Municipal corporation

(3) Subsection (1) does not restrict the activities of a municipal corporation.

APPENDIX B***Affiliate Relationships Code– Independent Directors***

Note: The following extract of the Affiliate Relationships Code is being provided as an appendix to this *Shareholder Direction* for reference purposes only and the reader is cautioned to review the Affiliate Relationships Code and its regulations for any updates or revisions, from time to time.

2.1.2 A utility shall ensure that at least one-third of its Board of Directors is independent from any affiliate.

GOVERNANCE – BOARD MANDATE

TORONTO HYDRO CORPORATION

Mandate – Board of Directors

1. General

- (1) The board of directors (**Board**) of *Toronto Hydro Corporation* (**Corporation**) is responsible for supervising the management of the business and affairs of the Corporation and its subsidiary entities (**Group**).
- (2) The composition, responsibilities, and authority of the Board are set out in this Mandate.
- (3) This Mandate, the Shareholder Direction issued by the City of Toronto (**Shareholder**) and the by-laws of the Corporation and such other procedures, not inconsistent therewith, as the Board may adopt from time to time shall govern the meetings and procedures of the Board.

2. Composition

- (1) The directors of the Corporation (**Directors**) should have a mix of competencies and skills necessary to enable the Board and Board committees to properly discharge their responsibilities.
- (2) All of the Directors shall be residents of Canada.
- (3) The Shareholder shall appoint Directors every 2 years.
- (4) In appointing Directors the Shareholder shall give due regard to the qualifications of the candidates including:
 - a) experience on a public utility commission or board of a major corporation or other commercial enterprise;
 - b) experience or knowledge with respect to:
 - i) corporate finance;
 - ii) corporate governance;

- iii) market development;
 - iv) large system operation and management;
 - v) urban energy industries;
 - vi) public policy issues and laws relating to the Corporation and its subsidiary entities and the electricity industry;
 - vii) environmental matters;
 - viii) labour relations;
 - ix) occupational health and safety issues;
 - c) commercial sensitivity and acumen;
 - d) independence of judgement;
 - e) personal integrity; and
 - f) at least three directors with financial management expertise.
- (5) For the purposes of determining whether a Director is independent, the Board shall use the definition of independence within the meaning of National Instrument 52-110 *Audit Committee* adopted by the Canadian Securities Administrators.
- (6) The Shareholder shall appoint a Chair of the Board.
- (7) The Secretary of the Corporation shall be secretary of the Board (*Secretary*).

3. Responsibilities

- (1) The Board is responsible for supervising the management of the business and affairs of the *Group*, including the following specific matters:
- a) establishing sound financial principles and performance objectives;
 - b) approving any dividend payment or distribution of capital;
 - c) appointing the officers of the Corporation;
 - d) approving the overall business strategy and related business plan;
 - e) approving the financing strategy, including the selection of financial institutions and related banking authorities;
 - f) directing labour and employee relations matters; and
 - g) approving the financial statements in accordance with the requirements of the *Business Corporations Act* (Ontario).

(2) In discharging their responsibilities, the Directors owe the following fiduciary duties to the Corporation:

- *a fiduciary duty*: they must act honestly and in good faith with a view to the best interests of the Corporation; and
- *a duty of care*: they must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

In discharging their responsibilities, the Directors are entitled to rely on the honesty and integrity of the senior officers of the Corporation and the auditors and other professional advisors of the Corporation.

In discharging their responsibilities, the Directors are also entitled to directors and officers liability insurance purchased by the Corporation and indemnification from the Corporation to the fullest extent permitted by law and the constating documents of the Corporation.

(3) The Board has specifically recognized its responsibilities for:

- (a) to the extent feasible, satisfying itself as to the integrity of the Chief Executive Officer (*CEO*) and other senior officers of the Corporation and that the CEO and other senior officers of the Corporation create a culture of integrity throughout the Group;
- (b) adopting a strategic planning process and approving annually (or more frequently if appropriate) a strategic plan which takes into account, among other things, the opportunities and risks of the business of the Group;
- (c) overseeing the identification of the principal risks of the business of the Group and overseeing the implementation of appropriate systems to manage these risks;
- (d) overseeing the integrity of the internal control and management information systems of the Group;
- (e) succession planning (including appointing, training and monitoring the senior officers of the Corporation);
- (f) recruiting and assessing the performance of the CEO, the compensation of the CEO and other officers of the Group, executive compensation disclosure and oversight of the compensation structure and benefit plans and programs of the Group;
- (g) assessing the effectiveness of the Board;
- (h) adopting a disclosure policy for the Group;
- (i) developing and overseeing the orientation of new Directors, and the continuing education of existing Directors, of the Group; and

- (j) developing the approach of the Corporation to corporate governance including a periodic review of the Code of Business Conduct of the Group.
- (4) In addition to those matters which must by law be approved by the Board, the Board oversees the development of, and reviews and approves, significant corporate plans and initiatives, including the annual business plan and budget, major acquisitions and dispositions and other significant matters of corporate strategy or policy, including the Environmental Policy, Occupational Health and Safety Policy, Code of Business Conduct, Disclosure Policy, Signing Policy and Treasury Policy.
- (5) The Board shall periodically review the Shareholder Direction and make recommendations to the Shareholder to facilitate and clarify interaction and communication between the Shareholder and the Board.
- (6) The Board shall periodically review the performance of the Board against the Shareholder Direction.
- (7) The Board shall periodically review the structure and mandate of each Board committee, the effectiveness of each committee, and the appointment and removal of committee members.
- (8) The Board shall periodically review performance under the Environmental Stewardship Policy with management.
- (9) To assist the Directors in discharging their responsibilities, the Board expects management of the Corporation to:
 - (a) review and update annually (or more frequently if appropriate) the strategic plan and report regularly to the Board on the implementation of the strategic plan in light of evolving conditions;
 - (b) prepare and present to the Board annually (or more frequently if appropriate) a business plan and budget and report regularly to the Board on the Corporation's performance against the business plan and budget; and
 - (c) report regularly to the Board on the Corporation's business and affairs and on any matters of material consequence for the Corporation and its Shareholder.

Additional expectations are developed and communicated during the annual strategic planning and budgeting process and during regular Board and Board committee meetings.

- (10) The Board considers that generally management should speak for the Corporation in its communications with securities holders and the public. The Corporation's investor relations personnel are required to respond to inquiries from securities holders and the public after review and discussion, as appropriate, by senior management and the Board and Board committees. The Corporation's investor relations personnel are available to the securities holders by telephone, fax and e-mail. The Corporation maintains an investor relations section on its website. Presentations at investor conferences are posted promptly on the Corporation's website. They are also available on request. The Board

reviews the Corporation's major communications with securities holders and the public. All disclosures on behalf of the Corporation are to be made in compliance with the Corporation's disclosure policy.

- (11) Directors are expected to attend Board meetings and meetings of Board committees of which they are members. Directors are also expected to spend the time needed, and to meet as frequently as necessary, to discharge their responsibilities.
- (12) Directors are expected to undertake such activities as are required from them to remain current in their knowledge of issues relating to the business of the Group and matters relating to any Board committee of which they are members.
- (13) Directors are expected to comply with the Code of Business Conduct of the Group.

4. Authority

- (1) The Board is authorized to carry out its responsibilities as set out in this Mandate.
- (2) The Board is authorized to retain, and to set and pay the compensation of, independent legal counsel and other advisors if it considers this appropriate.
- (3) The Board is authorized to invite officers and employees of the Corporation and others to attend or participate in its meetings and proceedings if it considers this appropriate.
- (4) The Directors have unrestricted access to the officers of the Corporation. The Directors will use their judgment to ensure that any such contact is not disruptive to the operations of the Corporation and, except for the chair of any committee established by the Board, will, to the extent not inappropriate, advise the Chair and the Chief Executive Officer of the Corporation of any direct communications between them and the officers of the Corporation.
- (5) The Board and the Directors have unrestricted access to the advice and services of the Secretary.
- (6) The Board may delegate certain of its functions to Board committees, each of which will have its own charter.

5. Meetings and Proceedings

- (1) The Board shall meet as frequently as is determined to be necessary but not less than four times each year.
- (2) Any Director or the Secretary may call a meeting of the Board.
- (3) The Chair is responsible for the agenda of each meeting of the Board, including input from other Directors and the officers and employees of the Corporation as appropriate. Meetings will include presentations by management and others when appropriate and allow sufficient time to permit a full and open discussion of agenda items.

- (4) Unless waived by all Directors, a notice of each meeting of the Board confirming the date, time, place and agenda of the meeting, together with any supporting materials, shall be forwarded to each Director at least three days before the date of the meeting.
- (5) The quorum for each meeting of the Board is a majority of the Directors. In the absence of the Chair, the other Directors shall appoint one of their number as chair of a meeting. The chair of a meeting shall not have a second or casting vote.
- (6) The Secretary or his delegate shall keep minutes of all meetings of the Board, including all resolutions passed by the Board. Minutes of meetings shall be distributed to the Directors.
- (7) An individual who is not a Director may be invited to attend a meeting of the Board for all or part of the meeting.
- (8) The Directors shall meet regularly alone to facilitate full communication.

6. **Review**

- (1) This Mandate shall be reviewed by the Corporate Governance Committee of the Corporation every 2 years and any recommended changes shall be brought to the Board of the Corporation for consideration and disposition.

August 2013

TORONTO HYDRO -ELECTRIC SYSTEM LIMITED.

Mandate – Board of Directors

1. General

- (1) The board of directors (**Board**) of *Toronto Hydro-Electric System Limited (Corporation)* is responsible for supervising the management of the business and affairs of the Corporation.
- (2) The composition, responsibilities, and authority of the Board are set out in this Mandate.
- (3) This Mandate and the by-laws of the Corporation and such other procedures, not inconsistent therewith, as the Board may adopt from time to time shall govern the meetings and procedures of the Board.

2. Composition

- (1) The directors of the Corporation (**Directors**) should have a mix of competencies and skills necessary to enable the Board and Board committees, if established, to properly discharge their responsibilities.
- (2) A majority of the Directors shall be residents of Canada. At least one third of the Directors shall be independent Directors. For the purposes of determining whether a Director is independent, the Board shall use the definition of independence adopted by the Ontario Energy Board from time to time.
- (3) The shareholder of the Corporation (**Shareholder**) shall appoint Directors every two years. Except for independent Directors, a Director shall cease to be a director of the Corporation if he or she ceases to be a director of the Shareholder.
- (4) The Shareholder shall appoint a Chair of the Board.
- (5) The Corporate Secretary of the Corporation shall be secretary of the Board (**Secretary**).

3. Responsibilities

- (1) The Board is responsible for supervising the management of the business and affairs of the Corporation.
- (2) In discharging their responsibilities, the Directors owe the following fiduciary duties to the Corporation:

- *a fiduciary duty*: they must act honestly and in good faith with a view to the best interests of the Corporation; and
- *a duty of care*: they must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

In discharging their responsibilities, the Directors are entitled to rely on the honesty and integrity of the senior officers of the Corporation and the auditors and other professional advisors of the Corporation.

In discharging their responsibilities, the Directors are also entitled to directors and officers liability insurance purchased by the Corporation and indemnification from the Corporation to the fullest extent permitted by law and the constating documents of the Corporation.

- (3) The Board has specifically recognized its responsibilities for:
- (a) to the extent feasible, satisfying itself as to the integrity of the President and other senior officers of the Corporation and that the President and other senior officers of the Corporation create a culture of integrity throughout the Corporation;
 - (b) overseeing a strategic plan which (i) takes into account, among other things, the opportunities and risks of the business of the Corporation and (ii) is consistent with the overall strategic plan approved by the Toronto Hydro Corporation (*THC*) Board of Directors (*THC Directors*) for THC and its subsidiary entities (*Group*);
 - (c) overseeing the identification of the principal risks of the business of the Corporation and overseeing the implementation of appropriate systems to manage these risks;
 - (d) overseeing the integrity of the internal control and management information systems of the Corporation; and
 - (e) except to the extent any policy is not considered appropriate or relevant for the Corporation, adopting all policies, including the disclosure policy, adopted by the THC Directors for the Group and any amendments thereto and ensuring compliance with such policies.
- (4) In addition to those matters which must by law be approved by the Board, the Board oversees the development of, and reviews and approves, in a manner consistent with the overall business plan and budget approved by the THC Directors for the Group, significant corporate plans and initiatives, major acquisitions and dispositions and other significant matters of corporate strategy or policy.
- (5) To assist the Directors in discharging their responsibilities, the Board expects management of the Corporation to:

- (a) review and update annually (or more frequently if appropriate) the strategic plan and report regularly to the Board on the implementation of the strategic plan in light of evolving conditions; and
- (b) report regularly to the Board on the Corporation's business and affairs and on any matters of material consequence for the Corporation and its shareholder.

Additional expectations are developed and communicated during the annual planning and budgeting process and during regular Board and Board committee meetings.

- (6) Directors are expected to attend Board meetings and meetings of Board committees of which they are members. Directors are also expected to spend the time needed, and to meet as frequently as necessary, to discharge their responsibilities.
- (7) Directors are expected to undertake such activities as are required from them to remain current in their knowledge of issues relating to the business of the Group and matters relating to any Board committee of which they are members.
- (8) Directors shall adopt the Code of Business Conduct of the Group and any amendments thereto and comply with the Code as amended.

4. Authority

- (1) The Board is authorized to carry out its responsibilities as set out in this Mandate.
- (2) The Board is authorized to retain, and to set and pay the compensation of, independent legal counsel and other advisors if it considers this appropriate.
- (3) The Board is authorized to invite officers and employees of the Corporation and others to attend or participate in its meetings and proceedings if it considers this appropriate.
- (4) The Directors have unrestricted access to the officers of the Corporation. The Directors will use their judgment to ensure that any such contact is not disruptive to the operations of the Corporation and, except for the chair of any committee established by the Board, will advise the Chair and the President of the Corporation of any direct material communications between them and the officers of the Corporation.

5. Meetings and Proceedings

- (1) The Board shall meet as frequently as is determined to be necessary.
- (2) Any Director or the Secretary may call a meeting of the Board.
- (3) The Chair is responsible for the agenda of each meeting of the Board, including input from other Directors and the officers and employees of the Corporation as appropriate. Meetings will include presentations by management and others when appropriate and allow sufficient time to permit a full and open discussion of agenda items.

- (4) Unless waived by all Directors, a notice of each meeting of the Board confirming the date, time, place and agenda of the meeting, together with any supporting materials, shall be forwarded to each Director at least three days before the date of the meeting.
- (5) The quorum for each meeting of the Board is a majority of the Directors. In the absence of the Chair, the other Directors shall appoint one of their number as chair of a meeting. The chair of a meeting shall not have a second or casting vote.
- (6) The Secretary or his delegate shall keep minutes of all meetings of the Board, including all resolutions passed by the Board. Minutes of meetings shall be distributed to the Directors.
- (7) An individual who is not a Director may be invited to attend a meeting of the Board for all or part of the meeting.
- (8) The Directors shall meet regularly alone to facilitate full communication.

6. Review

- (1) This Mandate shall be reviewed by the Corporate Governance Committee of THC every 2 years and any recommended changes shall be brought to the Board of the Corporation for consideration and disposition.



POLICY

Code of Business Conduct	<u>Policy Owner:</u> Vice President, Organizational Effectiveness, Environment, Health & Safety
	<u>Policy Approver:</u> Board of Directors, Toronto Hydro Corporation
	<u>Version Approval Date:</u> V3.0 2012-11-15
	<u>Last Review by PASC:</u> 2012-10-31
The most recent version of this policy can be obtained from http://pluggedin.torontohydro.com/policy/Pages/GovernancePolicies.aspx .	
The distribution of this policy is restricted not restricted.	

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1 DOCUMENT REVIEW & REVISION HISTORY

This policy is reviewed annually.

Version Number	Date of Review	Reviewed By	Brief Description of Change
V 3.0	2012-10-31	PASC	Added section 6.1.5 regarding image and reputation

2 DISTRIBUTION HISTORY

Version Number	Date of Issue	Recipients
V 3.0	2012-11-19	Toronto Hydro external website, and intranet site (http://pluggedin.torontohydro.com/policy/Pages/GovernancePolicies.aspx)

3 INTRODUCTION

As a reputable utility organization delivering electricity distribution and energy services to the City of Toronto, Toronto Hydro always strives to be a responsible business enterprise and corporate citizen, with strong and shared commitments to our stakeholders. We work to achieve the following strategic pillars:

- **People** (fully-engaged, safe and healthy workforce that meets the changing business requirements)
- **Finance** (meet financial objectives of the Shareholder)
- **Operations** (improve reliability through optimal and sustainable system management)
- **Customer** (provide value for money)

This requires us to execute our duties with highest standards of integrity and professionalism at all times. This Code of Business Conduct sets the basic principles on how Toronto Hydro and Toronto Hydro's employees should conduct the business activities to reach our business goals and fulfill commitments to our stakeholders.

4 POLICY OVERVIEW

This Code of Business Conduct sets forth the basic principles of business conduct Toronto Hydro expects its employees, officers and directors to follow.

It is expected that we will at all times exercise honesty and integrity in our duties, and live up to our commitments to society and our stakeholders. Our stakeholders include our customers and other business partners, our employees, the communities in which we operate, and our shareholder, the City of Toronto.

This Code outlines general principles of appropriate business conduct rather than attempting to cover every situation we may possibly encounter. It is not a substitute for the use of sound judgment and moral integrity in assessing such situations, and it does not supersede existing or subsequent Toronto Hydro policies issued in respect of specific matters. A failure by us to comply with the principles of appropriate business conduct set forth in this Code could result in damage to Toronto Hydro's economic well being or to its reputation and credibility with its stakeholders. The Code is designed to alert Toronto Hydro employees, officers, directors, consultants, suppliers and contractors to major legal and ethical issues that frequently arise. It also serves to establish appropriate channels for obtaining guidance and reporting Code violations.

The Vice President, Organizational Effectiveness and Environment, Health & Safety has been appointed to serve as Toronto Hydro's Ethics Officer.

All consultants, suppliers and contractors are to be made aware of the content of this Code. Each consultant, supplier and contractor shall either be provided with a copy of the Code or referred to the dedicated page on Toronto Hydro's website (www.torontohydro.com) each time an agreement to provide goods or services is executed with them or upon any change to the Code.

In this Code, "Toronto Hydro" means Toronto Hydro Corporation and all of its subsidiaries and related corporations.

Ethical Decision Making

One of the primary goals of this Code is to help all of us make ethical business decisions. The Code establishes principles to govern conduct in some general areas that pose ethical or legal concerns. No book of hard-and-fast rules, however long and detailed, could ever adequately cover all the dilemmas we face given the complexity and constantly changing nature of our work and our world.

Therefore, we may find it helpful to ask the following questions before taking action in specific situations:

- ◆ Am I adhering to the letter and spirit of the laws and regulations that may be involved?
- ◆ Is my action consistent with the overall values set forth in the Code?
- ◆ Would my action compromise my integrity or credibility, or that of Toronto Hydro?
- ◆ Does my action conform to Toronto Hydro's company policies?
- ◆ How would my actions appear to my supervisors, peers, subordinates, family, close personal friends, or to the public if reported in the news media?
- ◆ Does it make me feel uncomfortable?

Ultimately, employees are personally responsible for their decisions and should discuss ethical concerns, issues and questions with their supervisor or other contacts referred to under the "Compliance, Discipline and Reprisal" section below.

5 COMMITMENT TO SOCIETY

We believe that we have responsibilities to society because ultimately it is only with its implicit permission that the economy in which we participate is allowed to flourish. We therefore make the following commitments to society.

Obey the Law

- 5.1 We act in accordance with both the letter and the spirit of all laws and regulations applicable to the conduct of our business wherever we operate. To achieve this, Toronto Hydro provides us with the training required to obtain an understanding of the laws which apply to the carrying out of our responsibilities. With this training, we are expected to be sufficiently familiar, and act in accordance, with any laws that apply to our work, to recognize potential liabilities, and to know when to seek legal advice. If in doubt, we promptly seek clarification from Toronto Hydro's General Counsel.
- 5.2 We never commit or condone an illegal or improper act relating to Toronto Hydro's affairs, or instruct another employee, business partner or contractor to do so.
- 5.3 We acknowledge the importance to Toronto Hydro of complying with the Affiliate Relationships Code. We comply with, and ensure that all parties who provide services on behalf of Toronto Hydro comply with, the Affiliate Relationships Code.
- 5.4 We do not offer or make any payment (in money, property, services or any other form), directly or indirectly, through an agent or consultant, to any government official, political party, political party official, or candidate for political office for the purpose of persuading that person to exert influence in order to assist Toronto Hydro in obtaining or retaining business. We take measures reasonably within our power to ensure that any payment made to an agent is appropriate remuneration for legitimate services rendered and that no part is passed on by the agent as a bribe. We ensure that proper systems of control are in place to prevent and detect the payment of bribes.
- 5.5 We never request any payment (in money, property, services or any other form), directly or indirectly, to influence a decision or otherwise, nor do we accept any offered payment for any purpose other than as permitted in strict compliance with this Code.
- 5.6 We avoid all actions that are anti-competitive or otherwise contrary to laws that govern competitive practices in the marketplace.
- 5.7 We do not engage in, or give the appearance of being engaged in, any illegal or improper conduct that is in violation of this Code.

Confidentiality

- 5.8 We do not use for personal advantage any information that is obtained in the course of our employment and is not available to the public at large.

Examples of such information include:

- (a) information concerning a proposed or existing business transaction with Toronto Hydro (e.g., a contract to purchase new transformers);
- (b) the proposed acquisition or disposal of investments or other assets; and
- (c) the pending award or change of contract for the supply of materials, goods or services to Toronto Hydro.

5.9 We do not inform anyone of any material fact or change relating to Toronto Hydro before it has been generally disclosed by Toronto Hydro in accordance with its Disclosure Policy except as may be required in the ordinary course of business. If it is necessary to inform any persons in the ordinary course of business, we ensure that the recipients of the information understand that it must be kept confidential. Where such recipients are from outside of Toronto Hydro we request, where appropriate, that they confirm their commitment to non-disclosure in the form of a written confidentiality agreement.

5.10 We will comply at all times with the privacy policies approved by Toronto Hydro (see Toronto Hydro website www.torontohydro.com).

6 COMMITMENT TO STAKEHOLDERS

Maintaining the trust and confidence of our stakeholders is crucial to Toronto Hydro's economic wellbeing and to its reputation and credibility with its stakeholders. If such trust and confidence is lost, we will lose their support and the valuable contribution which each makes to Toronto Hydro's success. It is in recognition of this that we make the following commitments to our stakeholders.

TO ALL OF OUR STAKEHOLDERS

We are committed to protecting their interest in Toronto Hydro's economic well-being

We acknowledge that all stakeholders have an interest in Toronto Hydro's economic well-being to provide employment opportunities, purchase goods and services, contribute to economic partnerships, contribute to the quality of life in communities where we operate, and to enhance the value of our shareholder's investment. To protect these interests, we will act in accordance with the following standards:

6.1 Protect Toronto Hydro's Assets

Each of us has a responsibility to safeguard Toronto Hydro's assets.

6.1.1 With respect to corporate funds we will:

- (a) Exercise integrity, prudence and judgment in incurring and approving business expenses.
- (b) Ensure that business expenses are reasonable and serve Toronto Hydro's business interests.
- (c) Ensure that all transactions and expenses are properly authorized.
- (d) Record all transactions and expenses accurately, completely and promptly.
- (e) Ensure that the acquisition, use, disposal or movement of funds is made known, clearly identified, and not diverted for any other use than that for which they were approved.
- (f) Not conceal any fund or transaction from finance, management or Toronto Hydro's auditors.
- (g) Not enter into any transaction for the purpose of unlawfully evading any tax, duty or other levy imposed by a government, either for ourselves or for our counterparties.

6.1.2 With respect to physical assets (including corporate property involved in carrying out duties) we will:

- (a) Use these assets prudently and with due care.

- (b) Exercise reasonable safeguards to protect them against theft, damage, loss and waste.
- (c) Ensure that the acquisition, use, disposal or movement of assets is made known, clearly identified, and not diverted for any other use than that for which they were approved.
- (d) Not take, sell, loan, destroy or give away assets without proper authorization.

6.1.3 *With respect to intellectual capital we will:*

- (a) Treat any information that has not been publicly disclosed in accordance with Toronto Hydro's disclosure policy as confidential.
- (b) Take precautions to avoid inadvertent disclosure, for instance, by not discussing such information in public and using extra care in transmitting such information by fax or electronic mail.
- (c) Enter into confidentiality agreements to ensure those to whom we must disclose such information will not disclose it to others.
- (d) Not release information to the media without proper authorization.
- (e) Use only properly licensed computer software.
- (f) Not reproduce, distribute or alter materials such as computer software or videotapes without the permission of the copyright owner or authorized agent but instead obtain additional copies of needed materials by purchasing them through the appropriate channels.
- (g) Employ ethical means in conducting research by being honest in obtaining, interpreting, using and disclosing data.
- (h) Use Toronto Hydro intellectual property --brand names, logos, trademarks – only in an authorized manner and in accordance with all laws.
- (i) Comply with internal policies, procedures and guidelines relating to internal computer systems, including "Toronto Hydro Technology Use Guidelines". We acknowledge that Toronto Hydro reserves the broadest possible rights to ensure that Toronto Hydro's computer data base and all electronic communications systems, including electronic mail ("e-mail"), voice mail, the intranet and internet, and electronically created or stored data are used in compliance with internal policies, procedures and guidelines that guide the use, storage and transmission of information through this medium.

6.1.4 *With respect to business records and reports we will:*

- (a) Ensure honest and accurate recording, reporting and retention of information (including all business records, including financial reports, research reports, marketing information, sales reports, tax refunds, time sheets, claims and other documents including those submitted to governmental agencies) since almost all business records may become subject to public disclosure in the course of litigation or governmental investigations and records are also often obtained by outside parties or the media.
- (b) Ensure that all records and accounts accurately and truthfully reflect transactions and events, and conform both to generally accepted accounting principles and to the Toronto Hydro system of internal controls.
- (c) Ensure that no entry is made in any record that intentionally hides or disguises the true nature of any transaction.
- (d) Never withhold, or fail to communicate, information that should be brought to the attention of higher levels of management.
- (e) Attempt to be as clear, concise, truthful and accurate as possible when recording any information and avoid exaggeration, inappropriate language, guesswork, legal conclusions, and derogatory characterizations of people and their motives.
- (f) Not destroy or condone the destruction of records, except in accordance with internal document management, retention and disposition policies.

6.1.5 *With respect to Toronto Hydro's image and reputation:*

- (a) When presenting ourselves on behalf of Toronto Hydro, we must not conduct ourselves in any way that would negatively impact Toronto Hydro's image and reputation, and must comply with any relevant Toronto Hydro policies, procedures, and standards.
- (b) Ensure that our communication via social networks and digital media is consistent with the directions laid out in the Toronto Hydro Social Media and Digital Communication Guidelines.

6.2 Avoid Conflicts of Interest

A "conflict of interest" occurs when our direct or indirect personal interests, activities or influences could compromise, or could reasonably appear to compromise, our ability to perform our responsibilities objectively and in the best interests of Toronto Hydro. Conflicts of interest, no matter how innocent the intention, threaten Toronto Hydro's economic interests (including its reputation) by potentially leading us to make decisions based on personal interests rather than in the best interests of Toronto Hydro. Even if we do not allow our personal interests to influence our decisions, the existence of the conflict will jeopardize the trust of our stakeholders if they perceive that we may not be acting solely with Toronto Hydro's best interests in mind. We must therefore exercise common sense, sound judgment and moral integrity to avoid any conflict of interest. We must also make any situation that might constitute a potential conflict of interest known to management and seek approval to proceed in accordance with this Code.

We are to seek guidance from our supervisors, or otherwise in accordance with this Code, whenever there is a question concerning a possible conflict of interest between our personal interest and the interests of Toronto Hydro. Conflicts include any activity (even when it is unpaid), interest or association that might compromise, or appear to compromise, the independent exercise of our judgment in the best interests of the Company.

To avoid the appearance of a conflict of interest, any request by a director or senior representative of the Shareholder related to the material use or handling of Toronto Hydro assets or resources or requesting actions to be taken by an officer or employee of Toronto Hydro other than those actions directed by the individual(s) to whom that officer or employee directly or indirectly reports shall be reviewed by the Corporate Governance Committee. If an officer or employee of Toronto Hydro receives such a request from a director such request shall be referred to the Chair, Corporate Governance Committee for a review by that Committee prior to such action being taken.

Our responsibility to avoid conflicts of interest means that we must always act in the best interests of Toronto Hydro.

6.2.1 *With respect to outside business interests we will not, without approval:*

- (a) Operate, serve as directors, officers, or partners of, or perform work or services as employees, consultants or advisors for, any competitor or any actual or potential "business partner" (including suppliers and customers) or any other entity that could lead to a conflict of interest or situation prejudicial to Toronto Hydro's interests (including any situation where our performance of duties for Toronto Hydro is adversely affected).
- (b) Use Toronto Hydro time or resources (including equipment, tools, materials, supplies, facilities, personnel and information) to run our own business or engage in work for another organization, or to further the private interests of our family members, close personal friends or associates.

- (c) Take part in a Toronto Hydro corporate decision which might confer any benefit, monetary or otherwise, on a business partner or competitor of Toronto Hydro in which we, our family members, close personal friends or associates hold a direct or indirect business or ownership interest. For example, we will not award a contract to, or obtain goods or services from, an entity in which we or such family members, friends or associates have a private interest, except where the interest is solely in the form of insignificant stock interests held in public companies.
- (d) Take part in outside employment which creates the appearance of a, or an actual, conflict of interest.
- (e) While performing duties as a Toronto Hydro representative, solicit customers for any outside employment. We will not recommend or refer customers to businesses, including those businesses operated by ourselves or other Toronto Hydro employees. For the purpose of interpretation, "solicit" includes any inquiry or request made by a customer for an employee's "off-duty" services.

6.2.2 With respect to property transactions we will not:

- (a) Use our position at Toronto Hydro to influence any corporate decision involving real estate or personal property in which we, our family members, close personal friends or associates have a direct or indirect business or ownership interest. For example, we will not participate in a decision concerning the location of a Toronto Hydro facility that would directly or indirectly benefit lands owned by any such individuals.
- (b) Deal knowingly in real estate for the direct or indirect personal gain of ourselves, family members, close personal friends or associates, based on knowledge of any proposed or pending Toronto Hydro transaction such as the proposed location of a transmission line or other facility.
- (c) Influence the settlement of a claim against Toronto Hydro to the advantage of a private interest held by us, our family members, close personal friends or associates.

6.2.3 With respect to political activity we acknowledge that:

Each of us has the right to participate in the political process and to engage in political activities of our own choosing. However, while involved in such political activities we must at all times make clear that any views and actions are our own, and not those of Toronto Hydro. As in other activities, we must consider whether our political activity could adversely affect our performance of duties for Toronto Hydro or conflict with Toronto Hydro's responsibilities and, if so, avoid those activities. To determine if the political activity may create a potential conflict, we may contact the Ethics Officer, who will review the case and inform us of any action considered necessary to avoid the conflict.

6.2.4 With respect to gifts, gratuities, entertainment or benefits offered to us, our family members, close personal friends or associates (or to a third party receiving benefits for us or them) for less than full market value we will conduct ourselves as follows:

We will only accept gifts, entertainment and benefits in the normal exchanges common to business relationships. The following criteria will guide our judgment:

- (a) the gift, entertainment or benefit would be considered to be within the bounds of propriety taking into account all the circumstances of the occasion;
- (b) it does not, nor is it expected to, create a sense of obligation;
- (c) it would not appear to improperly influence a business decision or result in compromising objectivity;
- (d) it occurs infrequently; and

- (e) it would be valid for reimbursement on a Toronto Hydro expense statement if offered rather than received.

We will return inappropriate gifts or other benefits to the donor, accompanied by an explanation of Toronto Hydro's policy on this matter or, if considered appropriate, a copy of this Code. Perishable gifts can instead be donated to a charity and the donor notified. We will promptly advise our Ethics Officer of the circumstances of an inappropriate gift.

In some business settings, the return of a gift or refusal of a favour, benefit or entertainment would be offensive; in these cases, we should refer the circumstances to the Ethics Office for guidance.

Full and immediate disclosure in accordance with this Code of borderline cases will always be taken as good faith compliance with this Code.

6.3 TO OUR CUSTOMERS AND OTHER BUSINESS PARTNERS

We are committed to being fair and honest

6.3.1 To fulfill this commitment we:

- (a) Treat our business partners courteously, respectfully and in a professional and helpful manner.
- (b) Commit only to what we honestly believe we can deliver.
- (c) Honour the commitments we make.
- (d) Protect any information shared with us on a confidential basis by a business partner.
- (e) Do not release customer information to any third party without proper authorization from the customer or Toronto Hydro management.
- (f) Do not attempt to improperly influence the decisions of existing or potential business partners or attempt to secure preferential treatment for Toronto Hydro by offering gifts, entertainment or benefits which we ourselves would not be able to accept.
- (g) Do not use our position at Toronto Hydro to obtain personal favors or special consideration for ourselves, our family members, close personal friends or associates.
- (h) Select our suppliers objectively, based on fairness and the long-term best interests of Toronto Hydro.

6.4 TO OUR EMPLOYEES

We are committed to treating all employees with dignity and respect.

6.4.1 To fulfill this commitment we create a safe and healthy work environment where employees have opportunities for professional development, are treated with dignity and respect and are recognized for their contributions to Toronto Hydro and its customers.

6.5 TO THE COMMUNITIES WHERE WE OPERATE

We are committed to protecting the environment and enhancing the quality of life.

To fulfill this commitment we will act in accordance with the following standards:

6.5.1 Protect the Environment

We acknowledge that environmental protection is one of Toronto Hydro's fundamental

values and to demonstrate such value we will:

- (a) Ensure that we understand the environmental impact of our activities and treat it as an integral factor in all of our decisions.
- (b) Report immediately any environment mishaps.
- (c) Be open about and accountable for our environmental performance.
- (d) Strive to find business partners which conduct their business in an environmentally responsible manner.

6.5.2 Enhance the Quality of Life

We believe that a fundamental responsibility is to conduct our business on a sound commercial basis in a socially responsible manner. This is, we believe, the greatest contribution we can make to the communities where we operate. We also believe we have a responsibility to contribute to the well-being of these communities in other ways. While this commitment will take different forms in different communities, we will:

- (a) Support health, education and environmental initiatives.
- (b) Support and work with voluntary and charitable organizations that respond to community needs.
- (c) Get involved in and work with the community to assist in solving community problems.
- (d) Encourage our employees to contribute to their communities through involvement with charitable, community service and professional organizations. However, employees must consider whether their activities could pose a conflict of interest or adversely affect their performance of duties for Toronto Hydro, and should only use Toronto Hydro time or resources for such activities with the prior approval of management.
- (e) Encourage, support and seek partnerships with organizations which need our help, whether they be schools or social service organizations.
- (f) Involve local communities in decision making for issues that affect them.

6.6 TO OUR SHAREHOLDER

We are committed to enhancing value for our shareholder, the City of Toronto.

All of our ethical commitments are directed at protecting Toronto Hydro's well-being. Through these commitments, we will seek to enhance the value of our shareholder's investment.

7 POLICY OWNERSHIP, ADMINISTRATION, APPROVAL AND RESPONSIBILITIES

7.1 This policy is owned by the Vice President, Organizational Effectiveness, Environment, Health and Safety.

7.2 The Vice President, Organizational Effectiveness, Environment, Health and Safety is responsible for:

- (a) ensuring that this policy is comprehensive, clear and current;
- (b) ensuring that this policy is implemented and communicated to the departments and staff that are impacted;
- (c) ensuring ongoing compliance with this policy;
- (d) approving any exceptions to this policy, as required;
- (e) reviewing this policy as often as necessary, but at least annually;
- (f) modifying, amending or rescinding this policy at any time.

7.3 This policy is approved by the President & CEO of Toronto Hydro.

8 COMPLIANCE, DISCIPLINE AND REPRISAL

- 8.1 All Toronto Hydro employees, officers and directors must adhere to and actively support the principles and standards described in this Code, and adhere to the standards set out in applicable policies, guidelines and legislation.
- 8.2 Regardless of the approach used, the person or office contacted will handle your request promptly, discreetly and professionally. Discussions and inquiries will be strictly confidential to the fullest extent possible or permitted by policy or law.
- 8.3 Violations of the Code will not be tolerated. Any employee who fails to comply with the Code, or who withholds information during the course of an investigation regarding a possible violation of the Code, is subject to disciplinary action up to and including dismissal. Depending on the nature of the non-compliance, Toronto Hydro may have legal obligation to report the non-compliance to the appropriate authorities, which may lead to criminal prosecution or civil action.
- 8.4 Any situation or transaction that may violate, or could appear to violate, the letter or intent of the Code must be reported immediately to your supervisor or if this is uncomfortable or seems inappropriate, must be reported immediately to the next level of your management; or if preferred, Toronto Hydro's Ethics Officer.
- 8.5 The Ethics Officer may be contacted by regular mail addressed to the Ethics Officer, 14 Carlton St., Toronto, Ontario M5B 1K5 and marked CONFIDENTIAL, in person, or by way of a dedicated phone line established solely for this purpose [416.542.2767]. All issues raised with, and reported to, the Ethics Officer will be handled promptly, discreetly and professionally.
- 8.6 The Ethics Officer shall have the discretion to determine how any reported matter will be handled. This discretion shall include deciding, in each instance, with whom she should or should not discuss the details of the reported matter. She shall not have any obligation to discuss the matter with the Chair of the Board of Directors or any of the other directors or officers of Toronto Hydro, except, if the reported matter involves the conduct of any of the directors, the CEO or any other officer of Toronto Hydro, then the Ethics Officer shall immediately report the matter to the Chair of the Audit Committee of Toronto Hydro and comply with any directives received from the Chair. It is important to note that it is hoped that all callers will identify themselves when contacting the Ethics Officer since that will facilitate resolving any issues. However, we will respond to anonymous contacts.
- 8.7 All disclosures to the Ethics Officer will be kept strictly confidential to the fullest extent possible or permitted by policy or law unless, in the sole opinion of the Ethics Officer, the matter disclosed constitutes an actual or potential threat of harm to Toronto Hydro, its employees or the general public. In that event, the Ethics Officer will act in accordance with any disclosure procedure issued by Toronto Hydro's General Counsel.
- 8.8 Management is responsible for ensuring that no retaliatory action will be taken against anyone for making in good faith a report of an ethical or legal concern or violation. However, anyone who takes part in a prohibited activity may be disciplined even if they report it. An employee's decision to report will, in all cases, be given due consideration in the event any disciplinary action is necessary.

- 8.9 Any employee found to be retaliating against an individual who, in good faith, reports a known or suspected violation or supplies information about a concern will be subject to disciplinary action up to and including dismissal. Employees who knowingly submit false reports will also be subject to disciplinary action.

9 POLICY COMMUNICATION

<u>COMMUNICATION TRIGGER</u>	<u>TYPE OF COMMUNICATION</u>	<u>PARTY RESPONSIBLE FOR POLICY COMMUNICATION</u>	<u>AUDIENCE</u>	<u>ACKNOWLEDGEMENT?</u>
New Hire Policy Revision Annual Review	Intranet Posting Email Hard Copy Provided	VP, Organizational Effectiveness, Environment, Health & Safety	All Employees	No

10 RELATED LAWS, REGULATIONS AND DOCUMENTATION

- 10.1 Refer to the Disclosure Policy located on the intranet at

<http://pluggedin.torontohydro.com/policy/Pages/GovernancePolicies.aspx>

- 10.2 Refer to the Fraud-Theft Prevention Policy located on the intranet at

<http://pluggedin.torontohydro.com/policy/Pages/GovernancePolicies.aspx>

- 10.3 Refer to the Social Media and Digital Communication Guidelines located on the intranet at

<http://pluggedin.torontohydro.com/policy/Pages/GovernancePolicies.aspx>

- 10.4 Refer to the Workplace Harassment Policy located on the intranet at

<http://pluggedin.torontohydro.com/policy/Pages/OEEHSPolicies.aspx>

- 10.5 Refer to the Environmental Policy located on the intranet at

<http://pluggedin.torontohydro.com/policy/Pages/OEEHSPolicies.aspx>

- 10.6 Refer to the Violence Prevention in the Workplace Policy located on the intranet at

<http://pluggedin.torontohydro.com/policy/Pages/OEEHSPolicies.aspx>

TORONTO HYDRO CORPORATION

Charter – Audit Committee

1. General

- (1) The board of directors (***Board***) of Toronto Hydro Corporation (***Corporation***) has established the Audit Committee (***Committee***) to assist the Board in fulfilling its corporate governance and oversight responsibilities with respect to financial reporting, internal financial control structure, financial risk management systems, internal audit and external audit functions.
- (2) The composition, responsibilities and authority of the Committee are set out in this Charter.
- (3) This Charter and the by-laws of the Corporation and such other procedures, not inconsistent therewith, as the Committee may adopt from time to time shall govern the meetings and procedures of the Committee.

2. Composition

- (1) The Committee shall be composed of at least three directors of the Corporation (***Members***):
 - (a) all Members shall be *independent* (as determined by the Board in accordance with the rules of the Canadian Securities Administrators with respect to the role and composition of audit committees); and
 - (b) at least one of whom, including the chair of the Committee (Chair) is *financially literate* (ie, have the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the accounting issues that can reasonably be expected to be raised by the financial statements of the Corporation).
- (2) Members shall be appointed by the Board on the recommendation of the Chair of the Board and shall serve until they resign, cease to be a Director or are removed or replaced by the Board.
- (3) The Board shall designate one of the Members as Chair.
- (4) The Secretary of the Corporation shall be secretary of the Committee (***Secretary***).

3. Responsibilities

The Committee shall assist the Board in fulfilling its corporate governance and oversight responsibilities with respect to financial reporting, internal financial control structure, financial risk management systems, internal audit functions and external audit functions.

The Committee shall have the responsibilities set out below.

(1) *Managing the Relationship between the Corporation and its External Auditors*

The Committee shall be responsible for managing the relationship between the Corporation and its external auditors, including:

- (a) appointing and replacing the external auditors, subject to shareholder approval;
- (b) setting the compensation of the external auditors subject to the approval of the board of directors or shareholder, as applicable;
- (c) overseeing the work of the external auditors, including resolving disagreements between management and the external auditors with respect to financial reporting;
- (d) pre-approving all audit services and permitted non-audit services to be provided to the Corporation and its subsidiary entities by the external auditors in accordance with the “Policy on the Provision of services by the External Auditors”;
- (e) having the external auditors report to the Committee in a timely manner with respect to all required matters, including those set out in paragraph 3(2);
- (f) reviewing and approving the hiring policies of the Corporation with respect to present and former partners and employees of the external auditors;
- (g) ensuring the rotation of the audit partner having primary responsibility for the external audit of the Corporation, the audit partner responsible for reviewing the external audit and the external auditors at such intervals as may be required; and
- (h) reviewing and assessing the performance, independence and objectivity of the external auditors.

(2) *Overseeing the External Audit*

The Committee shall be responsible for overseeing the external audit of the Corporation, including:

- (a) reviewing and approving the engagement letter and the audit plan, including financial risk areas identified by the external auditors and management;

- (b) reviewing and assessing the accounting and reporting practices and principles used by the Corporation in preparing its financial statements, including:
 - (1) all significant accounting policies and practices used, including changes from preceding years and any proposed changes for future years;
 - (2) all significant financial reporting issues, estimates and judgments made;
 - (3) all alternative treatments of financial information discussed by the external auditors and management, the results of such discussions and the treatments preferred by the external auditors;
 - (4) any major issues identified by the external auditors with respect to the adequacy of internal control systems and procedures and any special audit steps adopted in light of material deficiencies and weaknesses;
 - (5) the effect of regulatory and accounting initiatives and off-balance sheet transactions or structures on the financial statements;
 - (6) any errors or omissions in, and any required restatement of, the financial statements for preceding years;
 - (7) all significant tax issues;
 - (8) the reporting of all material contingent liabilities; and
 - (9) any material written communications between the external auditors and management;
- (c) reviewing and assessing the results of the external audit and the external auditors' opinion on the financial statements;
- (d) reviewing and discussing with the external auditors and management any management or internal control letters issued or proposed to be issued by the external auditors;
- (e) reviewing and discussing with the external auditors any problems or difficulties encountered by them in the course of their audit work and management's response (including any restrictions on the scope of activities or access to requested information and any significant disagreements with management); and
- (f) reviewing and discussing with legal counsel any legal matters that may have a material impact on the financial statements, operations, assets or compliance policies of the Corporation and any material reports or enquiries received by the Corporation and its subsidiary entities from regulators or government agencies.

3. *Overseeing the Internal Audit*

The Committee shall be responsible for overseeing the internal audit of the Corporation, including:

- (a) periodically reviewing the Internal Audit Charter and making recommendations to the Board;
- (b) reviewing and approving the audit plan, including significant risk exposures identified by the internal auditor and management;
- (c) reviewing and discussing with the internal auditor and management the results of any internal audits;
- (d) reviewing and discussing with the internal auditors any problems or difficulties encountered by them in the course of their audit work and management's response (including any restrictions on the scope of activities or access to requested information and any significant disagreements with management);
- (e) appointing and replacing the internal auditor;
- (f) reviewing and assessing the performance of the internal auditor;
- (g) ensure the Committee is kept informed of emerging trends and successful practices in internal auditing; and
- (h) confirm there is effective and efficient coordination of activities between internal and external auditors.

(4) *Reviewing and Approving and Recommending to the Board for Approval the Financial Statements, MD&A and Interim Reports of the Corporation*

The Committee shall review and approve, and where required recommend to the Board for approval, the financial statements, management's discussion and analysis of financial condition and results of operations (**MD&A**) and interim financial reports of the Corporation, annual information form (**AIF**) and other public disclosure of financial information extracted from the financial statements of the Corporation with particular focus on:

- (a) the quality and appropriateness of accounting and reporting practices and principles and any changes thereto;
- (b) major estimates or judgments, including alternative treatments of financial information discussed by management and the external auditors, the results of such discussions and the treatment preferred by the external auditors;
- (c) material financial risks;
- (d) material transactions;

- (e) material adjustments;
- (f) compliance with loan agreements;
- (g) material off-balance sheet transactions and structures;
- (h) compliance with accounting standards;
- (i) compliance with legal and regulatory requirements; and
- (j) disagreements with management.

(5) *Overseeing Internal Financial Control Structure and Financial Risk Management Systems*

The Committee shall be responsible for overseeing the internal financial control structure and financial risk management systems of the Corporation, including:

- (a) reviewing and discussing with management and the external auditors the quality and adequacy of internal control over financial reporting structures of the Corporation, including any major deficiencies or weakness and the steps taken by management to rectify these deficiencies or weaknesses;
- (b) reviewing and discussing with management, the internal auditor and the external auditors the risk assessment and risk management policies of the Corporation, the major financial risk exposures of the Corporation and the steps taken by management to monitor and control these exposures;
- (c) reviewing and discussing with the Chief Executive Officer and the Chief Financial Officer of the Corporation the procedures undertaken by them in connection with the certifications required to be given by them in connection with annual and other filings required to be made by the Corporation under applicable securities laws; and
- (d) periodically reviewing the Treasury Policy and signing policies for the Corporation and its subsidiaries, making recommendations to the Board in respect of such policies and reviewing performance under those policies with Management.

(6) *Establish and Review Certain Procedures*

The Committee shall establish adequate policies and procedures, or require that adequate policies and procedures are established, with respect to the following and shall annually assess the adequacy of these procedures:

- (a) the review of the public disclosure of financial information extracted from the financial statements of the Corporation;

- (b) the receipt, retention and treatment of complaints received by the Corporation with respect to accounting, internal controls or auditing matters; and
- (c) the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.

4. Authority

- (1) The Committee is authorized to carry out its responsibilities as set out in this Charter and to make recommendations to the Board arising therefrom.
- (2) The Committee may delegate by written policy to the Chair and the Chief Financial Officer of the Corporation (**CFO**) the authority, within specified limits, to authorize in advance all engagements of the external auditors to provide pre-approved services to the Corporation and its subsidiary entities. The Chair and the CFO shall report all engagements authorized by them to the Committee at its next meeting.
- (3) The Committee shall have direct and unrestricted access to the external and internal auditors, officers and employees and information and records of the Corporation.
- (4) The Committee is authorized to retain, and to set and pay the compensation of, independent legal counsel and other advisors if it considers this appropriate.
- (5) The Committee is authorized to invite officers and employees of the Corporation and outsiders with relevant experience and expertise to attend or participate in its meetings and proceedings if it considers this appropriate.
- (6) The external auditors shall have direct and unrestricted access to the Committee and shall report directly to the Committee.
- (7) The Corporation shall pay directly or reimburse the Committee for the expenses incurred by the Committee in carrying out its responsibilities.

5. Meetings and Proceedings

- (1) The Committee shall meet as frequently as required but not less frequently than four times each year.
- (2) Any Member or the Secretary may call a meeting of the Committee. The external auditors or the CFO may ask a Member to call a meeting of the Committee.
- (3) The Chair shall approve the agenda of each meeting of the Committee, including input from the officers and employees of the Corporation, external auditors, other Members and other directors of the Corporation as appropriate. Meetings will include presentations by management or professional advisors and consultants when appropriate and allow sufficient time to permit a full and open discussion of agenda items.

- (4) Unless waived by all Members, a notice of each meeting of the Committee confirming the date, time, place and agenda of the meeting, together with any supporting materials, shall be forwarded to each Member at least three days before the date of the meeting.
- (5) The quorum for each meeting of the Committee is two Members. In the absence of the Chair, the other Members may appoint one of their number as chair of a meeting. The Chair of a meeting shall not have a second or casting vote.
- (6) The Chair or a delegate of the Chair shall report to the Board following each meeting of the Committee.
- (7) The Secretary or a delegate of the Secretary shall keep minutes of all meetings of the Committee, including all resolutions passed by the Committee. Minutes of all meetings shall be distributed to the Members. The minutes shall be available for review by the other directors of the Corporation after approval thereof by the Committee.
- (8) An individual who is not a Member may be invited to attend a meeting of the Committee for all or part of the meeting. A standing invitation to all meetings shall be given to the Chairman of the Board, the President and Chief Executive Officer of the Corporation, the CFO except where the meeting, or part of the meeting, is for Members only or a private session with the internal auditor or the external auditors. A standing invitation should be given to the internal auditor and the engagement partners of the external auditors for all meetings where financial information is reviewed and approved..
- (9) The Committee shall meet regularly alone and in private sessions with the internal audit leader, the external auditors and management of the Corporation to facilitate full communication.

6. Review

- (1) This Charter shall be reviewed by the Corporate Governance Committee of the Corporation every 2 years and any recommended changes shall be referred first to the Audit Committee for review and comment and second, after consideration of the input from the Audit Committee, to the Board of the Corporation for consideration and disposition.

TORONTO HYDRO CORPORATION

Charter – Corporate Governance Committee

1. General

- (1) The board of directors (***Board***) of *Toronto Hydro Corporation (Corporation)* has established the Corporate Governance Committee (***Committee***) to assist the Board in fulfilling its responsibilities with respect to the operation of the Board, Board committees, boards of its subsidiaries and corporate governance standards and practices.
- (2) The composition, responsibilities and authority of the Committee are set out in this Charter.
- (3) This Charter and the by-laws of the Corporation and such other procedures, not inconsistent therewith, as the Committee may adopt from time to time shall govern the meetings and procedures of the Committee.

2. Composition

- (1) The Committee shall be composed of at least two directors of the Corporation (***Members***).
- (2) Members shall be appointed by the Board on the recommendation of the Chair of the Board and shall serve until they resign, cease to be a Director or are removed or replaced by the Board.
- (3) The Board shall designate one of the Members as chair of the Committee (***Chair***).
- (4) The Secretary of the Corporation shall be secretary of the Committee (***Secretary***).

3. Responsibilities

The Committee shall assist the Board in fulfilling its responsibilities with respect to the operation of the Board and Board committees and corporate governance standards and practices. The Committee shall have the responsibilities set out below.

3.1 ***Responsibilities with respect to the Operation of the Board and Board Committees***

The Committee shall:

- (a) facilitate the periodic review of the operation of the Board and Board committees, including the agenda for and reports and other information provided at, meetings and the conduct of meetings, and make recommendations to the Board;
- (b) facilitate the periodic assessment of the performance of the Board and Board committees and report the results of that assessment to the Board;
- (c) facilitate the periodic assessment of the effectiveness of the relationship between the Board and the Chief Executive Officer and other senior officers of the Corporation and report the results of that assessment to the Board; and
- (d) facilitate the effective orientation and continuing education of the new and existing directors of the Corporation.

3.2 *Responsibilities with respect to Corporate Governance*

The Committee shall:

- (a) review with Management corporate governance standards, practices and new laws applicable to the Corporation and make recommendations to the Board;
- (b) annually review the Shareholder Direction from the City and make recommendations to the Board to facilitate and clarify interactions and communication between the Shareholder and the Board;
- (c) periodically review the articles and by-laws of the Corporation, the Code Of Business Conduct, the mandates of the Board and the boards of its subsidiaries, charters of the Board committees, the shareholder directions for the subsidiaries, and the Disclosure Policy, and make recommendations to the Board;
- (d) periodically review performance under the Disclosure Policy with Management;
- (e) review and approve the disclosure with respect to corporate governance practices required to be included in the annual and other filings required to be made by the Corporation under applicable securities laws;
- (f) review and approve any other disclosure of corporate governance practices before public disclosure by the Corporation; and
- (g) periodically review the Shareholder Direction and make recommendations regarding Board compensation to the Board for delivery to the Shareholder to ensure compensation of the Board is comparable to that of similar Boards in order to attract and retain competent Board members.

4. Authority

- (1) The Committee is authorized to carry out its responsibilities as set out in this Charter and to make recommendations to the Board arising therefrom.

- (2) The Committee is authorized to retain, and to set and pay the compensation of, independent legal counsel and other advisors if it considers this appropriate.
- (3) The Committee is authorized to invite officers and employees of the Corporation and others with relevant experience and expertise to attend or participate in its meetings and proceedings if it considers this appropriate.
- (4) The Corporation shall pay directly or reimburse the Committee for the expenses incurred by the Committee in carrying out its responsibilities.

5. Meetings and Proceedings

- (1) The Committee shall meet as frequently as required but not less frequently than twice each year.
- (2) Any Member or the Secretary may call a meeting of the Committee.
- (3) The Chair is responsible for the agenda of each meeting of the Committee, including input from the officers and employees of the Corporation, other Members and other directors of the Corporation as appropriate. Meetings will include presentations by management and others when appropriate and allow sufficient time to permit a full and open discussion of agenda items.
- (4) Unless waived by all Members, a notice of each meeting of the Committee confirming the date, time, place and agenda of the meeting, together with any supporting materials, shall be forwarded to each Member at least three days before the date of the meeting.
- (5) The quorum for each meeting of the Committee is two Members. In the absence of the Chair, the other Members may appoint one of their number as chair of a meeting. The chair of a meeting shall not have a second or casting vote.
- (6) The Chair or his delegate shall report to the Board following each meeting of the Committee.
- (7) The Secretary or his delegate shall keep minutes of all meetings of the Committee, including all resolutions passed by the Committee. Minutes of meetings shall be distributed to the Members. The minutes shall be available for review by the other directors of the Corporation after approval thereof by the Committee.
- (8) An individual who is not a Member may be invited to attend a meeting of the Committee for all or part of the meeting. The Chair of the Board has a standing invitation to attend all meetings of the Committee except for those meetings or parts of meetings where the Committee meets alone.
- (9) The Committee shall meet regularly alone to facilitate full communication.

6. Review

- (1) This Charter shall be reviewed every two years by the Committee and any recommended changes shall be referred to the Board of the Corporation for consideration and disposition.

GOVERNANCE – BOARD COMMITTEES

TORONTO HYDRO CORPORATION

Charter – Human Resources Committee

1. General

- (1) established a Compensation Committee to assist the Board in fulfilling its responsibilities with respect to the recruitment and assessment of the performance of the Chief Executive Officer (*CEO*) of the Corporation, the compensation of the CEO and the other officers (*Executive Officers*) of the Corporation and its subsidiary entities (*Group*), the review and approval of executive compensation disclosure and the oversight of the compensation structure and benefit plans and programs of the Group.
- (2) The Board also previously established a Health and Safety Committee to advise and assist the Board with respect to health and safety matters arising out of the activities of the Group.
- (3) The Board has determined that it was in the best interests of the Corporation to combine the activities and responsibilities of the Compensation Committee and the Health and Safety Committee under a single Human Resources Committee (*Committee*) of the Board and to eliminate the separate Compensation Committee and Health and Safety Committees.
- (4) The composition, responsibilities and authority of the Committee are set out in this Charter.
- (5) This Charter and the by-laws of the Corporation and such other procedures, not inconsistent therewith, as the Committee may adopt from time to time shall govern the meetings and procedures of the Committee.

2. Composition

- (1) The Committee shall be composed of at least three (3) directors of the Corporation (*Members*)
- (2) All Members shall be *independent* (as determined by the Board in accordance with the guidelines of the Canadian Securities Administrators), except as provided for in Subsection 2(3).

- (3) In accordance with the City of Toronto Amended and Restated Shareholder Direction to the Corporation, the Committee shall include one director of the Corporation who is also a City of Toronto Councillor in its membership.
- (4) Members shall be appointed by the Board on the recommendation of the Chair of the Board and shall serve until they resign, cease to be a director or are removed or replaced by the Board. Where possible, the Board shall appoint Members who have skills and experience with respect to executive compensation matters and other human resources related matters, with a view to establishing a Committee that has the skills and experience to make decisions on the suitability of the Group's compensation policies and practices and other human resources-related policies and practices.
- (5) The Board shall designate one of the Members as chair of the Committee (***Chair***). Where possible, the Chair shall have direct skills and experience with respect to executive compensation matters.
- (6) The Secretary of the Corporation shall be the secretary of the Committee (***Secretary***).

3. Responsibilities

The Committee shall assist the Board in fulfilling its responsibilities with respect to the recruitment and assessment of the performance of the CEO, the compensation of the CEO and the Executive Officers, the review and approval of executive compensation disclosure, the oversight of the compensation structure and benefit plans and programs of the Group and in respect of the environmental and health and safety matters that arise from the activities of the Group. The Committee shall have the responsibilities set out in the following:

3.1 *Responsibilities with respect to the CEO*

The Committee shall:

- (a) periodically review the position description of the CEO and make recommendations to the Board;
- (b) when requested by the Board, oversee the process of identifying and recruiting new candidates for appointment as CEO, including assessing the competencies and skills of identified individuals, reporting the results of that assessment to the Board and making a recommendation for appointment of the CEO to the Board;
- (c) annually, and more frequently if appropriate, make recommendations to the Board with respect to the compensation and benefits of the CEO, including:
 - (i) the review and approval of the base salary of the CEO;
 - (ii) the review and approval of the corporate and individual performance objectives relative to the performance-based incentive compensation of the CEO;

- (iii) the assessment of the performance of the CEO in light of those corporate and individual performance objectives; and
 - (iv) the review and approval of the performance-based incentive compensation payable to the CEO for the attainment of those corporate and individual performance objectives; and
- (d) review and approve the terms of the employment agreement and severance arrangements of the CEO for recommendation to the Board.

3.2 *Responsibilities with respect to the Executive Officers*

The Committee shall:

- (a) annually, and more frequently if appropriate, review and approve the CEO's proposals with respect to the compensation and benefits of the Executive Officers, including:
 - (i) the base salaries of the Executive Officers; and
 - (ii) the performance-based incentive compensation payable to the Executive Officers; and
- (b) review and approve the CEO's proposals with respect to the terms of the employment agreements and severance arrangements of the Executive Officers.

3.3 *Responsibilities with respect to Executive Compensation Disclosure*

The Committee shall:

- (a) review and approve the statement of executive compensation required to be filed by the Corporation in connection with annual and other filings under applicable securities laws; and
- (b) review and approve any other executive compensation disclosure before it is publicly disclosed by the Corporation.

3.4 *Responsibilities with respect to the Group's Compensation Structure and Benefit Plans and Programs*

The Committee shall be responsible to periodically review and assess the Group's compensation structure and benefit plans and programs and make recommendations to the Board with respect thereto.

Annually, and more frequently if appropriate, the Committee shall review and approve the corporate performance objectives of the Group and make recommendations to the Board with respect thereto.

3.5 *Responsibilities with respect to Succession Planning*

The Committee shall periodically, and at least annually, review with the Chair and the CEO succession planning for the CEO and the Executive Officers and report the results of that review to the Board.

3.6 *Responsibility with respect to Collective Bargaining*

The Committee shall review the recommendations of the Corporation's management in respect of collective bargaining negotiations and approve the parameters for such negotiations.

3.7 *Responsibility with respect to Health and Safety Matters:*

The Committee shall:

- (a) periodically reviewing the Environmental Policy and the Occupational Health and Safety Policy and making recommendations to the Board;
- (b) periodically reviewing performance under the Occupational Health and Safety Policy with Management;
- (c) reviewing new health and safety legislation with Management and informing the Board of its responsibilities under such legislation; and
- (d) reviewing significant health and safety issues.

4. Authority

- (1) The Committee is authorized to carry out its responsibilities as set out in this Charter and to make recommendations to the Board arising therefrom.
- (2) The Committee is authorized to retain, and to set and pay the compensation of, independent legal counsel and other advisors if it considers this appropriate.
- (3) The Committee is authorized to invite officers and employees of the Corporation and others with relevant experience and expertise to attend or participate in its meetings and proceedings if it considers this appropriate.
- (4) The Corporation shall pay directly or reimburse the Committee for the expenses incurred by the Committee in carrying out its responsibilities.

5. Meetings and Proceedings

- (1) The Committee shall meet as frequently as required but not less frequently than twice each year.
- (2) Any Member, the CEO or the Secretary may call a meeting of the Committee.
- (3) The Chair is responsible for the agenda of each meeting of the Committee, including input from the officers and employees of the Corporation, other Members and other directors of the Corporation as appropriate. Meetings will include presentations by

management and others when appropriate and allow sufficient time to permit a full and open discussion of agenda items.

- (4) Unless waived by all Members, a notice of each meeting of the Committee confirming the date, time, place and agenda of the meeting, together with any supporting materials, shall be forwarded to each Member at least three (3) days before the date of the meeting.
- (5) The quorum for each meeting of the Committee is a majority of the Members. In the absence of the Chair, the other Members may appoint another Member as chair of a meeting. The chair of a meeting shall not have a second or casting vote.
- (6) The Chair or his delegate shall deliver a report to the directors at the next meeting of the Board following each meeting of the Committee.
- (7) The Secretary or his delegate shall keep minutes of all meetings of the Committee, including all resolutions passed by the Committee. Minutes of all meetings shall be distributed to the Members. The minutes shall be available for review by the other directors of the Corporation after approval thereof by the Committee.
- (8) An individual who is not a Member may be invited to attend a meeting of the Committee for all or part of the meeting. The Chair of the Board, the President and Chief Executive Officer of the Corporation and the Vice President Organizational Effectives and Environment, Health & Safety of Toronto Hydro-Electric System Limited have a standing invitation to attend all meetings of the Committee except for those meetings or parts of meetings where the Committee meets alone. The Committee shall meet regularly alone to facilitate full communication.

6. Review

- (1) This Charter shall be reviewed by the Corporate Governance Committee of the Board every two (2) years and any recommended changes shall be referred first to the Human Resources Committee for review and comment and second, after consideration of the input from the Human Resources Committee, to the Board of the Corporation for consideration and disposition.
- (2) In addition to the bi-annual review, the Human Resources Committee may at any time review the Charter and make recommendations to the Corporate Governance Committee for their review and recommendations to the Board with respect thereto.

STRATEGIC PLANNING

This schedule provides an overview of Toronto Hydro's strategic planning framework.

The strategic planning framework is at the core of Toronto Hydro's governance practices, helping the utility run in such a way that it achieves its objectives in an effective and transparent manner. Strategic planning allows Toronto Hydro's management to govern the utility more efficiently, to allocate resources more strategically, and enables improved outcomes for the organization and, ultimately, for our ratepayers. Toronto Hydro's approach to strategic planning is governed through frameworks including:

- 1) Corporate Strategy;
- 2) Business Planning ;
- 3) Enterprise Risk Management ("ERM"); and
- 4) Corporate Disaster Preparedness ("CDP").

The strategic planning framework allows Toronto Hydro's leadership to:

- identify its strategic direction;
- better focus its resources on desired results;
- better understand and consider stakeholder needs and interests;
- control and mitigate risks through consistent and disciplined methods; and,
- better prepare for, respond to, and recover from, large-scale events facing the utility.

1. CORPORATE STRATEGY

Corporate Strategy is one of the key components of the Strategic Planning process.

Toronto Hydro's Corporate Strategy guides the process of establishing strategic goals for

the utility. Strategic goals reflect the utility's efforts to optimize the financial, human, social, and technological resources of the organization.

Toronto Hydro's strategic vision is to continuously improve ratepayer satisfaction by operating in a safe, reliable and environmentally responsible manner at optimal costs. To realize this vision, Toronto Hydro employs a framework consisting of four strategic pillars as illustrated in Figure 1 below.



Figure 1: Toronto Hydro Strategic Pillars

The pillars are aligned with the Ontario Energy Board's ("OEB") performance outcomes described in the RRFE Report¹ and the other regulatory instruments adopted by the OEB from time to time. The pillars focus the organization on:

- 1) providing value to its ratepayers;
- 2) building a safe, reliable and efficient distribution system;
- 3) maintaining a fully- engaged, safe and healthy workforce; and

¹ Report of the Board "Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach" (October 18, 2012) [the "RRFE Report"].

- 1 4) providing a financially stable and sustainable business model through efficient run
2 of operations and a productive workforce.

3
4 Within in each of Toronto Hydro’s pillars are a series of strategic objectives. Those
5 objectives are shown in Figure 2.



6 **Figure 2: Toronto Hydro’s Strategic Objectives**

7 Toronto Hydro reviews its corporate strategy annually using the four strategic pillars as
8 guidance. The corporate strategy is developed by the utility’s leadership for approval by
9 the Board of Directors.

12 **2. BUSINESS PLANNING**

13 Upon approval, Toronto Hydro translates the updated corporate strategy and objectives
14 into a Business Plan.

15
16 As with any enterprise business planning is an important element in the success of
17 Toronto Hydro. Good business planning addresses major issues facing the organization
18 and the industry. It engages and aligns Toronto Hydro business units on major initiatives

1 in support of achieving the strategy. It enables the respective business units to execute
2 their programs with a view to meeting the broad corporate objectives outlined in the
3 strategy and encourages them to keep on the track of achievement. Business planning is
4 also used as a means for deciding how to utilize limited resources and capabilities. Like
5 all utilities regulated by the OEB, Toronto Hydro produces and publishes detailed
6 financial reporting pursuant to the Electricity Reporting and Recordkeeping
7 Requirements (the “RRR”). For more information about the budgeting process, please
8 refer to Exhibit 4A, Tab 1, Schedule 1.

9
10 Leadership and managers are obliged to track divisional progress toward the goals
11 adopted by the Board of Directors, and to provide remedial action plans where
12 achievement is lagging.

13
14 This process is intended to create a sense of urgency within the organization with respect
15 to the Strategic Objectives (Figure 2, above). Achievement is a priority of every level of
16 the company and every effort is made to ensure that the organization as a whole has a
17 firm grasp of expectations. This is a demanding process, requiring a level of commitment
18 and focus that is significant. The utility takes the view that the development of the
19 Corporate Strategy is integral to success and worth a major, ongoing focus at every level.

20
21 As part of its performance-driven culture, Toronto Hydro uses a Balanced Scorecard
22 framework to track the effects of the implementation of the business plan against its
23 strategic goals.

24
25 The Balanced Scorecard approach is a commonly used framework to aid in the successful
26 execution of a corporate strategy.² Applying a Balanced Scorecard approach at Toronto
27 Hydro provides a number of benefits, including:

- 1 • aligning strategic objectives across all levels of the organization to improve
- 2 outcomes;
- 3 • short interval control, which provides management with a comprehensive picture
- 4 of business operations throughout the year and ability to direct corrective actions
- 5 to achieve desired results;
- 6 • facilitating communication and reinforce the utility's goals and strategies to all
- 7 employees;
- 8 • encouraging dialogue within the organization about strategic goals and
- 9 expectations; and
- 10 • strengthening good governance practices through the use of a consistent and
- 11 systematic approach to measure and report results across the organization.

12

13 The Balanced Scorecard aligns the strategic pillars with operational outcomes by
14 monitoring progress using a series of metrics. These metrics are referred to as Key
15 Performance Indicators ("KPIs").

16

17

18 **3. ENTERPRISE RISK MANAGEMENT ("ERM")**

19 ERM provides Toronto Hydro with a systematic, disciplined approach towards
20 identifying, evaluating, treating, monitoring and reporting on risks. ERM is an integral
21 part of the utility's strategic planning that embeds risk considerations in forecasting,
22 planning and program execution.

23

24 **3.1. Approach to ERM**

25 To manage risk prudently and systematically, Toronto Hydro employs an ERM
26 framework based on industry best practices and the International Organization for
27 Standardization ("ISO") 31000 guideline, illustrated in Figure 3 below.

28

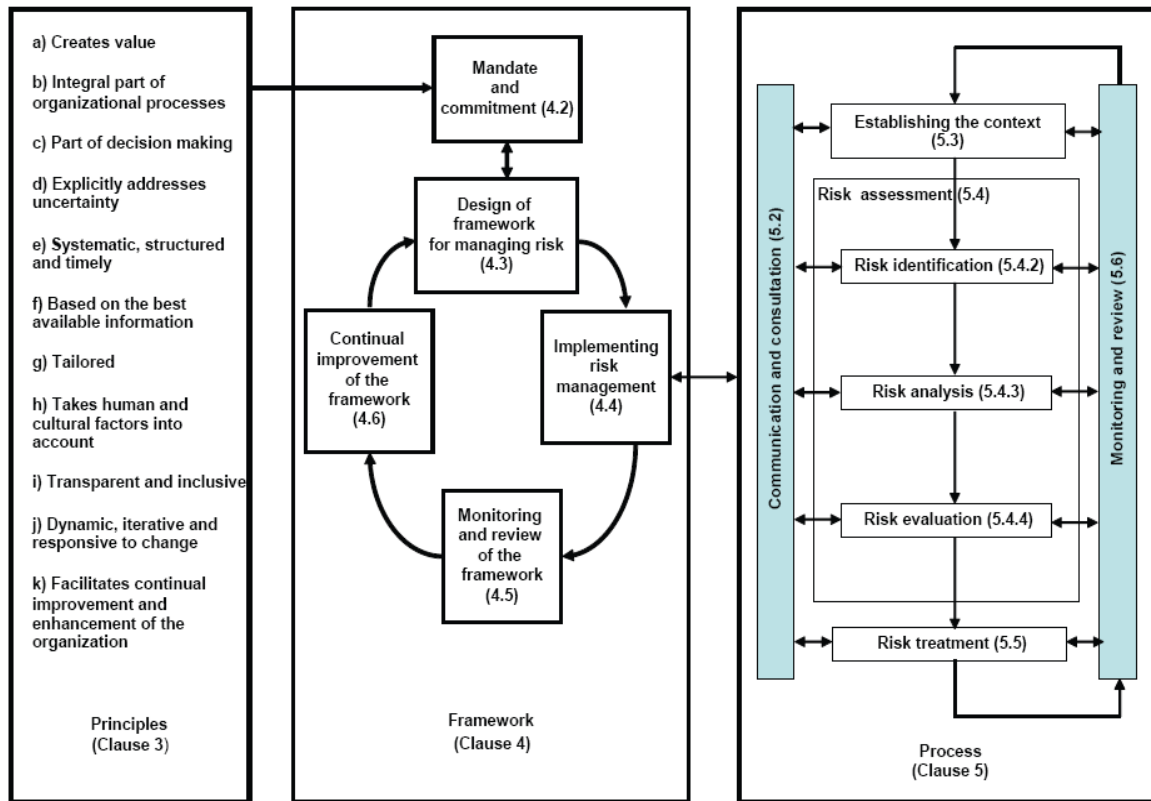


Figure 3: ISO 31000 Relationships between the Risk Management Principles, Framework and Process.

The ISO 31000 establishes principles and provides generic guidelines on risk management. The guideline recommends that organizations develop, implement and continuously improve a risk framework that is integrated into their overall governance, strategy, planning, management, reporting processes, policies, values and culture.

Accordingly, Toronto Hydro's ERM framework:

- provides a consistent, disciplined methodology for identifying, assessing, treating, monitoring and reporting risks;
- facilitates training and awareness on risk management; and
- integrates reporting of all levels of risk through risk metrics and other indicators.

Toronto Hydro's ERM framework has been recognized for its level of sophistication and accomplishments and as an example of best practices.

3.2. ERM governance

Toronto Hydro's risk governance structure helps the utility fulfill the ERM framework objectives. Figure 4 illustrates the four levels of risk governance that Toronto Hydro uses to identify and ultimately mitigate key risks.

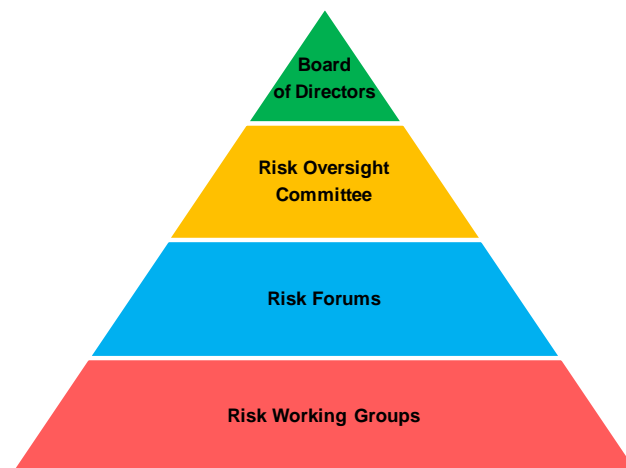


Figure 4: Toronto Hydro's risk governance structure

The Board of Directors reviews Toronto Hydro's risk profile to confirm that the greatest risks to the organization are being addressed and managed.

The responsibility of the Risk Oversight Committee ("ROC") is to assess the appropriateness and consistent application of the risk management systems that are in place to identify, manage, and monitor risks. The ROC is also responsible for bringing key risks to the attention of the Board of Directors and assisting management in addressing them.

Risk Management Forums and Working Groups oversee the execution of risk management in Toronto Hydro's operations and support the ROC and the Board of Directors by enabling effective, efficient, complete and transparent risk reporting.

3.3. Risk Assessment

Risk Assessment provides a framework through which risks are identified, evaluated and compared in support of determining appropriate risk tolerances. Toronto Hydro's Risk Assessment framework is based on the ISO 31000 risk management guideline illustrated in Figure 5 and has three phases.



Figure 5: Toronto Hydro's Risk Management Process

Phase 1 (Risk Identification) is performed at an enterprise level and considers both internal and external factors. Key risks facing the organization are identified and then broken down into their constituent parts at the business unit level. Risks identified here are called component risks. Such risks are more closely aligned to a business unit's activities and are typically more specific.

In Phase 2, a risk analysis is performed on the component risks using a standard risk assessment and reporting schedule maintained through this framework. Upon

1 completion, component risk assessments are aggregated back to the enterprise level, but
2 now with more granular information about how the risks can affect Toronto Hydro's
3 operations.

4
5 Phase 3 includes the management of risk on an ongoing basis. Here risk mitigation plans
6 are developed and reported on regularly. The framework provides a common risk
7 reporting process. Consistency in reporting is essential to ensure that risks are easily
8 comparable and can be aggregated.

9
10 Collectively, these three phases provide Toronto Hydro with the best information
11 available at a given point in time to make informed, risk-based decisions. Accordingly,
12 this approach has the following benefits to the utility:

- 13 • facilitating the engagement and support of staff at all levels in assessing risk and
14 building a risk-aware culture;
- 15 • providing a consistent approach (i.e., processes, tools, methodologies and
16 taxonomy) for the organization to talk about and compare risks;
- 17 • facilitating the allocation of accountability and responsibility for risk at the
18 appropriate level of the organization; and
- 19 • allowing risks to be considered when making resource decisions.

20 21 **3.4. Quantifying Risks**

22 Toronto Hydro employs a risk quantification model in assessing risk. This model uses
23 two main concepts: qualitative analysis and risk indicator scoring.

24
25 Qualitative analysis is composed of key concepts such as impact, likelihood and velocity.
26 "Likelihood" is used to refer to the chance of a risk occurring something happening,
27 whether defined, measured or determined objectively or subjectively, qualitatively or
28 quantitatively, and described using general terms. "Impact" is defined as the degree to

1 which the outcomes of an event would affect the utility and its objectives. “Velocity”
2 refers to defining how quickly the Risk Impact will be realized in the utility. Risk impact
3 is measured on a five-level scale (minor, moderate, major, severe and catastrophic). Risk
4 likelihood is also measured on a five-level scale (remote, unlikely, likely, very likely,
5 virtually certain). The higher the combined scores (i.e. impact multiplied by likelihood)
6 the greater the risk exposure.

7
8 Supporting this is the use of risk indicators, a set of measures that demonstrates if risks
9 are increasing, decreasing or remaining steady. These indicators are typically “leading”
10 in nature. A leading indicator is a metric that can indicate a potential change in risk prior
11 to that change occurring. This assists in forecasting potential future risk exposure.
12 Collectively the risk indicators and the qualitative analysis are reviewed to quantify risks
13 facing the utility.

14 15 **3.5. Risk Tolerance**

16 Toronto Hydro’s Risk Appetite Statement (“RAS”) supports the tools described above.
17 The RAS establishes a common framework between Toronto Hydro and the Board of
18 Directors regarding the utility’s tolerance for risk in the execution of its corporate
19 strategy.

20
21 Toronto Hydro’s corporate RAS is broken down into two pieces. The first part is the
22 Board of Director’s risk philosophy statement that sets general guidance on risk
23 tolerance. The risk philosophy statement is then broken down into more manageable risk
24 limits. Toronto Hydro identifies the specific strategic drivers and establishes the risk
25 tolerance along five levels (low to catastrophic) per strategic driver.

1 Toronto Hydro developed its RAS using a balanced approach, basing its risk acceptance
2 on both internal and external factors. The utility uses the RAS to inform and guide
3 decision making in its operations.

4 5 **3.6. Risk Reporting**

6 Risk reporting is an additional tool within the ERM framework used to ensure good
7 governance and to inform decision makers about risk.

8
9 Regular risk reporting provides management and the Board of Directors with the
10 assurance that established controls and risk treatment initiatives are functioning properly.
11 At the ROC, risk information is received and reviewed following a risk assessment and
12 risk reporting schedule. Key risk information is reviewed and decisions made regarding
13 risk management activities. At the Board of Director level, enterprise risks are reviewed
14 on a quarterly basis.

15 16 17 **4. CORPORATE DISASTER PREPAREDNESS**

18 The last piece of the Toronto Hydro strategic planning framework is the Corporate
19 Disaster Preparedness (“CDP”) framework. The CDP framework sets out an enterprise-
20 wide standard to manage corporate disasters. A corporate disaster is an event which
21 exceeds the organization’s regular response capabilities and requires a fundamentally
22 different set of operating procedures for effective corporate response. This framework is
23 an overarching management system and corporate standard for the development,
24 implementation and continuous improvement of all disaster preparedness functions,
25 namely emergency management, business continuity and contingency planning.

26
27 As an example, Toronto Hydro has experienced more frequent, large scale, rapid on-set
28 weather disasters that have impacted the reliable operation of Toronto Hydro’s

1 distribution system and has exceeded its regular response capability. Events such as the
2 recent Ice Storm (2013), July 8 Flash Floods (2013) and Hurricane Sandy (2012) are
3 examples of the types of weather events that exceed Toronto Hydro's standard response
4 practices and require additional planning and response resources for effective
5 management. Other potential disasters such as riots, terrorist attack, pandemics also pose
6 a potential disruption beyond the normal response capabilities of the corporation and also
7 fall into the scope of this CDP framework.

8
9 The CDP framework is based on best practices and international standards (CSA Z1600,
10 Emergency Management and Business Continuity and ISO 22301 Business Continuity
11 Management). In addition, Toronto Hydro follows other international best practices such
12 as the Incident Management System ("IMS") and Incident Command System ("ICS") to
13 ensure effective emergency response during an emergency. The IMS and ICS
14 frameworks are currently in the early stages of development and the utility plans to
15 significantly expand their implementation across the company, as discussed in the
16 Disaster Preparedness Management program.³

17
18 Training and scenario-based exercises are conducted throughout the year to help ensure
19 that the disaster management system is understood and roles and responsibilities under
20 emergencies are entrenched. As with the ICS and IMS framework, Toronto Hydro plans
21 to substantially expand the scope and frequency of emergency-related training exercises
22 to facilitate optimal preparedness to major contingency events by Toronto Hydro's
23 workforce, as further discussed in Exhibit 4B, Tab 2, Schedule 4. Expanding training and
24 other exercises over the 2015 to 2019 period would allow Toronto Hydro to rehearse the
25 use of disaster preparedness plans and protocols to assist in providing a more efficient
26 response.

27

³ Exhibit 4B, Tab 2, Schedule 4.

1 In addition to building and implementing this framework, Toronto Hydro enables the
2 utility to continuously improve its planning, response and coordination with municipal
3 and provincial emergency agencies. During an emergency, engagement and cooperation
4 between Toronto Hydro, the City and Province may be required for effective response
5 actions to be taken. To allow the utility to respond effectively in an emergency, Toronto
6 Hydro is available to liaise with these agencies twenty-four hours a day.

FINANCIAL PLANNING PROCESS

1. OVERVIEW

Currently, financial planning at Toronto Hydro is conducted annually and results in a three-year Plan – a detailed plan for the first year and a directional plan for the next two years. Given the requirements of the five-year Custom Incentive Rate (“CIR”) application, the term of the planning activities for the period beginning 2015 was extended to five years (the “planning activity”).

2. APPROACH

Toronto Hydro’s corporate plans are informed by a number of operational needs such as asset investment requirements, maintenance requirements, staffing requirements and legislative and regulatory obligations. The plans are also informed by other important considerations such as customer needs and preferences (including service levels and consumption-management tools), rate impacts, value-for-money, productivity, and maintaining the financial health and viability of the utility.

In other words, the utility considers a number of input considerations and objectives in order to generate its plans. No one of these considerations is determinative of the utility’s ultimate plan, but they all inform it. For example, while Toronto Hydro views that a capital investment approach well above \$500 million per year over the 2015-2019 period is optimal from an assets-needs perspective, in light of rate impacts and execution constraints, it has constrained its actual plan (and corresponding funding request to the OEB) to approximately \$500 million per year over the 2015-2019 period.

Toronto Hydro synthesizes these input considerations into a strategic planning philosophy called its four pillars, which are:

Customer Service

- ✓ To provide long-term value for your money
 - ✓ Make it easy to work with us
 - ✓ Help you conserve energy
- ✓ Provide you with tools and technology

Operations

- ✓ Keep the lights on
- ✓ Keep our system safe
- ✓ Build a grid that supports a modern city
- ✓ Maintain above average productivity

People

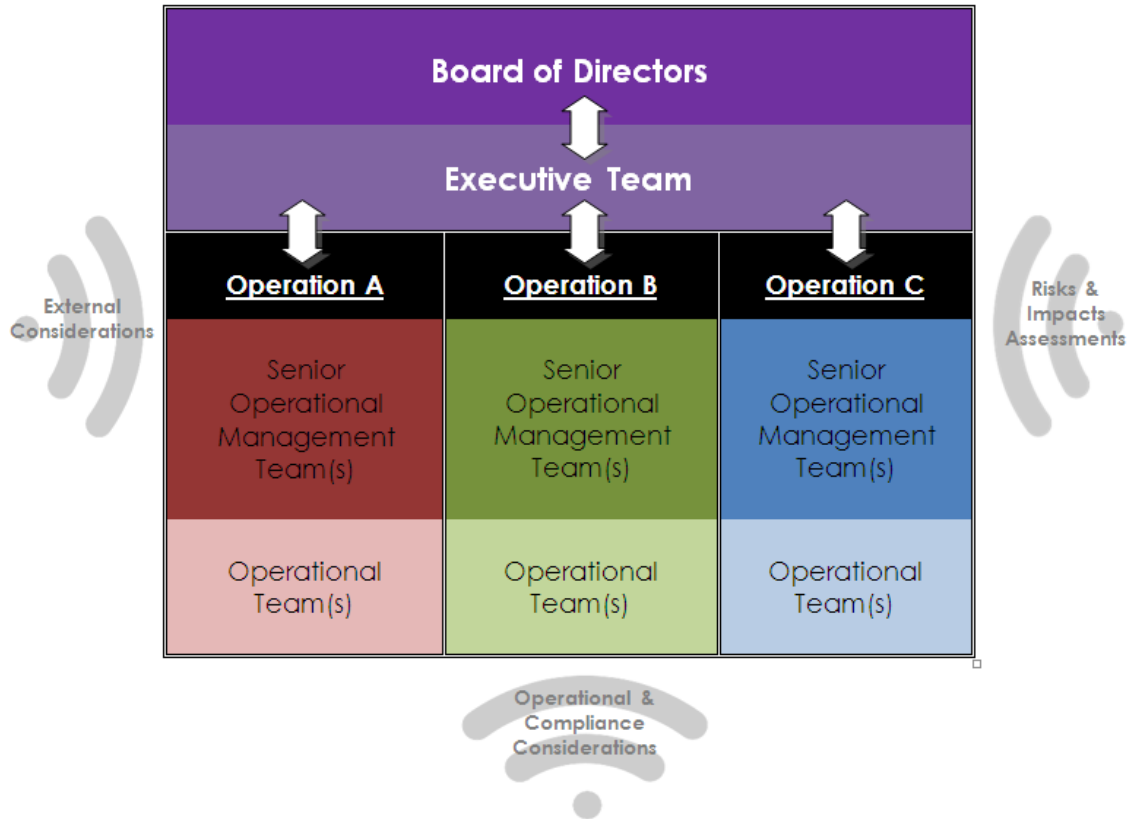
- ✓ Provide a healthy and safe workplace
- ✓ Develop a skilled and knowledgeable workforce
- ✓ Keep our workforce engaged and productive

Financial Strength

- ✓ Provide a Fair Return To Our Shareholder
- ✓ Continue to increase Shareholder Value

28 Toronto Hydro's planning activity is guided by its Strategic Pillars and compliance
29 requirements.

30 In executing its planning activities, the utility employs a combination of 'top-down' and
31 'bottom-up' planning models with an iterative planning process. That is, the overall
32 business strategy outlining the general direction of the organization is communicated
33 from the 'top' (senior management) 'down' to the operational teams. Subject matter
34 experts then incorporate this direction into their different functional areas and operational
35 realities, needs and strategies.



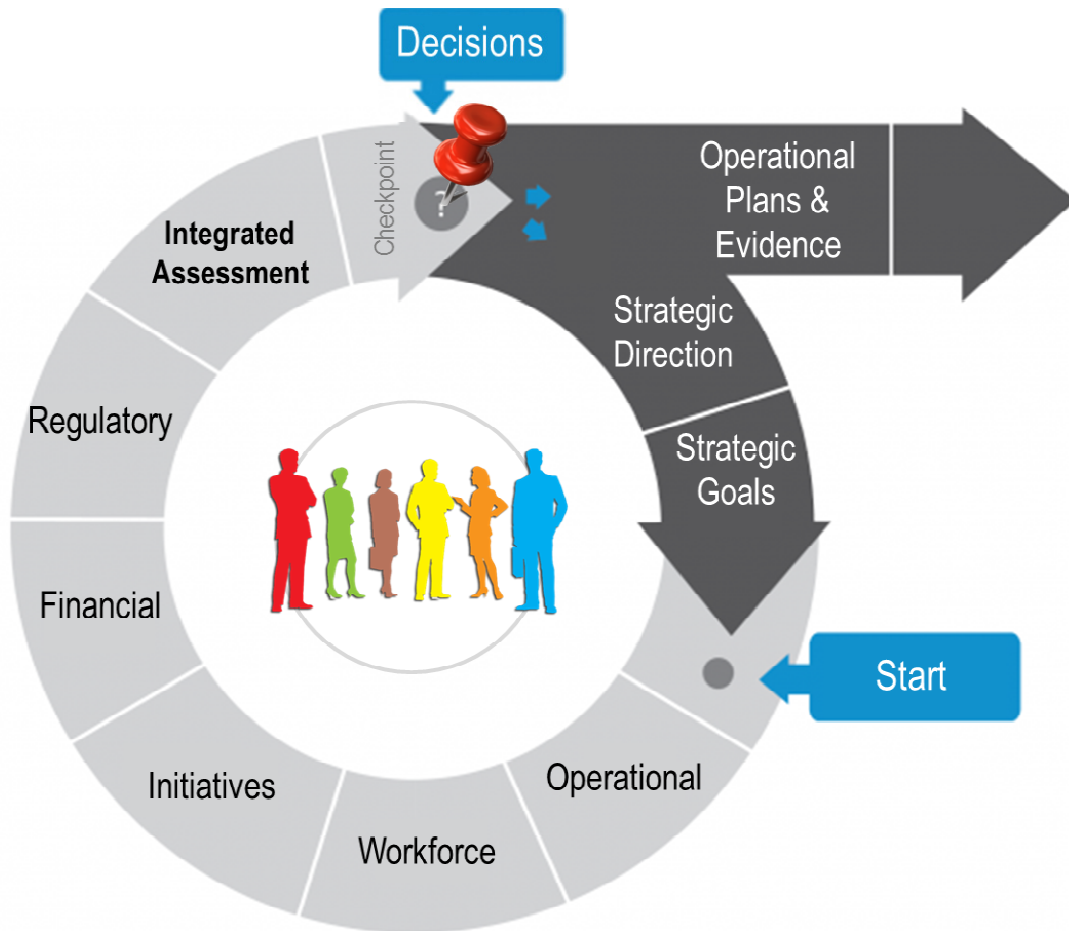
36 Finally, as operational plans incorporating the strategic direction are formed, they are
37 proposed to the senior leadership at Toronto Hydro for review, impact assessments and
38 approval.

39

40 In general, the planning process consists of four stages: 1. Corporate strategy
41 establishment; 2. Operational plan proposals; 3. Proposal reviews and selection; and 4.
42 Detailed development of projects and programs.

43

44 During the process, multiple planning activities are being concurrently conducted, and
45 inputs and outcome considerations are being formed. An iterative planning approach is
46 used in order to facilitate robust decision-making and prudent planning.



47 The results of the planning activity are reflected in this CIR application and include:

- 48 • A detailed OM&A plan for 2015; and
- 49 • Detailed annual capital investment plans for 2015 to 2019.

50

51 Further details of these results are in Exhibit 2B (DSP) and 4A (OM&A).

INTRODUCTION

In accordance with section 2.4.3 of the OEB's Filing Requirements (July 17, 2013), Exhibit 1C, Tab 4 provides the following financial information:

- Consolidated Audited Financial Statements for 2011-2013 (Schedule 2);
- Reconciliation of the financial results shown in the Audited Financial Statements with regulatory financial results (Schedule 3);
- Management's Discussion & Analysis for 2013 (Schedule 4);
- Annual Information From (Schedule 5);
- Public Offering Information (Schedule 6); and
- Rating Agency Reports (Schedule 7).

1 **AUDITED FINANCIAL STATEMENTS**

2

3 In accordance with section 2.4.3 of the OEB's Filing Requirements (July 17, 2013), this
4 schedule includes the following materials:

- 5 • 2011 Audited Financial Statements (Appendix A);
6 • 2012 Audited Financial Statements (Appendix B); and
7 • 2013 Audited Financial Statements (Appendix C).

Financial Statements

Toronto Hydro-Electric System Limited

DECEMBER 31, 2011

Financial Statements

Toronto Hydro-Electric System Limited

DECEMBER 31, 2011

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INDEPENDENT AUDITORS' REPORT

To the Shareholder of Toronto Hydro-Electric System Limited

We have audited the accompanying financial statements of Toronto Hydro-Electric System Limited, which comprise the balance sheet as at December 31, 2011, the statements of income, retained earnings and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Toronto Hydro-Electric System Limited as at December 31, 2011, and its financial performance and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Other matter

The financial statements of Toronto Hydro-Electric System Limited as at and for the year ended December 31, 2010 were audited by another auditor who expressed an unmodified opinion on those statements on March 11, 2011.

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

March 2, 2012

Toronto Hydro-Electric System Limited

BALANCE SHEETS

[in thousands of dollars]

As at December 31	2011 \$	2010 \$
ASSETS		
Current		
Cash and cash equivalents	66,744	175,513
Accounts receivable, net of allowance for doubtful accounts [note 15[b]]	191,456	184,645
Unbilled revenue [note 15[b]]	262,289	283,141
Payments in lieu of corporate taxes receivable	8,684	2,530
Inventories [note 4]	6,891	7,501
Prepaid expenses	4,404	3,805
Total current assets	540,468	657,135
Property, plant and equipment, net [note 5]	2,334,293	2,064,942
Intangible assets, net [note 6]	112,982	85,987
Regulatory assets [note 7]	77,322	85,113
Other assets [note 8]	7,331	7,518
Future income tax assets [note 17]	200,157	224,570
Total assets	3,272,553	3,125,265
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities [note 15[b]]	402,607	363,970
Other liabilities [note 9]	22,290	19,734
Deferred revenue	13,610	1,669
Promissory note payable to related party [notes 10 and 19]	-	245,057
Total current liabilities	438,507	630,430
Long-term liabilities		
Notes payable to related party [notes 10 and 19]	1,164,283	865,539
Promissory note payable to related party [notes 10 and 19]	245,058	245,058
Post-employment benefits [note 11]	176,370	166,790
Regulatory liabilities [note 7]	210,280	273,706
Other liabilities [note 12]	11,301	679
Asset retirement obligations [note 13]	4,831	4,939
Customers' advance deposits	35,930	45,462
Total long-term liabilities	1,848,053	1,602,173
Total liabilities	2,286,560	2,232,603
Commitments, contingencies and subsequent events [notes 20, 21 and 23]		
Shareholder's equity		
Share capital [note 18]	527,817	527,817
Retained earnings	445,419	352,088
Contributed surplus	12,757	12,757
Total shareholder's equity	985,993	892,662
Total liabilities and shareholder's equity	3,272,553	3,125,265

The accompanying notes are an integral part of the financial statements.

Toronto Hydro-Electric System Limited

STATEMENTS OF INCOME

[in thousands of dollars]

Year ended December 31	2011 \$	2010 \$
Revenues		
Sale of electricity	2,766,714	2,561,418
Other income	24,931	29,644
	2,791,645	2,591,062
Costs		
Purchased power	2,236,541	2,057,747
Operating expenses	235,643	214,385
Depreciation and amortization	146,505	164,959
	2,618,689	2,437,091
Income before the following:	172,956	153,971
Net financing charges	(74,478)	(69,657)
Gain on disposals of property, plant and equipment <i>[note 5]</i>	3,885	3,650
Income before provision for payments in lieu of corporate taxes	102,363	87,964
Provision for payments in lieu of corporate taxes <i>[note 17]</i>	9,032	23,946
Net income	93,331	64,018

STATEMENTS OF RETAINED EARNINGS

[in thousands of dollars]

Year ended December 31	2011 \$	2010 \$
Retained earnings, beginning of year	352,088	288,070
Net income	93,331	64,018
Retained earnings, end of year	445,419	352,088

The accompanying notes are an integral part of the financial statements.

Toronto Hydro-Electric System Limited

STATEMENTS OF CASH FLOWS

[in thousands of dollars]

Year ended December 31	2011 \$	2010 \$
OPERATING ACTIVITIES		
Net income	93,331	64,018
Adjustments for non-cash items		
Depreciation and amortization	146,505	164,959
Net change in other assets and liabilities	(1,549)	4,877
Payments in lieu of corporate taxes	(6,154)	8,962
Post-employment benefits	9,580	12,342
Future income taxes [note 17]	279	-
Gain on disposals of property, plant and equipment [note 5]	(3,885)	(3,650)
Changes in non-cash working capital balances		
Increase in accounts receivable	(6,811)	(26,624)
Decrease in unbilled revenue	20,852	9,604
Decrease (increase) in inventories	610	(1,277)
Increase in prepaid expenses	(599)	(595)
Increase in accounts payable and accrued liabilities	38,861	40,004
Increase (decrease) in deferred revenue	13,316	(324)
Net cash provided by operating activities	304,336	272,296
INVESTING ACTIVITIES		
Purchase of property, plant and equipment [note 5]	(378,378)	(356,525)
Purchase of intangible assets [note 6]	(52,805)	(28,387)
Net change in regulatory assets and liabilities	(31,725)	(16,011)
Proceeds on disposals of property, plant and equipment	4,974	3,486
Net cash used in investing activities	(457,934)	(397,437)
FINANCING ACTIVITIES		
Increase in note payable to related party [note 10]	53,043	198,680
Increase (decrease) in customers' advance deposits	(8,214)	12,554
Net cash provided by financing activities	44,829	211,234
Net increase (decrease) in cash and cash equivalents during the year	(108,769)	86,093
Cash and cash equivalents, beginning of year	175,513	89,420
Cash and cash equivalents, end of year	66,744	175,513
Supplementary cash flow information		
Total interest paid	77,006	70,992
Payments in lieu of corporate taxes	11,615	14,570

The accompanying notes are an integral part of the financial statements.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

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1. INCORPORATION

On June 23, 1999, Toronto Hydro-Electric System Limited ["LDC"] was incorporated under the *Business Corporations Act* (Ontario) and is wholly-owned by Toronto Hydro Corporation [the "Corporation"]. The incorporation was required in accordance with the provincial government's *Electricity Act, 1998* (Ontario) ["Electricity Act"].

LDC distributes electricity to customers located in the City of Toronto [the "City"] and is subjected to rate regulation. LDC is also engaged in the delivery of Conservation and Demand Management ["CDM"] activities.

2. REGULATION

In April 1999, the government of Ontario began restructuring the Province of Ontario ["Ontario"]'s electricity industry. Under regulations passed pursuant to the restructuring, LDC and other electricity distributors have been purchasing their electricity from the wholesale market administered by the Independent Electricity System Operator ["IESO"] and recovering the costs of electricity and certain other costs at a later date in accordance with procedures mandated by the Ontario Energy Board [the "OEB"].

The OEB has regulatory oversight of electricity matters in Ontario. The *Ontario Energy Board Act, 1998* (Ontario) [the "OEB Act"] sets out the OEB's authority to issue a distribution licence which must be obtained by owners or operators of an electricity distribution system in Ontario. The OEB prescribes licence requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses and filing process requirements for rate-setting purposes.

The OEB's authority and responsibilities include the power to approve and fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity customers and the responsibility for ensuring that electricity distribution companies fulfill their obligations to connect and service customers.

Regulatory developments in Ontario's electricity industry, including current and possible future consultations between the OEB and interested stakeholders, may affect LDC's electricity distribution rates and other permitted recoveries in the future.

LDC is required to charge its customers for the following amounts (all of which, other than distribution charges, represent a pass through of amounts payable to third parties):

- [i] *Distribution Charges.* Distribution charges are designed to recover the costs incurred by LDC in delivering electricity to customers and the OEB-allowed rate of return. Distribution charges are regulated by the OEB and are comprised of a fixed charge and a usage-based (consumption) charge. The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control (principally, sustained periods of hot or cold weather which increase the consumption of electricity and sustained periods of moderate weather which decrease the consumption of electricity).

Toronto Hydro-Electric System Limited

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December 31, 2011

- [ii] *Electricity Price and Related Regulated Adjustments.* The electricity price and related regulated adjustments represent a pass through of the commodity cost of electricity.
- [iii] *Retail Transmission Rate.* The retail transmission rate represents a pass through of wholesale costs incurred by distributors in respect of the transmission of electricity from generating stations to local areas. Retail transmission rates are regulated by the OEB.
- [iv] *Wholesale Market Service Charge.* The wholesale market service charge represents a pass through of various wholesale market support costs. Retail rates for the recovery of wholesale market service charges are regulated by the OEB.

LDC is required to satisfy and maintain prudential requirements with the IESO, which include credit support with respect to outstanding market obligations in the form of letters of credit, cash deposits or guarantees from third parties with prescribed credit ratings.

a) *Electricity Distribution Rates*

LDC's electricity distribution rates are typically effective from May 1 to April 30 of the following year. Accordingly, LDC's distribution revenue for the first four months of 2011 was based on the electricity distribution rates approved for the May 1, 2010 to April 30, 2011 rate year [the "2010 Rate Year"], and the distribution revenue for the remainder of 2011 and for the first four months of 2012 are and will be based on electricity distribution rates approved for the May 1, 2011 to April 30, 2012 rate year [the "2011 Rate Year"].

LDC's electricity distribution rates for the 2010 Rate Year and the 2011 Rate Year were determined through an application under the cost of service framework. The cost of service framework sets electricity distribution rates using a detailed examination of evidence and an assessment of the costs incurred by an electricity distributor to provide its service to its customers.

On April 9, 2010, the OEB issued its decision regarding LDC's electricity distribution rates for the 2010 Rate Year. The decision provided for a distribution revenue requirement and rate base of \$518,700,000 and \$2,140,700,000, respectively. In addition, the decision provided for capital program spending levels and operating, maintenance and administration spending levels of \$350,000,000 and \$204,100,000, respectively.

On July 7, 2011, the OEB issued its decision regarding LDC's electricity distribution rates for the 2011 Rate Year. The decision provided for a distribution revenue requirement and rate base of \$522,044,000 and \$2,298,227,000, respectively. In addition, the decision provided for capital program spending levels and operating, maintenance and administration spending levels of \$378,800,000 and \$238,000,000, respectively.

On August 26, 2011, LDC filed a rate application, following the cost of service framework, with the OEB seeking approval of separate and successive revenue requirements and corresponding electricity distribution rates for three rate years commencing on May 1, 2012, May 1, 2013 and May 1, 2014 [the "2012-2014 Rate Application"]. The requested distribution revenue requirements for these rate years were \$571,369,000, \$639,492,000, and \$712,777,000, respectively, and the expected rate bases for these rate years were \$2,636,291,000, \$3,053,499,000, and \$3,503,165,000, respectively.

Toronto Hydro-Electric System Limited

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[all tabular amounts in thousands of dollars]

December 31, 2011

Pursuant to the incentive regulation mechanism framework, the OEB established, as a preliminary issue in the 2012-2014 Rate Application, that it would consider the question of whether the application filed by LDC was acceptable or whether it should be dismissed. In particular, the OEB established that in order for it to find that LDC's 2012-2014 Rate Application was acceptable, LDC would be required to show why and how LDC cannot adequately manage its resources and financial needs under the incentive regulation mechanism framework. The incentive regulation mechanism framework provides for an annual adjustment to an electricity distributor's rates based on a formulaic calculation with no direct examination of evidence regarding the electricity distributor's actual costs and infrastructure needs.

LDC filed evidence supporting its position for electricity distribution rates to be set under the cost of service framework as part of its 2012-2014 Rate Application. In particular, LDC provided evidence that it cannot adequately manage its resources and financial needs under the incentive regulation mechanism framework. The OEB established a process by which a portion of LDC's evidence was tested during an oral hearing held in November 2011 [note 23[b]].

b) Street Lighting Activities

On June 15, 2009, LDC filed an application with the OEB seeking an electricity distribution licence for a new wholly-owned legal entity to which the Corporation intended to transfer the street lighting assets of Toronto Hydro Energy Services Inc. ["TH Energy"]. Concurrently, LDC filed another application with the OEB seeking approval for the merger of LDC and the new legal entity. The main objective of these applications was to transfer the street lighting assets to the regulated electricity distribution activities of LDC to increase the overall safety of the related infrastructure.

On February 11, 2010, the OEB issued its decision in regard to these applications. In its decision, the OEB agreed that, under certain conditions, the treatment of certain types of street lighting assets as regulated assets is justified. The OEB ordered the Corporation to provide a detailed valuation of the street lighting assets and to perform an operational review to determine which street lighting assets could become regulated assets. The Corporation performed a detailed asset operational review and financial valuation of the street lighting assets, which was submitted to the OEB on January 31, 2011.

On August 3, 2011, the OEB issued its final decision allowing the transfer of a portion of the street lighting assets to the new wholly-owned legal entity, and for LDC to amalgamate with the new legal entity [note 23[a]].

c) Conservation and Demand Management Activities

On March 31, 2010, the Minister of Energy and Infrastructure of Ontario, under the guidance of sections 27.1 and 27.2 of the OEB Act, directed the OEB to establish CDM targets to be met by electricity distributors. Accordingly, on November 12, 2010, the OEB amended LDC's distribution licence to require LDC, as a condition of its licence, to achieve 1,304 Gigawatt-Hours of energy savings and 286 Megawatts of summer peak demand savings, over the period beginning January 1, 2011 through December 31, 2014.

Effective January 1, 2011, LDC entered into an agreement with the Ontario Power Authority ["OPA"] to deliver CDM programs in the amount of approximately \$50,000,000 extending from January 1, 2011 to December 31, 2014. As at December 31, 2011, LDC received approximately \$19,875,000 from the OPA for the delivery of CDM

Toronto Hydro-Electric System Limited

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[all tabular amounts in thousands of dollars]

December 31, 2011

programs. All programs to be delivered are fully funded and paid in advance by the OPA. These programs are expected to support the achievement of the mandatory CDM targets described above.

On January 10, 2011, LDC filed an application with the OEB seeking an order granting approval of funding for CDM programs specific to its customer base. LDC requested funding for eight specific CDM programs amounting to \$50,700,000. On July 12, 2011, the OEB issued its decision regarding the CDM programs of LDC. In its decision, the OEB approved with modifications two of the eight programs for a total funding of \$5,320,000. The modifications directed by the OEB included changes to the term and nature of those two programs. The OEB did not approve the other six programs as it considered them to be duplicative of existing CDM programs already funded by the OPA.

On August 3, 2011, LDC filed a letter with the OEB informing them that, due to the modified terms and nature of the two approved programs, LDC's revised economic assessment showed these two programs to be uneconomic, and that they would not be implemented. Accordingly, LDC expects to continue to work with the OPA to expand the roster of current CDM programs in order to achieve its mandated CDM targets.

d) Contact Voltage

On December 10, 2009, the OEB issued an initial decision in regard to the costs incurred in 2009 for the remediation of safety issues related to contact voltage relating to LDC's electricity distribution infrastructure. The decision provided for the recovery of allowable actual expenditures incurred above the amount deemed as controllable expenses in LDC's 2009 approved electricity distribution rates. At the time of the decision, LDC estimated the allowable recovery of costs at \$9,050,000.

On October 29, 2010, the OEB issued a second decision in the matter, following further review of costs incurred by LDC. In this decision, the OEB deemed the balance allowable for recovery at \$5,296,000. The variance from LDC's original estimate is mainly due to the OEB's interpretation of the definition of controllable expenses used to determine the final allowable recovery. In connection with this decision from the OEB, LDC revised its recovery estimate for contact voltage costs, resulting in an increase in operating expenses of \$3,754,000 in 2010. On November 18, 2010, LDC filed a motion to review the decision with the OEB seeking an amendment to allow for recovery in accordance with the initial decision rendered on December 10, 2009. On March 25, 2011, the OEB issued its decision on the LDC motion, denying the requested additional recovery.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of LDC have been prepared in accordance with Canadian generally accepted accounting principles ["GAAP"], including accounting principles prescribed by the OEB in the handbook "Accounting Procedures Handbook for Electric Distribution Utilities" ["AP Handbook"], are presented in Canadian dollars and reflect the significant accounting policies summarized below:

a) Regulation

The following regulatory treatments have resulted in accounting treatments which differ from Canadian GAAP for enterprises operating in an unregulated environment:

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December 31, 2011

Regulatory Assets and Liabilities

In accordance with Canadian GAAP, LDC currently follows specific accounting policies unique to a rate-regulated business. Under rate-regulated accounting ["RRA"], the timing and recognition of certain expenses and revenues may differ from those otherwise expected under Canadian GAAP in order to appropriately reflect the economic impact of regulatory decisions regarding LDC's regulated revenues and expenditures. These timing differences are recorded as regulatory assets and regulatory liabilities on LDC's balance sheets and represent current rights and obligations regarding cash flows expected to be recovered from or refunded to customers, based on decisions and approvals by the OEB. These assets and liabilities can be recognized for rate-setting and financial reporting purposes only if the OEB directs the relevant regulatory treatment or if future OEB direction is judged to be probable. In the event that the disposition of these balances was assessed to no longer be probable, the balances would be recorded in LDC's statements of income in the period that the assessment is made. The measurement of regulatory assets and liabilities is subject to certain estimates and assumptions, including assumptions made in the interpretation of the regulation and the OEB's decisions.

Contributions in aid of construction

Capital contributions received from outside sources are used to finance additions to property, plant and equipment of LDC. According to the AP Handbook, capital contributions received are treated as a "credit" to property, plant and equipment. The amount is subsequently depreciated by a charge to accumulated depreciation and a credit to depreciation expense at an equivalent rate to that used for the depreciation of the related property, plant and equipment.

Allowance for funds used during construction

The AP Handbook provides for the inclusion of an Allowance for Funds Used During Construction ["AFUDC"] when capitalizing construction-in-progress assets, until such time as the asset is substantially complete. A concurrent credit of the same amount is made to net financing charges when the allowance is capitalized. The interest rate for capitalization is prescribed by the OEB and modified on a periodic basis, and is applied to the balance of the construction-in-progress assets on a simple interest basis. The interest rate for capitalization, for the period from January 1 to September 30, 2011, was 4.29%, and from October 1, 2011 to December 31, 2011, was 3.92%. AFUDC is included in property, plant and equipment, intangible assets, and construction-in-progress assets for financial reporting purposes, charged to operations through depreciation and amortization expense over the service life of the related assets and recovered through future revenue.

b) Cash and cash equivalents

Cash and cash equivalents include cash in bank accounts and short-term investments with terms to maturity of 90 days or less from their date of acquisition.

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c) Inventories

Inventories consist primarily of small consumable materials mainly related to the maintenance of the electricity distribution infrastructure. LDC classifies all major construction related components of its electricity distribution system infrastructure to property, plant and equipment. Once capitalized, these items are not depreciated until they are put into service. Inventories are carried at the lower of cost and net realizable value, with cost determined on an average cost basis net of a provision for obsolescence.

d) Property, plant and equipment

Property, plant and equipment are stated at cost and are removed from the accounts at the end of their estimated average service lives, except in those instances where specific identification allows their removal at retirement or disposition.

In the event that facts and circumstances indicate that property, plant and equipment may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the asset are compared to the carrying amount of the asset to determine if a write-down is required. The impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value, which is determined by the estimated future discounted cash flows.

Effective January 1, 2011, LDC revised its estimates of useful lives of certain items of property, plant and equipment following a detailed review and analysis supported by external third-party evidence. These changes in estimates have been accounted for on a prospective basis in the financial statements effective January 1, 2011.

Effective January 1, 2011, LDC revised its estimates of burden rates of certain items of property, plant and equipment following a detailed review and analysis of all the components included in such burden rates. These changes in estimates of burden rates include changes in the allocation of engineering and administration costs, changes in the calculation of standard labour rates, and changes in the calculation of materials handling costs. These changes in estimates have been accounted for on a prospective basis in the financial statements effective January 1, 2011.

The changes discussed above were reflected in the 2011 electricity distribution rates approved by the OEB on July 7, 2011 [note 2[a]]. Accordingly, these changes decreased distribution revenues by approximately \$24,600,000, increased operating expenses by approximately \$22,000,000, decreased depreciation expenses by approximately \$33,000,000 and decreased Payments in Lieu of Corporate Taxes ["PILs"] by approximately \$13,600,000 for the year ended December 31, 2011 and are expected to impact depreciation expenses proportionately in future periods.

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Depreciation is provided on a straight-line basis over the estimated service lives at the following annual rates:

	<u>2011</u>	<u>2010</u>
Distribution lines	2.0% to 5.0%	2.5% to 4.0%
Transformers	3.3% to 5.0%	3.3% to 4.0%
Stations	2.5% to 10.0%	2.5% to 6.7%
Meters	2.5% to 6.7%	2.9% to 6.7%
Buildings	1.3% to 5.0%	2.0%
Rolling stock	12.5% to 25.0%	12.5% to 33.3%
Other capital assets	4.0% to 20.0%	4.0% to 20.0%
Assets under capital lease	14.3% to 25.0%	25.0%
Equipment and tools	10.0% to 16.7%	10.0% to 16.7%
Computer hardware	16.7% to 25.0%	20.0% to 25.0%
Communications	10.0% to 20.0%	10.0% to 20.0%

Construction in progress relate to assets not currently in use and therefore are not depreciated.

e) Intangible assets

Intangible assets are stated at cost. Amortization is provided on a straight-line basis over their estimated service lives at the following annual rates:

	<u>2011</u>	<u>2010</u>
Computer software	20.0% to 25.0%	20.0%
Contributions	4.0%	4.0%

Software in development and contributions for work in progress relate to assets not currently in use and therefore are not amortized.

f) Workplace Safety and Insurance Act

LDC is a Schedule 1 employer for workers' compensation under the *Workplace Safety and Insurance Act, 1997* (Ontario) [the "WSIA"]. As a Schedule 1 employer under the WSIA, LDC is required to pay annual premiums into an insurance fund established under the WSIA and recognizes expenses based on funding requirements.

g) Revenue recognition

Revenues from the sale of electricity are recorded on a basis of cyclical billings and also include unbilled revenues accrued in respect of electricity delivered but not yet billed.

Other income, which includes revenues from electricity distribution related services, is recognized as the services are rendered.

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[all tabular amounts in thousands of dollars]

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h) Financial instruments

At inception, all financial instruments which meet the definition of a financial asset or financial liability are to be recorded at fair value, unless fair value cannot be reliably determined. Gains and losses related to the measurement of financial instruments are reported in the statements of income. Subsequent measurement of each financial instrument will depend on the balance sheet classification elected by LDC. The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between willing parties.

The following summarizes the accounting classification LDC has elected to apply to each of its significant categories of financial instruments:

Cash equivalents and short-term investments	Investments Held to Maturity
Accounts receivable and unbilled revenue	Loans and Receivables
Accounts payable and accrued liabilities	Other Financial Liabilities
Obligations under capital lease	Other Financial Liabilities
Customers' advance deposits	Other Financial Liabilities
Short-term and long-term debt	Other Financial Liabilities

LDC uses the following methods and assumptions to estimate the fair value of each class of financial instruments for which carrying amounts are included in the balance sheet:

- Cash equivalents, comprising short-term investments, are classified as "Investments Held to Maturity" and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Accounts receivable and unbilled revenue are classified as "Loans and Receivables" and are measured at amortized cost, which, upon initial recognition, are considered equivalent to fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Accounts payable and accrued liabilities are classified as "Other Financial Liabilities" and are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Obligations under capital lease are classified as "Other Financial Liabilities" and are initially measured at their fair value. Subsequent measurements are based on discounted cash flow analysis and approximate their carrying values as management believes that the fixed interest rates are representative of current market rates.
- Customers' advance deposits are classified as "Other Financial Liabilities" and are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of the current portion, and the discounted long-term portion approximates the carrying value, taking into account interest accrued on the outstanding balance.
- Short-term debt and long-term debt are classified as "Other Financial Liabilities" and are initially measured at their fair value. The carrying amounts are carried at amortized cost, based on an initial fair value as determined

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at the time using quoted market price for similar debt instruments. The fair value of the long-term debt is calculated by discounting the related cash flows at the estimated yield to maturity of similar debt instruments [note 15].

i) Fair value measurements

LDC utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A fair value hierarchy exists that prioritizes observable and unobservable inputs used to measure fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect LDC's assumptions with respect to how market participants would price an asset or liability. The fair value hierarchy includes three levels of inputs that may be used to measure fair value:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis;
- Level 2 – Observable inputs other than level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

j) Employee future benefits

Pension plan

LDC provides a pension plan for its full-time employees through the Ontario Municipal Employees Retirement System ["OMERS"]. OMERS is a multi-employer, contributory, defined benefit pension plan established in 1962 by Ontario for employees of municipalities, local boards and school boards. Both participating employers and employees are required to make plan contributions based on participating employees' contributory earnings. LDC recognizes the expense related to this plan as contributions are made.

Employee future benefits other than pension

Employee future benefits other than pension provided by LDC include medical, dental and life insurance benefits, and accumulated sick leave credits. These plans provide benefits to employees when they are no longer providing active service. Employee future benefit expense is recognized in the period in which the employees render services on an accrual basis.

The accrued benefit obligations and the current service costs are calculated using the projected benefit method prorated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. 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. The excess of the net actuarial gains or losses over 10% of the accrued benefit obligation is amortized into expense over the average remaining service period of active

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employees to full eligibility. The effects of a curtailment gain or loss are recognized in income in the year of the event giving rise to the curtailment. The effects of a settlement gain or loss are recognized in the period in which a settlement occurs.

k) Asset retirement obligations

LDC recognizes a liability for the future removal and handling costs for contamination in distribution equipment in service and in storage and for the future environmental remediation of certain properties. Initially, the liability is measured at present value and the amount of the liability is added to the carrying amount of the related asset. In subsequent periods, the asset is depreciated and the liability is adjusted quarterly for the discount applied upon initial recognition of the liability ["accretion expense"] and for changes in the underlying assumptions. The liability is recognized when the asset retirement obligation ["ARO"] is incurred and when the fair value is determined.

l) Customers' advance deposits

Customers' advance deposits are cash collections from customers to guarantee the payment of energy bills. The customers' advance deposits liability includes interest credited to the customers' deposit accounts, with the debit charged to net financing charges. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

m) Payments in lieu of corporate taxes

LDC is exempt from tax under the *Income Tax Act* (Canada) ["ITA"] provided that all of its capital is owned by the Corporation, a Municipal Electricity Utility ["MEU"], and not more than 10% of its respective income is derived from activities carried on outside the municipal geographical boundaries of the City. A corporation exempt from tax under the ITA is also exempt from tax under the *Taxation Act, 2007* (Ontario) ["TA"] and the *Corporations Tax Act* (Ontario) ["CTA"].

LDC is a MEU for purposes of the PILs regime contained in the Electricity Act. The Electricity Act provides that a MEU that is exempt from tax under the ITA, the CTA and the TA is required to make, for each taxation year, a PILs payment to the Ontario Electricity Financial Corporation in an amount equal to the tax that it would be liable to pay under the ITA and the TA (for years ending after 2008) or the CTA (for years ending prior to 2009) if it were not exempt from tax. The PILs regime came into effect on October 1, 2001, at which time LDC was deemed to have commenced a new taxation year for purposes of determining its respective liability for PILs payments.

LDC uses the liability method of accounting for income taxes. Under the liability method, future income tax assets and liabilities are determined based on differences between the accounting and tax bases of assets and liabilities and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period the change is substantively enacted. Future income tax assets are evaluated and if realization is not considered more likely than not, a valuation allowance is established. In accordance with the Canadian Institute of Chartered Accountants ["CICA"] Handbook Section 3465 – "Income Taxes", LDC recognizes future income taxes associated with its rate-regulated operations and records an offsetting regulatory asset or liability for the future income taxes that are expected to be recovered or refunded through future regulated prices charged to customers.

Toronto Hydro-Electric System Limited

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n) Use of estimates

The preparation of LDC's financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the year. The estimates are based on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Significant areas requiring the use of management estimates relate to unbilled revenue, regulatory assets and liabilities, environmental liabilities and AROs, employee future benefits, and revenue recognition. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Ministry of Energy, or the Ministry of Finance of Ontario ["Ministry of Finance"].

o) Future Accounting Pronouncements

Adoption of New Accounting Standards

Publicly accountable enterprises in Canada were required to adopt International Financial Reporting Standards ["IFRS"] in place of Canadian GAAP for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. On September 10, 2010, the Accounting Standards Board granted an optional one-year deferral for IFRS adoption for entities subject to rate regulation due to the uncertainty created by the International Accounting Standards Board ["IASB"] in regard to RRA. To date, the IASB has not approved any temporary exemption or finalized a RRA standard under IFRS. LDC elected to take the optional one-year deferral of its adoption of IFRS; therefore, it continues to prepare its financial statements in accordance with Canadian GAAP accounting standards in Part V of the CICA Handbook in 2011.

LDC's IFRS conversion project was proceeding as planned to meet the January 1, 2011 conversion date. In the absence of a definitive plan to consider the issuance of a RRA standard by the IASB, LDC decided to evaluate the option of adopting United States ["US"] GAAP effective January 1, 2012 as an alternative to IFRS. LDC's current application of Canadian GAAP for RRA is generally consistent with US GAAP. Under US GAAP, LDC's financial reporting is expected to be more comparable with its current Canadian GAAP results than it would be under IFRS and is expected to facilitate comparability with other large North American utilities.

On July 8, 2011, the Corporation filed an application with the applicable Canadian securities regulatory authorities pursuant to section 5.1 of National Instrument 52-107 "Acceptable Accounting Principles and Auditing Standards", to permit the Corporation to prepare its consolidated financial statements in accordance with US GAAP without qualifying as a US Securities and Exchange Commission issuer.

On July 21, 2011, the applicable Canadian securities regulatory authorities issued a decision which gave the Corporation the option to prepare its consolidated financial statements in accordance with US GAAP for its fiscal years beginning on or after January 1, 2012 but before January 1, 2015. The decision is similar to that obtained by other Canadian rate-regulated utilities.

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On August 19, 2011, LDC filed a letter with the OEB stating its intention to adopt US GAAP as the basis for the calculation of electricity distribution rates starting in 2012 in accordance with the guidelines provided by the OEB. In the OEB guidelines, the OEB indicated to Ontario utilities that it would permit the use of US GAAP for the calculation of electricity distribution rates if such utilities receive approval from the Ontario Securities Commission and if it benefits electricity distribution consumers.

On August 26, 2011, the board of directors of the Corporation approved the adoption of US GAAP for financial reporting purposes for the year beginning on January 1, 2012. Accordingly, LDC plans to commence reporting under US GAAP in its first quarterly financial statements in 2012. As a result of this decision, LDC's IFRS conversion project efforts have been reduced. However, the work has been managed in such a way that it can effectively be restarted when a future transition to IFRS is required.

LDC's interim financial statements for the first quarter of 2012 are expected to be prepared in accordance with US GAAP and applied retrospectively to LDC's opening US GAAP balance sheet as at January 1, 2011. Based on the results of the detailed assessment of the differences between US GAAP and Canadian GAAP as it applies to its business, LDC does not believe that the adoption of US GAAP will have a material impact on its financial statements in the future.

4. INVENTORIES

Inventories consist of the following:

	2011 \$	2010 \$
Consumables, tools and other maintenance items	1,745	2,077
Fuses	1,625	1,731
Drums and reels	938	1,092
Other	2,583	2,601
	6,891	7,501

For the year ended December 31, 2011, LDC recognized operating expenses of \$6,567,000, related to inventory used to service electrical distribution assets [2010 - \$4,727,000].

Toronto Hydro-Electric System Limited

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5. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consist of the following:

	2011			2010		
	Cost \$	Accumulated depreciation \$	Net book value \$	Cost \$	Accumulated depreciation \$	Net book value \$
Land	16,761	—	16,761	9,560	—	9,560
Distribution lines	2,755,344	1,404,998	1,350,346	2,517,584	1,353,037	1,164,547
Transformers	652,102	360,398	291,704	609,702	341,706	267,996
Stations	277,905	137,246	140,659	259,337	128,254	131,083
Meters	238,459	124,117	114,342	214,859	114,808	100,051
Buildings	154,932	62,403	92,529	151,543	55,609	95,934
Rolling stock	78,016	43,154	34,862	73,749	43,208	30,541
Other capital assets	68,282	43,805	24,477	58,700	35,177	23,523
Assets under capital lease	14,269	1,251	13,018	886	351	535
Equipment and tools	44,208	31,785	12,423	41,604	29,732	11,872
Computer hardware	44,625	35,602	9,023	40,634	31,228	9,406
Communications	31,537	23,912	7,625	26,818	21,013	5,805
Construction in progress	226,524	—	226,524	214,089	—	214,089
	4,602,964	2,268,671	2,334,293	4,219,065	2,154,123	2,064,942

For the year ended December 31, 2011, AFUDC in the amount of \$3,786,000 [2010 - \$1,850,000] was capitalized to property, plant and equipment and credited to net financing charges.

As at December 31, 2011, the net book value of stranded meters related to the deployment of smart meters amounting to \$20,366,000 [December 31, 2010 - \$23,120,000] was included in property, plant and equipment. In the absence of rate regulation, property, plant and equipment would have been \$20,366,000 lower as at December 31, 2011 [December 31, 2010 - \$23,120,000 lower].

For the year ended December 31, 2011, LDC recognized a gain of \$3,885,000 [2010 - \$3,650,000] on disposals of surplus properties, of which \$1,375,000 [2010 - \$2,750,000] relates to surplus properties for which the OEB reduced electricity distribution rates in 2010. LDC began recognizing the actual gain realized on the sale of these properties over a one-year period from May 1, 2010 to mirror the actual timing of the reduction in 2010 electricity distribution rates.

For the year ended December 31, 2011, LDC recorded depreciation expense of \$120,696,000 [2010 - \$148,744,000] of which \$1,177,000 [2010 - \$204,000] related to assets under capital lease.

Toronto Hydro-Electric System Limited

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6. INTANGIBLE ASSETS, NET

Intangible assets consist of the following:

	2011			2010		
	Cost \$	Accumulated amortization \$	Net book value \$	Cost \$	Accumulated amortization \$	Net book value \$
Computer software	222,598	154,186	68,412	172,692	129,293	43,399
Contributions	14,059	1,440	12,619	2,043	524	1,519
Software in development	3,582	—	3,582	39,191	—	39,191
Contributions for work in progress	28,369	—	28,369	1,878	—	1,878
	268,608	155,626	112,982	215,804	129,817	85,987

For the year ended December 31, 2011, LDC acquired \$52,805,000 of intangible assets [2010 - \$28,387,000]. All intangible assets are subject to amortization when they become available for use. Software in development and contributions for work in progress relate to assets not currently available for use and therefore are not amortized.

For the year ended December 31, 2011, \$49,907,000 of software in development were transferred to computer software [2010 - \$29,266,000].

For the year ended December 31, 2011, AFUDC in the amount of \$1,419,000 [2010 - \$1,658,000] was capitalized to intangible assets and credited to net financing charges.

For the year ended December 31, 2011, LDC recorded amortization expense on intangible assets of \$25,809,000 [2010 - \$16,215,000].

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7. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

	2011 \$	2010 \$
Smart meters	61,422	67,719
Late payment penalties settlement	—	7,750
IFRS conversion project	—	6,089
Settlement variances	14,119	—
Special purpose charge variance	572	3,555
Other	1,209	—
	77,322	85,113

Regulatory liabilities consist of the following:

	2011 \$	2010 \$
Future income taxes	200,436	224,570
Regulatory assets recovery account	6,361	40,275
PILs variances	2,365	5,675
Settlement variances	—	2,277
Other	1,118	909
	210,280	273,706

For the year ended December 31, 2011, LDC disposed of approved net regulatory liabilities amounting to \$34,528,000 through permitted distribution rate adjustments [2010 - \$23,003,000].

The regulatory assets and liabilities of LDC are as follows:

a) *Smart Meters*

The smart meters regulatory asset account relates to Ontario's decision to install smart meters throughout Ontario. LDC substantially completed its smart meter project as at December 31, 2010. In connection with this initiative, the OEB ordered LDC to record all expenditures and related revenues from 2008 to 2010 to a regulatory asset account and allowed LDC to keep the net book value of the stranded meters in property, plant and equipment. Starting on January 1, 2011, LDC began recording smart meter costs in property, plant and equipment and intangible assets as a regular distribution activity as directed by the OEB. LDC expects to apply to the OEB to transfer the 2008 to 2010 smart meter costs from regulatory assets to property, plant and equipment and intangible assets, as well as to transfer the net book value of the stranded meters from property, plant and equipment to regulatory assets in 2012.

Toronto Hydro-Electric System Limited

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LDC incurred smart meter capital expenditures amounting to \$nil for the year ended December 31, 2011 [2010 - \$19,799,000]. As at December 31, 2011, smart meter capital expenditures, net of accumulated depreciation, totalling \$59,227,000 were recorded to regulatory assets [December 31, 2010 - \$65,588,000]. These expenditures would otherwise have been recorded as property, plant and equipment and intangible assets under Canadian GAAP for unregulated businesses. In the absence of rate regulation, property, plant and equipment and intangible assets would have been \$54,825,000 and \$4,402,000 higher, respectively, as at December 31, 2011 [December 31, 2010 - \$59,416,000 and \$6,172,000 higher, respectively].

For the year ended December 31, 2011, deferred smart meter operating expenses were reduced by \$490,000 which would have reduced expenses under Canadian GAAP for unregulated businesses [2010 - were increased by \$3,109,000]. For the year ended December 31, 2011, smart meter depreciation expense of \$6,361,000 [2010 - \$5,357,000] were deferred which would have been expensed under Canadian GAAP for unregulated businesses. In the absence of rate regulation, for the year ended December 31, 2011, operating expenses would have been \$490,000 lower [2010 - \$3,109,000 higher], and depreciation expense would have been \$6,361,000 higher [2010 - \$5,357,000 higher].

For the year ended December 31, 2011, smart meter customer revenues of \$5,866,000 were deferred [2010 - \$5,774,000]. In the absence of rate regulation, for the year ended December 31, 2011, revenue would have been \$5,866,000 higher [2010 - \$5,774,000 higher].

b) Late Payment Penalties Settlement

The late payment penalties settlement regulatory asset account was related to the settlement costs associated with the late payment charges class action. All of the MEUs involved in the settlement, including LDC, requested an order from the OEB allowing for the future recovery from customers of all costs related to the settlement. On February 22, 2011, the OEB approved the recovery of the costs of \$7,526,000. The recovery is occurring over a 21-month period which commenced on August 1, 2011. Accordingly, the balance approved for recovery was transferred to the Regulatory Assets Recovery Account ["RARA"].

c) IFRS Conversion Project

This regulatory asset account included the incremental costs incurred by LDC for its initially planned conversion to IFRS. On July 7, 2011, the OEB reduced the allowable recoverable costs from \$6,134,000 to \$3,050,000 as it appeared that a portion of the costs claimed for recovery by LDC were included in prior period electricity distribution rates. In connection with this decision from the OEB, LDC revised its estimate for IFRS conversion costs recovery, resulting in an increase in operating expenses of \$3,017,000 in the second quarter of 2011. The remaining regulatory asset balance of \$3,050,000, which included carrying charges, was transferred to the RARA and is being recovered over a nine-month period which commenced on August 1, 2011. Under Canadian GAAP for unregulated businesses, these costs would have been recorded to operating expenses. In the absence of rate regulation, for the year ended December 31, 2011, operating expenses would have been \$3,017,000 lower [2010 - \$3,108,000 higher].

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d) Settlement Variances

This account is comprised of the variances between amounts charged by LDC to customers, based on regulated rates, and the corresponding cost of non-competitive electricity service incurred by LDC. The settlement variances relate primarily to service charges, non-competitive electricity charges, imported power charges and the global adjustment. Accordingly, LDC has deferred the variances between the costs incurred and the related recoveries in accordance with the criteria set out in the accounting principles prescribed by the OEB in the AP Handbook.

The balance for settlement variances continues to be calculated and attract carrying charges in accordance with the OEB's direction. For the year ended December 31, 2011, settlement variances of \$34,938,000 were disposed through rate adjustments [2010 - \$20,016,000].

e) Special Purpose Charge Variance

On April 9, 2010, the OEB informed electricity distributors of a Special Purpose Charge ["SPC"] assessment under Section 26.1 of the OEB Act, for the Ministry of Energy and Infrastructure conservation and renewable energy program costs. The OEB assessed LDC the amount of \$9,698,000 for its apportioned share of the total provincial amount of the SPC of \$53,695,000 in accordance with the rules set out in Ontario Regulation 66/10 [the "SPC Regulation"]. In accordance with Section 9 of the SPC Regulation, LDC was allowed to recover this balance. The recovery was completed as at April 30, 2011.

As at December 31, 2011, the balance in the account consists of LDC's assessment of \$9,698,000 less the recoveries received from customers. In the absence of rate regulation, revenue for the year ended December 31, 2011, would have been \$3,050,000 higher [2010 - \$6,123,000 higher] and operating expenses for the year ended December 31, 2011 would have \$nil impact [2010 - \$9,698,000 higher].

f) Future Income Taxes

This regulatory liability account relates to the expected future electricity distribution rate reduction for customers arising from timing differences in the recognition of future tax assets [note 3[m]].

As at December 31, 2011, LDC recorded a future income tax asset and a corresponding regulatory liability of \$200,436,000 [December 31, 2010 - \$224,570,000] with respect to its rate-regulated activities. The future income tax asset and the corresponding regulatory liability as at December 31, 2010, have been recast, to reflect an adjustment of \$30,247,000 resulting from a change in methodology used to determine the timing differences between the tax value and book value of the assets for accounting purposes.

g) Regulatory Assets Recovery Account

The RARA consists of balances of regulatory assets or regulatory liabilities approved for disposition by the OEB through rate riders. The RARA is subject to carrying charges following the OEB prescribed methodology and related rates.

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On April 16, 2009, the OEB approved the disposition of regulatory liabilities of \$7,582,000, for amounts arising from the extended effectiveness of certain rate riders into the 2008 rate year, over a one-year period commencing on May 1, 2009 and ending on April 30, 2010.

On April 9, 2010, the OEB approved the disposition of net regulatory liabilities of \$68,140,000, consisting of credit balances for settlement variances and PILs variances of \$58,225,000 and \$11,900,000, respectively, and intangible assets debit balance of \$1,985,000, over a two-year period commencing on May 1, 2010 and ending on April 30, 2012.

On October 29, 2010, the OEB approved the disposition of regulatory assets of \$5,296,000, for amounts in connection with the contact voltage remediation activities, for the period commencing on November 1, 2010 and ending on April 30, 2012 [note 2[d]].

On February 22, 2011, the OEB approved the disposition of the Late Payment Penalties Settlement regulatory asset of \$7,526,000, over a 21-month period commencing on August 1, 2011 and ending on April 30, 2013.

On July 7, 2011, the OEB approved the disposition of net regulatory liabilities of \$8,572,000, consisting of credit balances for settlement variances, PILs variances and 2008 RARA residual of \$7,460,000, \$3,373,000, and \$789,000, respectively, and an IFRS cost debit balance of \$3,050,000, over a nine-month period commencing on August 1, 2011 and ending on April 30, 2012.

h) PILs Variances

The PILs variances regulatory liability account relates to the differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in the rate adjustment model. As at December 31, 2011, the balance in this account consisted of an over-recovery from customers of \$2,365,000 [December 31, 2010 - \$5,675,000].

8. OTHER ASSETS

Other assets consist of the following:

	2011 \$	2010 \$
Prepaid leases	7,279	7,368
Other	52	150
	7,331	7,518

Toronto Hydro-Electric System Limited

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9. CURRENT PORTION OF OTHER LIABILITIES

Current portion of other liabilities consist of the following:

	2011 \$	2010 \$
Customers' advance deposits	20,108	18,790
Obligations under capital lease <i>[note 20]</i>	1,871	182
Other	311	762
	22,290	19,734

10. LONG-TERM DEBT

Long-term debt consists of the following:

	2011 \$	2010 \$
Notes payable to the Corporation:		
6.16% Long-term note payable to the Corporation due May 6, 2013	179,456	179,100
5.20% Long-term note payable to the Corporation due November 14, 2017	244,186	244,062
4.54% Long-term note payable to the Corporation due November 12, 2019	243,814	243,686
5.59% Long-term note payable to the Corporation due May 21, 2040	198,708	198,691
3.59% Long-term note payable to the Corporation due November 18, 2021	298,119	—
6.16% Promissory note payable to the Corporation due May 6, 2013	245,058	490,115
Total notes payable to the Corporation	1,409,341	1,355,654
Less: Current portion of promissory note payable	—	245,057
Long-term debt	1,409,341	1,110,597
Comprising:		
Long-term notes payable to the Corporation	1,164,283	865,539
Promissory note payable to the Corporation	245,058	245,058

All long-term debt of LDC ranks equally.

Toronto Hydro-Electric System Limited

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a) Long-term notes payable to the Corporation

Long-term notes payable to the Corporation are comprised of the following:

[i] \$180,000,000, which bears interest at a rate of 6.16% per annum, with a maturity date of May 6, 2013, extendable upon mutual consent.

[ii] \$245,058,000, which bears interest at a rate of 5.20% per annum, with a maturity date of November 14, 2017, extendable upon mutual consent.

[iii] \$245,058,000, which bears interest at a rate of 4.54% per annum, with a maturity date of November 12, 2019, extendable upon mutual consent.

[iv] \$200,000,000, which bears interest at a rate of 5.59% per annum, with a maturity date of May 21, 2040, extendable upon mutual consent.

[v] \$300,000,000, which bears interest at a rate of 3.59% per annum, with a maturity date of November 18, 2021, extendable upon mutual consent.

b) Promissory note payable to the Corporation

On July 1, 1999, LDC issued a promissory note to the City ["Initial Note"] in the principal amount of \$947,000,000 in partial consideration for the assets in respect of the electricity distribution system transferred by the Toronto Hydro-Electric Commission and the City to LDC effective July 1, 1999. The Initial Note was non-interest bearing until December 31, 1999 and interest bearing thereafter at the rate of 6% per annum. Pursuant to the terms of By-law No. 374-1999 of the City made under section 145 of the Electricity Act, the principal amount of the Initial Note was adjusted effective January 1, 2000 to \$980,231,000 to reflect the deemed debt to equity structure of LDC permitted by the OEB. At the same time, the Initial Note was replaced by a promissory note ["Replacement Note"] issued by LDC, which was interest bearing at the rate of 6.8% per annum. At December 31, 2002, the Replacement Note was payable on the earlier of demand and December 31, 2003.

Concurrent with the closing of the Corporation's debenture offering on May 7, 2003, the City transferred the Replacement Note to the Corporation in consideration for the issuance by the Corporation to the City of a new promissory note in the principal amount of \$980,231,000. Following the issuance of the new promissory note to the City, on May 7, 2003, LDC issued a promissory note payable on demand to the Corporation in the principal amount of \$980,231,000.

On September 5, 2006, LDC amended and restated the promissory note payable to the Corporation effective May 1, 2006 by fixing the interest rate at 6.16% and establishing an agreed repayment schedule. LDC is required to pay the principal amount of the note as follows: \$245,057,000 on the last business day before each of December 31, 2007, December 31, 2009, December 31, 2011 and on May 6, 2013. On December 31, 2007, LDC made the first scheduled payment of \$245,057,000 to the Corporation. On December 31, 2009, LDC made the second scheduled payment of \$245,057,000 to the Corporation. On December 30, 2011, LDC made the third scheduled payment of

Toronto Hydro-Electric System Limited

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\$245,057,000 to the Corporation. Interest is calculated and payable quarterly in arrears on the last business day of March, June, September and December of each year.

11. EMPLOYEE FUTURE BENEFITS

Pension

For the year ended December 31, 2011, LDC's OMERS current service pension costs were \$13,813,000 [2010 - \$11,519,000]. For the year ended December 31, 2011, OMERS contribution rates were 7.4% up to the year's maximum pensionable earnings ["YMPE"] and 10.7% over YMPE for normal retirement age ["NRA"] of 65 [December 31, 2010 - 6.4% up to YMPE and 9.7% over YMPE for NRA of 65].

Employee future benefits other than pension

LDC has a number of unfunded benefit plans providing retirement and post-employment benefits (excluding pension) to most of its employees. LDC pays certain medical, dental and life insurance benefits under unfunded defined benefit plans on behalf of its retired employees. LDC pays accumulated sick leave credits, up to certain established limits based on service, in the event of retirement, termination or death of certain employees.

LDC measures its accrued benefits obligation for accounting purposes as at December 31 of each year. The latest actuarial valuation was performed as at January 1, 2010.

a) Accrued benefit obligation

	2011 \$	2010 \$
Balance, beginning of year	198,630	172,280
Experience loss at beginning of year	—	7,547
Adjustment due to reorganization	478	4,235
Current service cost	3,820	3,407
Interest cost	11,307	10,911
Benefits paid	(7,383)	(7,083)
Actuarial losses	35,809	7,333
Balance, end of year	242,661	198,630

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b) Reconciliation of the accrued benefit obligation to the balance sheet accrued benefit liability

	2011 \$	2010 \$
Accrued benefit obligation	242,661	198,630
Unamortized net actuarial losses	(65,425)	(30,094)
Unamortized past service costs	(866)	(1,746)
Post-employment benefits liability	176,370	166,790

c) Components for net periodic defined benefit costs

	2011 \$	2010 \$
Current service cost	3,820	3,407
Interest cost	11,307	10,911
Actuarial losses	35,809	14,880
Cost incurred in the year	50,936	29,198
Differences between costs incurred and costs recognized in the year in respect of:		
Actuarial gains	(35,022)	(14,514)
Past service costs	873	745
	(34,149)	(13,769)
Defined benefit costs recognized	16,787	15,429
Capitalized as part of property, plant and equipment	6,758	7,388
Charged to operations	10,029	8,041

Toronto Hydro-Electric System Limited

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d) Significant assumptions

	2011 %	2010 %
Accrued benefit obligation as at December 31:		
Discount rate	4.8	5.8
Rate of compensation increase	4.0	4.0
Benefit costs for years ended December 31:		
Discount rate	5.8	6.0
Rate of compensation increase	4.0	4.0
Assumed health care cost trend rates as at December 31:		
Rate of increase in dental costs	4.0	4.0

For December 31, 2011, medical costs are assumed to increase at 7.0% [2010 - 7.5%] graded down by 0.5% [2010 - 0.5%] annual decrements to 5.0% [2010 - 5.0%] in 2016 and thereafter.

e) Sensitivity analysis

Assumed health and dental care cost trend rates have a significant effect on the amounts reported for health and dental care plans. A one-percentage-point change in assumed health and dental care cost trend rates would have the following effects for 2011:

	Increase \$	Decrease \$
Total of current service and interest cost (at 5.8%)	2,675	(1,835)
Accrued benefit obligation as at December 31, 2011 (at 4.8%)	36,693	(28,227)

Assumed interest rates have a significant effect on the amounts reported for the total accrued benefit obligation and expense. A one-percentage-point change in assumed interest rates would have the following effects for 2011:

	Increase \$	Decrease \$
Accrued benefit obligation as at December 31, 2011	(32,872)	42,630
Estimated expense for fiscal 2012	(2,972)	3,378

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12. OTHER LIABILITIES

Other long-term liabilities consist of the following:

	2011 \$	2010 \$
Obligations under capital lease <i>[note 20]</i>	11,301	369
Other	—	310
	11,301	679

For the year ended December 31, 2011, LDC acquired property, plant and equipment through capital lease transactions totalling \$13,717,000 [2010 - \$176,000]. These non-cash transactions have been excluded from the statements of cash flows.

13. ASSET RETIREMENT OBLIGATIONS

Reconciliation between the opening and closing ARO liability balances is as follows:

	2011 \$	2010 \$
Balance, beginning of year	4,939	7,490
ARO liabilities settled in the year	(688)	(2,290)
Accretion expense	168	190
Revision in estimated cash flows	412	(451)
Balance, end of year	4,831	4,939

As at December 31, 2011, LDC estimates the undiscounted amount of cash flows required over the next one to 45 years to settle the ARO liabilities is \$5,676,000 [December 31, 2010 - \$6,425,000]. Discount rates ranging from 1.39% to 5.29% [December 31, 2010 – 1.39% to 5.89%] were used to calculate the carrying value of the ARO liabilities. No assets have been legally restricted for settlement of the liability.

14. CAPITAL DISCLOSURES

LDC's main objectives when managing capital are to:

- ensure ongoing access to funding to maintain and refurbish its electricity distribution system; and
- align its capital structure for regulated activities with the deemed debt to equity structure set by the OEB.

As at December 31, 2011, LDC's definition of capital includes long-term debt and obligations under capital lease, including the current portion thereof, and shareholder's equity, and has remained unchanged from December 31, 2010. As at December 31, 2011, shareholder's equity amounted to \$985,993,000 [December 31, 2010 -

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

\$892,662,000] and long-term debt, including the current portion thereof, amounted to \$1,422,513,000 [December 31, 2010 - \$1,355,654,000]. LDC's capital structure as at December 31, 2011 was 59% debt and 41% equity [December 31, 2010 - 60% debt and 40% equity]. There were no changes in LDC's approach to capital management during the year.

15. FINANCIAL INSTRUMENTS

a) *Recognition and measurement*

The carrying value and fair value of LDC's financial instruments consist of the following:

	2011		2010	
	\$		\$	
	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	66,744	66,744	175,513	175,513
Accounts receivable, net of allowance for doubtful accounts	191,456	191,456	184,645	184,645
Unbilled revenue	262,289	262,289	283,141	283,141
Accounts payable and accrued liabilities	402,607	402,607	363,970	363,970
Obligations under capital lease	13,172	13,172	551	551
Customers' advance deposits	56,038	56,038	64,252	64,252
Long-term notes payable to the Corporation				
6.16% due May 6, 2013	179,456	190,682	179,100	196,236
5.20% due November 14, 2017	244,186	278,458	244,062	268,272
4.54% due November 12, 2019	243,814	270,077	243,686	254,620
5.59% due May 21, 2040	198,708	244,838	198,691	217,091
3.59% due November 18, 2021	298,119	306,680	—	—
Promissory note payable to the Corporation due May 6, 2013	245,058	259,650	490,115	521,312

b) *Risk Factors*

The following is a discussion of risks and related mitigation strategies that have been identified by LDC for financial instruments. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks listed.

LDC's activities provide for a variety of financial risks, particularly credit risk, interest rate risk and liquidity risk.

Credit risk

LDC is exposed to credit risk from financial instruments as a result of the risk of counterparties defaulting on their obligations. LDC monitors and limits its exposure to credit risk on a continuous basis.

Toronto Hydro-Electric System Limited

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[all tabular amounts in thousands of dollars]

December 31, 2011

LDC's credit risk associated with accounts receivable is primarily related to electricity bill payments from customers. LDC has approximately 709,000 customers, the majority of which are residential. LDC collects security deposits from customers in accordance with direction provided by the OEB. As at December 31, 2011, LDC held security deposits in the amount of \$56,038,000 [December 31, 2010 - \$64,252,000].

The carrying amount of accounts receivable is reduced through an allowance for doubtful accounts and the amount of the related impairment loss is recognized in the statements of income. Subsequent recoveries of receivables previously provisioned are credited to the statements of income.

Credit risk associated with accounts receivable is as follows:

	2011 \$	2010 \$
Total accounts receivable	204,266	196,381
Less: Allowance for doubtful accounts	(12,810)	(11,736)
Total accounts receivable, net	191,456	184,645
Of which:		
Outstanding for not more than 30 days	163,675	163,618
Outstanding for more than 30 days but not more than 120 days	24,671	21,495
Outstanding for more than 120 days	15,920	11,268
Less: Allowance for doubtful accounts	(12,810)	(11,736)
Total accounts receivable, net	191,456	184,645

Reconciliation between the opening and closing allowance for doubtful accounts balances is as follows:

	2011 \$	2010 \$
Balance, beginning of year	(11,736)	(12,387)
Provision for doubtful accounts	(10,158)	(6,966)
Write-offs	9,741	9,224
Recoveries	(657)	(1,607)
Balance, end of year	(12,810)	(11,736)

Unbilled revenue represents amounts for which LDC has a contractual right to receive cash through future billings but are unbilled at period-end. As at December 31, 2011, total unbilled revenue was \$262,289,000 [December 31, 2010 - \$283,141,000]. Unbilled revenue is considered current.

As at December 31, 2011, there were no significant concentrations of credit risk with respect to any class of financial assets or counterparties. LDC's maximum exposure to credit risk is equal to the carrying value of its financial assets.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

Interest rate risk

LDC is exposed to interest rate risk through holding certain financial instruments, and short-term borrowings which may be obtained under the Corporation's revolving credit facility may expose LDC to fluctuations in short-term interest rates (borrowings in the form of prime rate loans in Canadian dollars and Bankers' Acceptance ["BAs"] and letters of credit). LDC attempts to minimize interest rate risk by borrowing in long-term fixed rate debt, and by extending or shortening the term of its short-term money market investments by assessing the monetary policy stance of the Bank of Canada, while ensuring that all payment obligations are met on an ongoing basis. The fee payable for BAs and letters of credit is based on a margin determined by reference to the Corporation's credit rating.

Cash balances, which are not required to meet day-to-day obligations of LDC, are either held in bank accounts or invested in Canadian money market instruments, exposing LDC to fluctuations in short-term interest rates. These fluctuations could impact the level of interest income earned by LDC.

LDC is exposed to fluctuations in interest rates as its regulated rate of return is derived using a formulaic approach, which is based in part on a forecast of long-term Government of Canada bond yields and A-rated Canadian utility bond spreads. LDC estimates that a 1% (100 basis point) reduction in long-term Government of Canada bond yields, used in determining its regulated rate of return would reduce LDC's annual net income, as at December 31, 2011, by approximately \$4,600,000.

LDC is also exposed to fluctuations in interest rates for the valuation of its post-employment benefit obligations [note 11[e]].

Liquidity risk

LDC is exposed to liquidity risk related to commitments associated with financial instruments. LDC monitors and manages its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. LDC's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing net financing charges. LDC has access to credit facilities through the Corporation and monitors cash balances daily to ensure that sufficient levels of liquidity are on hand to meet financial commitments as they come due. Liquidity risks associated with financial commitments are as follows:

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

December 31, 2011			
	Due within 1 year \$	Due between 1 year and 5 years \$	Due after 5 years \$
Financial liabilities			
Accounts payable and accrued liabilities	402,607	—	—
Obligations under capital lease	1,871	8,042	3,259
Promissory note payable to the Corporation	—	245,058	—
Long-term notes payable to the Corporation			
6.16% due May 6, 2013	—	180,000	—
5.20% due November 14, 2017	—	—	245,058
4.54% due November 12, 2019	—	—	245,058
5.59% due May 21, 2040	—	—	200,000
3.59% due November 18, 2021	—	—	300,000
Interest payments on promissory note payable and long-term notes payable to the Corporation	72,392	194,031	360,893
	476,870	627,131	1,354,268

Hedging and Derivative risk

As at December 31, 2011 and December 31, 2010, LDC had not entered into hedging and derivative financial instruments.

Foreign exchange risk

As at December 31, 2011, LDC had limited exposure to the changing values of foreign currencies. While LDC purchases goods and services which are payable in US dollars, and purchases US currency to meet the related payables commitments when required, the impact of these transactions is not material to the financial statements.

16. FINANCIAL GUARANTEES

LDC is required to satisfy prescribed prudential requirements with the IESO for the purchase of electricity.

As at December 31, 2011, \$45,000,000 [December 31, 2010 - \$45,000,000] was utilized under the Corporation's bilateral credit facility in the form of letters of credit to support the prudential requirements of LDC.

17. PAYMENTS IN LIEU OF CORPORATE TAXES

The provision for PILs differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rate. Reconciliation between the statutory and effective tax rates is set out below:

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

Statements of Income

	2011 \$	2010 \$
Rate reconciliation		
Income before PILs	102,363	87,964
Statutory Canadian federal and provincial income tax rate	28.25%	31.00%
Expected provision for PILs	28,918	27,269
Temporary differences not benefited	(16,032)	(1,303)
Other	(3,854)	(2,020)
Provision for PILs	9,032	23,946
Effective tax rate	8.82%	27.22%
Components of provision for PILs		
Current tax provision	8,753	23,946
Future income tax provision related to the origination and reversal of temporary differences	279	—
Provision for PILs	9,032	23,946

Balance Sheets

Significant components of LDC's future income tax assets are as follows:

	2011 \$	2010 \$
Property, plant and equipment and intangible assets	100,933	121,872
Regulatory adjustments	50,109	56,142
Post-employment benefits liability	44,093	41,698
Other taxable temporary differences	5,022	4,858
Future income tax assets	200,157	224,570

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

18. SHARE CAPITAL

Share capital consists of the following:

	2011 \$	2010 \$
Authorized		
The authorized share capital of LDC consists of an unlimited number of common shares		
Issued and outstanding		
1,000 common shares	527,817	527,817

19. RELATED PARTIES

For LDC, transactions with related parties include transactions with the City, the Corporation and TH Energy. All transactions with related parties are in the ordinary course of business and measured at exchange amounts and normal trade terms.

2011	City \$	Corporation \$	TH Energy \$
Revenues	131,691	—	1,850
Operating expenses and capital expenditures	28,946	2,837	—
Net financing charges	—	77,609	—
Accounts receivable, net of allowance for doubtful accounts	6,761	—	20,978
Other Assets	7,279	—	—
Accounts payable and accrued liabilities	24,235	7,926	—
Long-term notes and promissory note payable	—	1,409,341	—
Customers' advance deposits	8,714	—	—

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

2010	City \$	Corporation \$	TH Energy \$
Revenues	128,931	—	2,018
Operating expenses and capital expenditures	14,019	3,784	—
Net financing charges	—	72,006	—
Accounts receivable, net of allowance for doubtful accounts	4,065	—	25,166
Other Assets	7,368	—	—
Accounts payable and accrued liabilities	12,164	6,473	—
Long-term notes and promissory note payable	—	1,355,654	—
Customers' advance deposits	10,953	—	—

Revenues represent amounts charged to the City primarily for electricity, and TH Energy for the provision of goods and services. Operating expenses and capital expenditures represent amounts charged by the City for purchased road cut repairs, property taxes and other services, and the Corporation for purchased corporate and management services. Net financing charges represent interest paid to the Corporation on the long-term notes and promissory note payable [note 10].

Accounts receivable, net of allowance for doubtful accounts represent receivables from the City primarily for relocation services and sale of electricity, and TH Energy for the provision of goods and services. Other assets represent amounts for prepaid land leases from the City. Accounts payable and accrued liabilities represent amounts payable to the City relating to road cut repairs and other services, as well as funds received from the City for the construction of electricity distribution assets, and the Corporation for purchased corporate and management services. Long-term notes and promissory note payable represent amounts borrowed from the Corporation [note 10]. Customers' advance deposits represent funds received from the City for future expansion projects.

20. COMMITMENTS

Operating lease obligations and future commitments

As at December 31, 2011, the future minimum annual lease payments under property operating leases and future commitments with remaining terms from one to five years and thereafter were as follows:

	\$
2012	27,713
2013	23,441
2014	7,490
2015	6,486
2016	6,307
Thereafter	4,755
Total amount of future minimum payments	76,192

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

During the first quarter of 2011, LDC entered into an agreement with Hydro One Networks Inc. to reinforce the 115 kilovolt transmission system between Leaside Transformer Station ["TS"] and Bridgman TS under the Toronto Midtown Transmission Reinforcement Project, which terminates on the 25th anniversary of the in service date. LDC is expected to pay the estimated capital contributions and work chargeable by making progress payments based on various payment milestone dates, with \$17,600,000 and \$15,278,000 payable in 2012 and 2013, respectively, and any difference from the estimated costs to be settled at a later date. These commitments have been reflected in the table above.

Capital lease obligations

As at December 31, 2011, the future minimum annual lease payments under capital leases with remaining lease terms from one to five years and thereafter were as follows:

	\$
2012	2,454
2013	2,445
2014	2,404
2015	2,327
2016	2,267
Thereafter	3,380
Total amount of future minimum payments	15,277
Less interest and executory costs	2,105
	13,172
Current portion [note 9]	1,871
Long-term portion [note 12]	11,301

Included in the capital lease obligations is an equipment lease entered into by LDC in the third quarter of 2011 which expires in June 2018 and bears interest at a rate of 4.7%.

21. CONTINGENCIES

a) Legal Proceedings

In the ordinary course of business, LDC is subject to various litigation and claims with customers, suppliers, former employees and other parties. On an ongoing basis, LDC assesses the likelihood of any adverse judgments or outcomes as well as potential ranges of probable costs and losses. A determination of the provision required, if any, for these contingencies is made after analysis of each individual issue. The provision may change in the future due to new developments in each matter or changes in approach, such as a change in settlement strategy. LDC is subject to various legal actions that arise in the normal course of business and if damages were awarded under these actions, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with these actions.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

Christian Helm Class Action

On December 6, 2010, a statement of claim in a proposed class action was issued against LDC. The claim seeks general and special damages in the amount of \$100,000,000 for disgorgement of unjust gains allegedly resulting from the receipt of interest on overdue accounts at a rate exceeding 5% per annum in contravention of the *Interest Act* (Canada) ["Interest Act"]. A statement of defence has been filed. Prior to any certification of the action as a class proceeding, cross summary judgment motions were heard in June 2011 to determine whether the Interest Act has been breached [note 23[c]].

2 Secord Avenue

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) ["Class Proceedings Act"] seeking damages in the amount of \$30,000,000 as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence and third party claim have been served by LDC and a third party defence and counterclaim against LDC seeking damages in the amount of \$51,000,000 have been filed. A certification order has been issued. Affidavits of documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with the action.

On December 20, 2010, LDC was served with a statement of claim by the City seeking damages in the amount of \$2,000,000 as a result of the fire at 2 Secord Avenue. A statement of defence and third party claim have been served. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with the action.

By order of the court, the above actions and a smaller non-class action commenced in April 2009 involving the same incident will be tried at the same time or consecutively.

2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act* seeking damages in the amount of \$30,000,000 as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action seeks damages in the amount of \$10,000,000 from LDC. Both actions are at a preliminary stage and the certification hearing is scheduled for September 2012. Statements of defence to the main action and to the third party claim have not been filed. Accordingly, given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with these actions.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

Another third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice seeking damages in the amount of \$30,000,000 as compensation for damages allegedly suffered as a result of the fire at 2369 Lakeshore Boulevard West. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action seeks damages in the amount of \$400,000 from LDC. LDC has filed a statement of defence, crossclaim and counterclaim. Examinations for discovery have not taken place but are to be completed by February 29, 2012 pursuant to a court ordered timetable. Accordingly, given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with these actions.

On August 29, 2011, LDC was served with a statement of claim by the owner of the building and the property management company for the building seeking damages in the amount of \$2,000,000 as a result of the fire at 2369 Lakeshore Boulevard West. LDC has filed a statement of defence and counterclaim. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with the action.

Adamopoulos

An action was commenced against LDC in November 2004 in the Ontario Superior Court of Justice seeking damages in the amount of \$7,750,000 as compensation for damages allegedly suffered as a result of a motor vehicle accident involving an LDC vehicle on January 9, 2001. The plaintiff's motion increasing its claim for damages to \$23,790,000 was granted on July 7, 2010. This matter has been settled and a court order has been issued dismissing the action and all related claims by payment of a total amount of approximately \$4,550,000. LDC's liability insurance covered the settlement amount.

b) OEB PILs Proceeding

The OEB conducted a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for certain MEUs. On June 24, 2011, the OEB issued its decision for these MEUs and provided guidelines for the calculation and further disposition of the balances accumulated in the PILs regulatory variance accounts.

LDC has reviewed the balances of its PILs regulatory variance accounts and applied the guidelines provided by the OEB. As at December 31, 2011, LDC estimated its liability at approximately \$2,779,000. This balance has been recorded in LDC's financial statements. LDC intends to apply for disposition of this balance in 2012. The amount to be approved by the OEB will be based on the OEB's interpretation and application of its guidelines and the final balance which is yet to be approved by the OEB could differ materially from LDC's estimation of its liability.

c) Payments in Lieu of Additional Municipal and School Taxes

The Ministry of Finance has issued assessments in respect of payments in lieu of additional municipal and school taxes under section 92 of the Electricity Act that are in excess of the amounts LDC believes are payable. The

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

dispute arose as a result of inaccurate information incorporated into Ontario Regulation 224/00. LDC has worked with the Ministry of Finance to resolve this issue, and as a result the Ministry of Finance issued Ontario Regulation 423/11 on August 31, 2011. The new regulation revoked Ontario Regulation 224/00 and corrected inaccurate information retroactively to 1999.

The balance assessed by the Ministry of Finance on its most recent statement of account amounts to approximately \$10,043,000 above the balance accrued by LDC. While LDC expects that reassessments will be issued as a consequence of the change in regulation, there can be no assurance that LDC will not have to pay the full assessed balance in the future.

22. COMPARATIVE FINANCIAL STATEMENTS

Certain comparative amounts of the financial statements have been reclassified from statements previously presented to conform to the presentation of the 2011 financial statements.

23. SUBSEQUENT EVENTS

a) Street Lighting Activities

On January 1, 2012, the Corporation completed the transfer of street lighting assets to LDC for a purchase price of \$28,460,000, subject to post closing adjustment and transaction costs [note 2[b]].

b) Electricity Distribution Rates

On January 5, 2012, the OEB rendered its decision on the preliminary issue and dismissed LDC's cost of service 2012-2014 Rate Application. In its decision, the OEB found that LDC was not permitted to deviate from the standard incentive regulation mechanism framework cycle, and LDC will therefore be required to file its request for electricity distribution rates commencing on May 1, 2012 pursuant to the formulaic adjustment and the incremental capital module provided for under the incentive regulation mechanism framework [note 2[a]].

On January 25, 2012, LDC filed with the OEB a motion to review the OEB's January 5, 2012 decision.

On February 6, 2012, LDC filed a notice of appeal with the Ontario Divisional Court regarding the OEB's January 5, 2012 decision.

Pursuant to the OEB's decision of January 5, 2012, LDC is currently preparing an application for electricity distribution rates using the incentive regulation mechanism framework, including the filing of an incremental capital module. The quantum of this application is consistent with the capital program spending levels previously approved by the OEB for the 2011 Rate Year.

Under the incentive regulation mechanism framework, LDC has to significantly reduce its costs structure, and in particular its operating expenses, in order to meet its financial obligations. Accordingly, in the first quarter of 2012, LDC began implementing a restructuring program aimed at reducing its operating costs in the future. The main component of this restructuring program is a workforce reduction plan targeting both union and management

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

employees. As at March 2, 2012, the costs incurred as a result of the restructuring program amounted to approximately \$19,300,000, which were mainly related to employee severance and buy-out costs.

LDC continues to assess all of the impacts related to the imposition by the OEB of the incentive regulation mechanism framework, which impacts may include additional restructuring costs. The incremental restructuring costs could have a material impact on LDC's financial statements in the future.

c) Christian Helm Class Action

On February 1, 2012, prior to the release of the decisions on the summary judgment motions, the parties reached a settlement of the matter, which settlement now requires court approval. The Settlement Approval Hearing is scheduled for April 30, 2012. If the settlement receives court approval, damages and costs of approximately \$6,000,000 shall be paid by LDC. In 2010, LDC accrued a liability to cover the expected settlement.

If the settlement does not receive court approval, the decision on the cross summary judgment motions will be released. In this event, if the court finds a breach of the Interest Act, subject to appeals, the proceeding will continue, and LDC will rely on other defences. While LDC believes it has a defence to this claim, there is no guarantee that it will be successful in defending the action and therefore, the outcome of this proceeding could have a material impact on LDC's financial statements and results of operations [note 21[a]].

Financial Statements

Toronto Hydro-Electric System Limited

DECEMBER 31, 2012

Financial Statements

Toronto Hydro-Electric System Limited

DECEMBER 31, 2012

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INDEPENDENT AUDITORS' REPORT

To the Shareholder of Toronto Hydro-Electric System Limited

We have audited the accompanying financial statements of Toronto Hydro-Electric System Limited, which comprise the balance sheets as at December 31, 2012 and December 31, 2011, the statements of net income and comprehensive income, shareholder's equity and cash flows for the years ended December 31, 2012 and December 31, 2011, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with United States Generally Accepted Accounting Principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Toronto Hydro-Electric System Limited as at December 31, 2012 and December 31, 2011 and its statements of net income and comprehensive income, shareholder's equity and cash flows for the years ended December 31, 2012 and December 31, 2011 in accordance with United States Generally Accepted Accounting Principles.

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

February 28, 2013

Toronto Hydro-Electric System Limited

BALANCE SHEETS

[in thousands of dollars]

As at December 31	2012 \$	2011 \$
ASSETS		[note 23]
Current		
Cash and cash equivalents	67,258	66,744
Accounts receivable, net of allowance for doubtful accounts [note 15[b]]	185,941	191,456
Unbilled revenue [note 15[b]]	274,272	262,289
Income tax receivable	4,710	8,684
Inventories [note 5]	7,555	6,891
Regulatory assets [note 9]	1,658	-
Other assets [note 6]	4,680	4,404
Total current assets	546,074	540,468
Property, plant and equipment, net [note 7]	2,504,428	2,334,293
Intangible assets, net [note 8]	134,080	112,982
Regulatory assets [note 9]	119,556	143,038
Other assets [note 10]	8,098	7,331
Deferred income tax assets [note 17]	193,242	200,157
Total assets	3,505,478	3,338,269
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities [note 15[b]]	377,948	399,435
Restructuring accrual [note 11]	11,954	-
Customers' advance deposits	40,048	40,238
Deferred conservation credit	19,908	13,610
Post-retirement benefits [note 13]	9,925	7,915
Other liabilities [note 20]	1,850	2,182
Regulatory liabilities [note 9]	-	7,293
Notes payable to related party [notes 12 and 19]	179,835	-
Promissory notes payable to related party [notes 12 and 19]	319,071	-
Total current liabilities	960,539	470,673
Notes payable to related party [notes 12 and 19]	985,343	1,164,283
Promissory note payable to related party [notes 12 and 19]	-	245,058
Customers' advance deposits	6,790	15,800
Post-retirement benefits [note 13]	243,965	236,411
Other liabilities [note 20]	9,385	11,301
Regulatory liabilities [note 9]	196,809	203,919
Asset retirement obligations [note 14]	5,004	4,831
Total liabilities	2,407,835	2,352,276
Commitments, contingencies and subsequent events [notes 2, 20 and 21]		
Shareholder's equity		
Share capital [note 18]	556,278	527,817
Retained earnings	528,608	445,419
Contributed surplus	12,757	12,757
Total shareholder's equity	1,097,643	985,993
Total liabilities and shareholder's equity	3,505,478	3,338,269

The accompanying notes are an integral part of the financial statements.

Toronto Hydro-Electric System Limited

STATEMENTS OF NET INCOME AND COMPREHENSIVE INCOME

[in thousands of dollars]

Year ended December 31	2012 \$	2011 \$
Revenues		<i>[note 23]</i>
Sale of electricity	2,799,404	2,766,714
Other income	41,057	39,143
	2,840,461	2,805,857
Costs		
Purchased power	2,275,209	2,236,541
Operating expenses	236,386	252,378
Depreciation and amortization	140,352	146,505
	2,651,947	2,635,424
Income before the following:	188,514	170,433
Net financing charges	(76,209)	(74,478)
Gain on disposals of property, plant and equipment	1,805	3,885
Restructuring costs <i>[note 11]</i>	(27,796)	-
Income before income taxes	86,314	99,840
Income tax expense <i>[note 17]</i>	3,125	6,509
Net income and comprehensive income	83,189	93,331

STATEMENTS OF SHAREHOLDER'S EQUITY

[in thousands of dollars]

Year ended December 31	2012 \$	2011 \$
Share capital <i>[note 18]</i>	556,278	527,817
Retained earnings, beginning of year	445,419	352,088
Net income	83,189	93,331
Retained earnings, end of year	528,608	445,419
Contributed surplus	12,757	12,757
Total shareholder's equity	1,097,643	985,993

The accompanying notes are an integral part of the financial statements.

Toronto Hydro-Electric System Limited

STATEMENTS OF CASH FLOWS

[in thousands of dollars]

Year ended December 31	2012 \$	2011 \$
OPERATING ACTIVITIES		<i>[note 23]</i>
Net income	83,189	93,331
Adjustments for non-cash items		
Depreciation and amortization	140,352	146,505
Change in other non-current assets	(767)	187
Change in other non-current liabilities	626	(253)
Post-retirement benefits	9,564	44,299
Deferred income taxes <i>[note 17]</i>	(245)	279
Gain on disposals of property, plant and equipment	(1,805)	(3,885)
Changes in non-cash working capital balances <i>[note 22]</i>	(7,001)	59,521
Net cash provided by operating activities	223,913	339,984
INVESTING ACTIVITIES		
Purchase of property, plant and equipment <i>[note 7]</i>	(290,067)	(378,378)
Purchase of intangible assets <i>[note 8]</i>	(42,057)	(52,805)
Net change in regulatory assets and liabilities	14,581	(66,379)
Proceeds on disposals of property, plant and equipment	2,665	4,974
Net cash used in investing activities	(314,878)	(492,588)
FINANCING ACTIVITIES		
Common shares issued <i>[note 18]</i>	28,461	-
Increase in notes payable to related party <i>[note 12]</i>	74,013	53,043
Decrease in customers' advance deposits	(9,200)	(8,214)
Repayment of capital lease liability	(1,795)	(994)
Net cash provided by financing activities	91,479	43,835
Net increase (decrease) in cash and cash equivalents during the year	514	(108,769)
Cash and cash equivalents, beginning of year	66,744	175,513
Cash and cash equivalents, end of year	67,258	66,744
Supplementary cash flow information		
Total interest paid	72,998	77,006
Total income taxes paid (recovered)	(1,200)	11,615

The accompanying notes are an integral part of the financial statements.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

[all tabular amounts in thousands of Canadian dollars]

1. INCORPORATION

On June 23, 1999, Toronto Hydro-Electric System Limited ["LDC"] was incorporated under the *Business Corporations Act* (Ontario), and is wholly-owned by Toronto Hydro Corporation [the "Corporation"]. The incorporation was required in accordance with the provincial government's *Electricity Act, 1998* (Ontario) ["Electricity Act"].

LDC distributes electricity to customers located in the City of Toronto [the "City"] and is subject to rate regulation. LDC is also engaged in the delivery of Conservation and Demand Management ["CDM"] activities.

2. BASIS OF PRESENTATION

These audited financial statements of LDC have been prepared in accordance with United States ["US"] Generally Accepted Accounting Principles ["GAAP"] with respect to the preparation of annual financial information, and are presented in Canadian dollars. These are LDC's first US GAAP annual financial statements. LDC's financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. The comparative financial statements have been adjusted retroactively from the financial statements previously presented to conform to the presentation of LDC's 2012 financial statements prepared in accordance with US GAAP.

A reconciliation of the balance sheets between Canadian GAAP and US GAAP as at January 1, 2011 and December 31, 2011 and a reconciliation of net income for the year ended December 31, 2011 accompany the financial statements [note 23].

LDC has evaluated the events and transactions occurring after the balance sheet date through February 28, 2013 when LDC's financial statements were available to be issued after the approval by the Corporation's Board of Directors, and did not identify any events or transactions which required recognition in the financial statements and/or disclosure in the notes to the financial statements.

3. REGULATION

In April 1999, the Government of Ontario began restructuring Ontario's electricity industry. Under regulations passed pursuant to the restructuring, LDC and other electricity distributors have been purchasing their electricity from the wholesale market administered by the Independent Electricity System Operator ["IESO"] and recovering the costs of electricity and certain other costs at a later date in accordance with procedures mandated by the Ontario Energy Board [the "OEB"].

The OEB has regulatory oversight of electricity matters in Ontario. The *Ontario Energy Board Act, 1998* (Ontario) sets out the OEB's authority to issue a distribution licence that must be obtained by owners or operators of an electricity distribution system in Ontario. The OEB prescribes licence requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for separate businesses, and filing process requirements for rate-setting purposes.

The OEB's authority and responsibilities include the power to approve and fix rates for the transmission and distribution of electricity, the power to provide continued rate protection for rural and remote electricity customers, and the responsibility for ensuring that electricity distribution companies fulfill their obligations to connect and service customers.

LDC is required to charge its customers for the following amounts (all of which, other than distribution charges, represent a pass through of amounts payable to third parties):

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- [i] *Distribution Charges.* Distribution charges are designed to recover the costs incurred by LDC in delivering electricity to customers and the OEB-allowed rate of return. Distribution charges are regulated by the OEB and are comprised of a fixed charge and a usage-based (consumption) charge. The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control (principally, sustained periods of hot or cold weather which increase the consumption of electricity, and sustained periods of moderate weather which decrease the consumption of electricity).
- [ii] *Electricity Price and Regulated Adjustments.* The electricity price and regulated adjustments represent the pass through of the commodity and other costs of electricity.
- [iii] *Retail Transmission Rate.* The retail transmission rate represents a pass through of wholesale costs incurred by distributors in respect of the transmission of electricity from generating stations to local areas. Retail transmission rates are regulated by the OEB.
- [iv] *Wholesale Market Service Charge.* The wholesale market service charge represents a pass through of various wholesale market support costs. Retail rates for the recovery of wholesale market service charges are regulated by the OEB.

LDC is required to satisfy and maintain prudential requirements with the IESO, which include credit support with respect to outstanding market obligations in the form of letters of credit, cash deposits or guarantees from third parties with prescribed credit ratings.

a) Electricity Distribution Rates

Regulatory developments in Ontario's electricity industry, including current and possible future consultations between the OEB and interested stakeholders, may affect LDC's electricity distribution rates and other permitted recoveries in the future.

LDC's electricity distribution rates for 2011 were determined through an application under the Cost of Service ["COS"] framework. The COS framework sets electricity distribution rates using a detailed examination of evidence and an assessment of the costs incurred by an electricity distributor to provide services to its customers.

On July 7, 2011, the OEB issued its decision regarding LDC's electricity distribution rates for 2011. The decision provided for a distribution revenue requirement and rate base of \$522,044,000 and \$2,298,227,000, respectively. In addition, the decision provided for capital program spending levels and operating, maintenance and administration spending levels of \$378,800,000 and \$238,000,000, respectively.

On August 26, 2011, LDC filed a rate application, following the COS framework, with the OEB seeking approval of separate and successive revenue requirements and corresponding electricity distribution rates for 2012, 2013 and 2014. Pursuant to the Incentive Regulation Mechanism ["IRM"] framework, the OEB established, as a preliminary issue in this application, that it would consider the question of whether the application filed by LDC under the COS framework was acceptable or whether it should be dismissed. The IRM framework provides for a standard adjustment to an electricity distributor's rates based on a formulaic calculation with the possibility to request an Incremental Capital Module ["ICM"] to address specific capital expenditure needs that occur during the IRM term, and are not otherwise funded by the formulaic calculation. In order to determine whether a distributor is eligible for the ICM, the OEB conducts a review of the application by way of a detailed examination of a distributor's evidence and consideration of a number of criteria, such as materiality, need and prudence.

LDC filed evidence supporting its position for electricity distribution rates to be set under the COS framework for 2012, 2013 and 2014. The OEB established a process by which a portion of LDC's evidence was tested during an oral hearing held in November 2011.

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On January 5, 2012, the OEB rendered its decision on the preliminary issue and dismissed LDC's COS framework application for 2012, 2013 and 2014. In its decision, the OEB found that LDC was not permitted to deviate from the standard IRM framework cycle. Accordingly, LDC was required to file its request for electricity distribution rates for 2012, 2013, and 2014 pursuant to the IRM framework and to use the ICM to request the capital needed for infrastructure renewal.

On January 25, 2012, LDC filed a motion with the OEB to review the OEB's January 5, 2012 decision [the "Motion"].

On February 6, 2012, LDC filed a notice of appeal with the Ontario Divisional Court regarding the OEB's January 5, 2012 decision [the "Appeal"].

On May 10, 2012, LDC filed an application for electricity distribution rates for 2012, 2013, and 2014 using the IRM framework, including the filing of an ICM application [the "IRM/ICM Application"]. The formulaic adjustment, requested by LDC, follows the guidelines provided by the OEB and seeks to increase the current revenue requirement by 0.68% to \$525,500,000 for 2012, \$529,100,000 for 2013 and \$532,700,000 for 2014. The 2013 and 2014 formulaic adjustment may be subject to change depending on future inflation and market data.

The IRM/ICM Application proposed by LDC requests rate riders to enable the recovery of capital expenditures. Accordingly, the amount of capital expenditures included in LDC's proposed IRM/ICM Application amounts to \$448,700,000 for 2012, \$534,500,000 for 2013 and \$439,500,000 for 2014.

On August 16, 2012, the OEB issued its decision on the issues list for the application filed May 10, 2012. In that decision, the OEB stated that further procedural steps would be determined pending LDC's response to the OEB as to whether LDC would continue to pursue the Motion and the Appeal. On August 20, 2012, LDC filed a notice of abandonment with the Ontario Divisional Court thereby terminating the Appeal. On the same date, LDC advised the OEB that it would withdraw its Motion for review.

While the IRM/ICM Application proposed by LDC has been under consideration by the OEB, capital spending in 2012 has been maintained at a reduced amount. As it was no longer practical to achieve the previously requested capital spending of \$448,700,000 in 2012, an update to the IRM/ICM Application was submitted by LDC on October 31, 2012 modifying the requested capital expenditures for 2012 and 2013 to \$283,000,000 and \$579,100,000, respectively, and requesting that consideration for 2014 be deferred to a second phase of the proceeding, once LDC has received a decision from the OEB in respect of phase one. On November 3, 2012, the OEB accepted LDC's request for a two-phase proceeding: phase one comprising LDC's 2012 and 2013 work program proposals and phase two comprising LDC's 2014 work program proposal.

The current application is expected to be subject to an in-depth review by the OEB. There can be no assurance that the OEB will allow for the total or partial recovery of the capital expenditure balances requested in the current application. The financial effect of the OEB decision will be recorded in the period it becomes known and could be material to LDC's financial performance.

b) Street Lighting Activities

On June 15, 2009, LDC filed an application with the OEB seeking an electricity distribution licence for a new wholly-owned legal entity to which the Corporation intended to transfer the street lighting assets of Toronto Hydro Energy Services Inc. ["TH Energy"]. Concurrently, LDC filed another application with the OEB seeking approval for the merger of LDC and the new legal entity. The main objective of these applications was to transfer the street lighting assets to the regulated electricity distribution activities of LDC to increase the overall safety of the related infrastructure.

On February 11, 2010, the OEB issued its decision in regard to these applications. In its decision, the OEB agreed that, under certain conditions, the treatment of certain types of street lighting assets as regulated assets is justified.

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The OEB ordered the Corporation to provide a detailed valuation of the street lighting assets and to perform an operational review to determine which street lighting assets could become regulated assets. The Corporation performed a detailed asset operational review and financial valuation of the street lighting assets, which was submitted to the OEB on January 31, 2011.

On August 3, 2011, the OEB issued its final decision allowing the transfer of a portion of the street lighting assets to the new wholly-owned legal entity (1798594 Ontario Inc.), and for LDC to amalgamate with the new legal entity. On January 1, 2012, the Corporation completed the asset transfer and amalgamation. The purchase price for such assets, including a post-closing adjustment, was \$42,473,000, subject to transaction costs [note 19].

c) CDM Activities

On March 31, 2010, the Minister of Energy and Infrastructure of Ontario, under the guidance of sections 27.1 and 27.2 of the *Ontario Energy Board Act, 1998* (Ontario), directed the OEB to establish CDM targets to be met by electricity distributors. Accordingly, on November 12, 2010, the OEB amended LDC's distribution licence to require LDC, as a condition of its licence, to achieve 1,304 Gigawatt-Hours of energy savings and 286 Megawatts of summer peak demand savings, over the period beginning January 1, 2011 through December 31, 2014.

Effective January 1, 2011, LDC entered into an agreement with the Ontario Power Authority ["OPA"] in the amount of approximately \$50,000,000 to deliver CDM programs extending from January 1, 2011 to December 31, 2014. As at December 31, 2012, LDC received approximately \$35,366,000 [December 31, 2011 - \$19,875,000] from the OPA for the delivery of CDM programs. All programs to be delivered are fully funded and paid in advance by the OPA. Amounts received but not yet spent are presented under current liabilities as deferred conservation credit. Upon the expiration of the agreement, LDC is required to repay to the OPA any excess funding received for program administration less any cost efficiency incentives. These programs are expected to support the achievement of the mandatory CDM targets described above.

On December 21, 2012, the Minister of Energy of Ontario issued a direction to the OPA under subsection 25.32(4.1) of the *Electricity Act* to extend the funding time period for OPA-contracted province-wide CDM initiatives under the *Green Energy Act, 2009* (Ontario) framework to December 31, 2015.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Regulation

The following regulatory treatments have resulted in accounting treatments which differ from US GAAP for enterprises operating in an unregulated environment:

Regulatory Assets and Liabilities

LDC has determined that its assets and liabilities arising from rate-regulated activities qualify for the application of regulatory accounting treatment in accordance with Financial Accounting Standards Board Accounting Standards Codification 980 – "Regulated Operations" ["ASC 980"], which includes accounting principles prescribed by the OEB in the "Accounting Procedures Handbook for Electricity Distributors". Under rate-regulated accounting, the timing and recognition of certain expenses and revenues may differ from those otherwise expected under US GAAP in order to appropriately reflect the economic impact of regulatory decisions regarding LDC's regulated revenues and expenditures. These timing differences are recorded as regulatory assets and regulatory liabilities on LDC's balance sheets and represent existing rights and obligations regarding cash flows expected to be recovered from or refunded to customers, based on decisions and approvals by the OEB. Regulatory assets and liabilities can be recognized for rate-setting and financial reporting purposes only if the OEB directs the relevant regulatory treatment or if future OEB direction is judged to be probable. In the event that the disposition of these balances was assessed to no longer be probable, the balances would be recorded in LDC's statements of net income and comprehensive

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income in the period that the assessment is made. The measurement of regulatory assets and liabilities is subject to certain estimates and assumptions, including assumptions made in the interpretation of the regulation and the OEB's decisions.

Regulatory assets and liabilities are classified as current if they are expected to be recovered from, or refunded to, customers within 12 months after each reporting period. All other regulatory asset and liability balances are classified as long-term on the balance sheets.

Allowance for funds used during construction

The OEB provides for the inclusion of an Allowance for Funds Used During Construction ["AFUDC"] when capitalizing construction-in-progress assets, until such time as the asset is substantially complete. A concurrent credit of the same amount is made to net financing charges when the allowance is capitalized. The interest rate for capitalization is prescribed by the OEB and modified on a periodic basis, and is applied to the balance of the construction-in-progress assets on a simple interest basis. The interest rate for capitalization for the period from January 1, 2012 to March 31, 2012 was 3.92%, from April 1, 2012 to September 30, 2012 was 3.51%, and from October 1, 2012 to December 31, 2012 was 3.23% [January 1, 2011 to September 30, 2011 - 4.29%; October 1, 2011 to December 31, 2011 - 3.92%]. AFUDC is included in property, plant and equipment and intangible assets for financial reporting purposes, charged to operations through depreciation and amortization expense over the useful lives of the related assets and recovered through future revenue.

b) Cash and cash equivalents

Cash and cash equivalents include cash in bank accounts and short-term investments with terms to maturity of 90 days or less from their date of acquisition.

c) Accounts receivable

Accounts receivable are recorded at the invoiced amount and overdue amounts bear interest at OEB-approved rates. The carrying amount of accounts receivable is reduced through an allowance for doubtful accounts and the amount of the related impairment loss is recognized in the statements of net income and comprehensive income. Subsequent recoveries of receivables previously provisioned and written off are credited to the statements of net income and comprehensive income. Management estimates uncollectible accounts receivable after considering historical loss experience and the characteristics of existing accounts.

d) Inventories

Inventories consist primarily of small consumable materials mainly related to the maintenance of the electricity distribution infrastructure. LDC classifies all major construction related components of its electricity distribution system infrastructure to property, plant and equipment. Once capitalized, these items are not depreciated until they are put into service. Inventories are carried at the lower of cost and market, with cost determined on an average cost basis net of a provision for obsolescence.

e) Property, plant and equipment

Property, plant and equipment are stated at cost and are removed from the accounts at the end of their estimated average useful lives, except in those instances where specific identification allows their removal at retirement or disposition. The cost of property, plant and equipment represents the original cost, consisting of direct materials and labour, contracted services, AFUDC, and overhead directly attributable to the capital project.

Capital contributions received are used to finance additions to property, plant and equipment. According to the accounting principles prescribed by the OEB, capital contributions received are treated as a credit to property, plant

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and equipment. The amount is subsequently depreciated by a charge to accumulated depreciation and a credit to depreciation expense at an equivalent rate to that used for the depreciation of the related property, plant and equipment.

In the event that facts and circumstances indicate that property, plant and equipment may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the asset are compared to the carrying amount of the asset to determine if a write-down is required. The impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value, which is determined by the estimated future discounted cash flows.

Depreciation is provided on a straight-line basis over the estimated useful lives at the following annual rates:

Distribution lines	2.0% to 5.0%
Transformers	3.3% to 5.0%
Stations	2.5% to 10.0%
Meters	2.5% to 6.7%
Buildings	1.3% to 5.0%
Rolling stock	12.5% to 25.0%
Other capital assets	4.0% to 20.0%
Equipment and tools	10.0% to 16.7%
Assets under capital lease	14.3% to 25.0%
Computer hardware	16.7% to 25.0%
Communications	10.0% to 20.0%

Construction in progress relates to assets not currently in use and therefore is not depreciated.

f) Intangible assets

Effective January 1, 2012, LDC revised its estimate of useful life of its Customer Care and Billing Customer Information System from five years to ten years as a result of an analysis completed related to the useful life assessment. This change has been accounted for on a prospective basis in the financial statements effective January 1, 2012. The change in estimate reduced amortization expense by approximately \$4,000,000 for the year ended December 31, 2012 with an offsetting increase in the carrying value of intangible assets. The change in estimate will decrease future amortization expense by \$4,000,000 per year over the term of the original useful life with no impact to the final year of the original useful life, and thereafter increase future amortization expense by \$4,000,000 per year.

Intangible assets are stated at cost. Amortization is provided on a straight-line basis over the estimated useful lives at the following annual rates:

Computer software	10.0% to 25.0%
Contributions	4.0%

Software in development and contributions for work in progress relate to assets not currently available for use and therefore are not amortized. Contributions represent payments made to Hydro One Networks Inc. for dedicated infrastructure pursuant to an agreement in order to receive connections to transmission facilities.

g) Restructuring

Restructuring charges are recorded based upon planned employee termination dates, site closure and consolidation plans, and contract terminations. Restructuring charges can include severance costs to eliminate a specified number of employee positions, infrastructure charges to vacate facilities and consolidate operations, and contract

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cancellation costs. The timing of associated cash payments is dependent upon the type of restructuring charge and can extend over a multi-year period.

h) Workplace Safety and Insurance Act

LDC is a Schedule 1 employer for workers' compensation under the *Workplace Safety and Insurance Act, 1997* (Ontario) [the "WSIA"]. As a Schedule 1 employer under the WSIA, LDC is required to pay annual premiums into an insurance fund established under the WSIA and recognizes expenses based on funding requirements.

i) Revenue recognition

Revenue from the sale of electricity is recorded on the basis of cyclical billings and includes an estimated amount for electricity delivered and not yet billed, the amount of which is impacted by energy demand, customer class usage patterns and composition, and weather conditions.

Other income, which includes revenues from electricity distribution related services and revenues from demand billable activities, is recognized as the services are rendered.

In the course of its operations, LDC collects Harmonized Sales Tax ["HST"] from its customers. When customers are billed, a current liability for HST is recognized which corresponds to the revenue derived from the services provided by LDC. When expenses are incurred by LDC, a current asset for HST is recorded which corresponds to the expenditures derived from the goods or services received by LDC. LDC's revenues and expenses exclude HST. This net asset or liability is settled with the appropriate government authority.

j) Financial instruments

At inception, all financial instruments which meet the definition of a financial asset or financial liability are recorded at fair value, unless fair value cannot be reliably determined. Gains and losses related to the measurement of financial instruments are reported in the statements of net income and comprehensive income. Subsequent measurement of each financial instrument will depend on the balance sheet classification elected by LDC. The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between willing parties.

The following summarizes the accounting classification LDC has elected to apply to each of its significant categories of financial instruments:

Cash equivalents and short-term investments	Held for Trading
Accounts receivable and unbilled revenue	Loans and Receivables
Accounts payable and accrued liabilities	Other Financial Liabilities
Obligations under capital lease	Other Financial Liabilities
Customers' advance deposits	Other Financial Liabilities
Short-term and long-term debt	Other Financial Liabilities

LDC uses the following methods and assumptions to estimate the fair value of each class of financial instruments for which carrying amounts are included in the balance sheets:

- Cash equivalents, comprising short-term investments, are classified as "Held for Trading" and are measured at fair value. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Accounts receivable and unbilled revenue are classified as "Loans and Receivables" and are measured at amortized cost, which, upon initial recognition, are considered equivalent to fair value. Subsequent

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measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.

- Accounts payable and accrued liabilities are classified as “Other Financial Liabilities” and are initially measured at fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Obligations under capital lease are classified as “Other Financial Liabilities” and are initially measured at fair value. Subsequent measurements are based on a discounted cash flow analysis and approximate the carrying value as management believes that the fixed interest rates are representative of current market rates.
- Customers’ advance deposits are classified as “Other Financial Liabilities” and are initially measured at fair value. Subsequent measurements are recorded at cost plus accrued interest. The carrying amounts approximate fair value because of the short maturity of the current portion, and the long-term portion approximates the carrying value, taking into account interest accrued on the outstanding balance.
- Short-term debt and long-term debt are classified as “Other Financial Liabilities” and are initially measured at fair value. The carrying amounts are carried at amortized cost, based on an initial fair value as determined at the time using quoted market price for similar debt instruments. The fair value of the debt is calculated by discounting the related cash flows at the estimated yield to maturity of similar debt instruments [note 15[a]].

k) Fair value measurements

LDC utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A fair value hierarchy exists that prioritizes observable and unobservable inputs used to measure fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect LDC’s assumptions with respect to how market participants would price an asset or liability. The fair value hierarchy includes three levels of inputs that may be used to measure fair value:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis;
- Level 2: Other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly or indirectly; and
- Level 3: Unobservable inputs, supported by little or no market activity, used to measure the fair value of the assets or liabilities to the extent that observable inputs are not available.

l) Employee future benefits

Multi-employer pension plan

LDC provides a pension plan for its full-time employees through the Ontario Municipal Employees Retirement System [“OMERS”]. OMERS is a multi-employer, contributory, defined benefit pension plan established in 1962 by Ontario for employees of municipalities, local boards and school boards. Both participating employers and employees are required to make plan contributions based on participating employees’ contributory earnings. The OMERS plan is accounted for as a defined contribution plan where LDC recognizes the expense related to this plan as contributions are made, since it is not practicable to determine LDC’s portion of pension obligations or the fair value of plan assets. LDC is not responsible for any other contractual obligations other than the contributions.

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Post-retirement benefits other than pension

LDC has a number of unfunded benefit plans providing post-retirement benefits (other than pension) to its employees. LDC pays certain medical, dental and life insurance benefits under unfunded defined benefit plans on behalf of its retired employees. LDC pays accumulated sick leave credits, up to certain established limits based on service, in the event of retirement, termination or death of certain employees.

LDC periodically measures its accumulated benefit obligation for accounting purposes as at December 31 of the applicable year. The latest actuarial valuation was performed as at January 1, 2012.

The cost of providing benefits under the defined benefit plans is determined using the projected unit credit method and based on assumptions that reflect management's best estimate. All actuarial gains and losses and prior service costs are recognized in other comprehensive income ["OCI"] as they arise and subsequently reclassified to a regulatory asset on the balance sheets. This results in the full recognition of the benefit obligation as a liability on the balance sheets.

Actuarial gains or losses are amortized into net periodic benefit cost for the current period when the net cumulative unrecognized actuarial gains or losses in the regulatory asset at the end of the previous reporting period exceed 10% of the accumulated benefit obligation at that date. These gains or losses are recognized over the expected average remaining service period of active employees participating in the plans.

The prior service costs in the regulatory asset are recognized as an expense on a straight-line basis over the average remaining service period of employees active at the date of amendment.

The effects of a curtailment loss are recognized in the statements of net income and comprehensive income when its occurrence is probable and reasonably estimable. The effects of a curtailment gain are recognized in the statements of net income and comprehensive income when the related employees terminate or the plan suspension or amendment is adopted. The effects of a settlement gain or loss are recognized in the statements of net income and comprehensive income in the period in which a settlement occurs.

m) Asset retirement obligations

LDC recognizes a liability for the future removal and handling costs for contamination in distribution equipment and for the future environmental remediation of certain properties. Initially, the liability is measured at present value and the amount of the liability is added to the carrying amount of the related asset. In subsequent periods, the capitalized amount is depreciated over the useful life of the related asset and the liability is adjusted quarterly for the discount applied upon initial recognition of the liability ["accretion expense"] and for changes in the underlying assumptions. The liability is recognized when the asset retirement obligation ["ARO"] is incurred and when the fair value can be reasonably estimated.

LDC has not recorded a liability related to certain AROs as a reasonable estimate of fair value could not be made. LDC does not recognize an ARO for active properties which support LDC's distribution operations since it cannot reasonably determine the amount of any remediation costs related to possible contamination, and a reliable estimate cannot be made until environmental site assessments have been completed. LDC expects to use the majority of its installed assets in perpetuity. If, at some future date, a particular asset is shown not to meet the perpetuity assumption, it will be reviewed to determine if an ARO exists.

n) Customers' advance deposits

Security deposits from electricity customers are cash collections to guarantee the payment of electricity bills. The electricity customer security deposits liability includes related interest amounts owed to the customers with the debit charged to net financing charges. Deposits that are refundable upon demand are classified as a current liability.

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Security deposits on Offers to Connect are cash collections from specific customers to guarantee the payment of additional costs relating to expansion projects. This liability includes related interest amounts owed to the customers with the debit charged to net financing charges. Deposits are classified as a current liability when LDC no longer has an unconditional right to defer payment of the liability for at least 12 months after the reporting period.

o) Income Taxes

Under the Electricity Act, LDC is required to make Payments In Lieu of Corporate Taxes ["PILs"] to the Ontario Electricity Financial Corporation. These payments are calculated in accordance with the *Income Tax Act* (Canada) and the *Taxation Act, 2007* (Ontario) as modified by regulations made under the Electricity Act and related regulations. This effectively results in LDC paying taxes similar to what would be imposed under the Federal and Ontario Tax Acts.

LDC uses the liability method of accounting for income taxes. Under the liability method, current income taxes payable are recorded based on taxable income. LDC recognizes deferred income tax assets and liabilities for the future tax consequences of events that have been included in the financial statements or income tax returns. Deferred income tax assets and liabilities are determined based on the difference between the carrying value of assets and liabilities on the balance sheets and their respective tax basis using the enacted tax rates by the balance sheet date in effect for the year in which the differences are expected to reverse. Tax benefits associated with income tax positions taken, or expected to be taken, in a tax return are recorded only when it is more likely than not that they will be realized, and are measured at the largest amount of the benefit that has a likelihood greater than 50 percent of being realized upon settlement. Deferred income tax assets are evaluated and unless realization is considered more likely than not, a valuation allowance is established.

ASC 980 requires the recognition of deferred income tax assets and liabilities and related regulatory liabilities and assets for the amount of deferred income taxes expected to be refunded to, or recovered from, customers in future electricity distribution rates. As at December 31, 2012, LDC recorded a deferred income tax asset and a corresponding regulatory liability of \$193,276,000 with respect to its rate-regulated activities that will be included in the rate-setting process [note 9]. These amounts include a gross up to reflect the income tax benefits associated with reduced revenues resulting from the realization of deferred tax assets. Deferred income taxes that are not included in the rate-setting process are charged or credited to the statements of net income and comprehensive income.

The benefits of the refundable apprenticeship and co-operative investment tax credits ["ITCs"] are credited against the related expense in the statements of net income and comprehensive income. All other types of ITCs are recorded as a reduction to income tax expense in the current period to the extent that realization of such benefit is more likely than not.

p) Use of estimates

The preparation of LDC's financial statements in accordance with US GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the year. The estimates are based on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Significant areas requiring the use of management estimates relate to unbilled revenue, regulatory assets and liabilities, environmental liabilities and AROs, employee future benefits, income taxes (including deferred income taxes), and revenue recognition. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Ministry of Energy of Ontario, or the Ministry of Finance of Ontario ["Ministry of Finance"].

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q) *Future Accounting Pronouncements*

A number of new standards and interpretations are not yet effective for the year ended December 31, 2012, and have not been applied in preparing these financial statements. LDC continues to analyze these standards and had initially determined that the following could have a significant effect on the financial statements.

In December 2011, the Financial Accounting Standards Board issued Accounting Standards Update ["ASU"] No. 2011-11, "Balance Sheet (Topic 210): *Disclosures about Offsetting Assets and Liabilities*" ["ASU 2011-11"]. The amendments require an entity to disclose both gross and net information about financial instruments and transactions eligible for offset in the balance sheets. ASU 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Retrospective application is required. The ASU No. 2013-01, "Balance Sheet (Topic 210): *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*", was issued in January 2013 to amend the scope of ASU 2011-11 to clarify that the disclosure requirements are limited to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions that are either offset in the balance sheets or subject to enforceable master netting arrangements or similar agreements. Based on LDC's analysis, the adoption of these amendments are not expected to have an impact on LDC's balance sheets or significantly impact disclosures.

5. INVENTORIES

Inventories consist of the following:

	2012 \$	2011 \$
Fuses	2,137	1,625
Consumables, tools and other maintenance items	1,968	1,745
Drums and reels	1,115	938
Other	2,335	2,583
	7,555	6,891

For the year ended December 31, 2012, LDC recognized operating expenses of \$6,934,000 related to inventory used to service electrical distribution assets [2011 - \$9,196,000].

6. CURRENT PORTION OF OTHER ASSETS

Current portion of other assets consists of the following:

	2012 \$	2011 \$
Prepaid expenses	4,369	4,006
Deferred financing costs	311	398
	4,680	4,404

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7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	2012			2011		
	Cost \$	Accumulated depreciation \$	Net book value \$	Cost \$	Accumulated depreciation \$	Net book value \$
Land	16,747	—	16,747	16,761	—	16,761
Distribution lines	2,930,296	1,460,979	1,469,317	2,755,344	1,404,998	1,350,346
Transformers	672,981	377,900	295,081	652,102	360,398	291,704
Stations	286,229	145,601	140,628	277,905	137,246	140,659
Meters	243,152	133,789	109,363	238,459	124,117	114,342
Buildings	160,368	69,248	91,120	154,932	62,403	92,529
Rolling stock	73,239	43,834	29,405	78,016	43,154	34,862
Other capital assets	70,291	47,561	22,730	68,282	43,805	24,477
Equipment and tools	45,611	33,936	11,675	44,208	31,785	12,423
Assets under capital lease	13,538	2,948	10,590	14,269	1,251	13,018
Computer hardware	50,511	40,003	10,508	44,625	35,602	9,023
Communications	32,082	26,597	5,485	31,537	23,912	7,625
Construction in progress	291,779	—	291,779	226,524	—	226,524
	4,886,824	2,382,396	2,504,428	4,602,964	2,268,671	2,334,293

For the year ended December 31, 2012, AFUDC in the amount of \$994,000 [2011 - \$3,786,000] was capitalized to property, plant and equipment and credited to net financing charges.

As at December 31, 2012, the net book value of stranded meters related to the deployment of smart meters amounting to \$17,647,000 [December 31, 2011 - \$20,366,000] was included in property, plant and equipment. In the absence of rate regulation, property, plant and equipment would have been \$17,647,000 lower as at December 31, 2012 [December 31, 2011 - \$20,366,000 lower].

For the year ended December 31, 2012, capital contributions in the amount of \$22,061,000 [2011 - \$36,381,000] were credited to property, plant and equipment.

For the year ended December 31, 2012, LDC recorded depreciation expense of \$119,393,000 [2011 - \$120,696,000] of which \$1,985,000 [2011 - \$1,177,000] related to assets under capital lease.

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8. INTANGIBLE ASSETS

Intangible assets consist of the following:

	2012			2011		
	Cost \$	Accumulated amortization \$	Net book value \$	Cost \$	Accumulated amortization \$	Net book value \$
Computer software	242,254	174,410	67,844	222,598	154,186	68,412
Contributions	19,649	2,175	17,474	14,059	1,440	12,619
Software in development	14,210	—	14,210	15,598	—	15,598
Contributions for work in progress	34,552	—	34,552	16,353	—	16,353
	310,665	176,585	134,080	268,608	155,626	112,982

For the year ended December 31, 2012, LDC acquired \$42,057,000 of intangible assets [2011 - \$52,805,000]. Contributions for work in progress relate to payments for connection projects to increase electricity distribution system capacity. All intangible assets are subject to amortization when they become available for use. Software in development and contributions for work in progress relate to assets not currently available for use and therefore are not amortized.

For the year ended December 31, 2012, \$19,656,000 of software in development was transferred to computer software [2011 - \$49,907,000].

For the year ended December 31, 2012, AFUDC in the amount of \$1,331,000 [2011 - \$1,419,000] was capitalized to intangible assets and credited to net financing charges.

For the year ended December 31, 2012, LDC recorded amortization expense on intangible assets of \$20,959,000 [2011 - \$25,809,000].

As at December 31, 2012, estimated future amortization expense related to intangible assets is as follows:

	\$
2013	17,940
2014	17,741
2015	16,815
2016	13,850
2017	11,481

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9. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

	2012 \$	2011 \$ [note 23]
Accounting policy changes	61,499	64,785
Smart meters	55,599	61,422
Regulatory assets recovery account	2,466	931
Settlement variances	1,071	14,119
Other	579	1,781
Total regulatory assets	121,214	143,038
Less: Current portion of regulatory assets	1,658	—
Long-term portion of regulatory assets	119,556	143,038

Regulatory liabilities consist of the following:

	2012 \$	2011 \$ [note 23]
Deferred income taxes	193,276	200,436
Income and other taxes variance account	2,398	2,365
Regulatory assets recovery account	—	7,293
Other	1,135	1,118
Total regulatory liabilities	196,809	211,212
Less: Current portion of regulatory liabilities	—	7,293
Long-term portion of regulatory liabilities	196,809	203,919

For the year ended December 31, 2012, LDC disposed of approved net regulatory liabilities amounting to \$8,838,000 through permitted distribution rate adjustments [2011 - \$34,528,000].

The regulatory assets and liabilities of LDC are as follows:

a) Accounting Policy Changes

This regulatory asset account relates to the accounting policy changes upon adoption of US GAAP, primarily related to the expected future electricity distribution charges to customers arising from timing differences in the recognition of actuarial losses and prior service costs of other post-retirement benefits [note 23]. The amount is amortized over the same period as the corresponding actuarial losses and prior service costs. The period in which recovery is expected cannot be determined at this time.

b) Smart Meters

The smart meters regulatory asset account relates to Ontario's decision to install smart meters throughout Ontario. LDC substantially completed its smart meter project as at December 31, 2010. In connection with this initiative, the OEB ordered LDC to record all expenditures and related revenues from 2008 to 2010 to a regulatory asset account and allowed LDC to keep the net book value of the stranded meters in property, plant and equipment. Effective January 1, 2011, LDC has recorded smart meter costs in property, plant and equipment and intangible assets as a

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regular distribution activity as directed by the OEB. LDC expects to apply to the OEB in the future for both the transfer of the 2008 to 2010 smart meter costs from regulatory assets to property, plant and equipment and intangible assets, and the transfer of the net book value of the stranded meters from property, plant and equipment to regulatory assets.

As at December 31, 2012, smart meter capital expenditures, net of accumulated depreciation, totalling \$52,865,000 were recorded to regulatory assets [December 31, 2011 - \$59,227,000]. These expenditures would otherwise have been recorded as property, plant and equipment and intangible assets under US GAAP for unregulated businesses. In the absence of rate regulation, property, plant and equipment and intangible assets would have been \$50,234,000 and \$2,631,000 higher, respectively, as at December 31, 2012 [December 31, 2011 - \$54,825,000 and \$4,402,000 higher, respectively].

For the year ended December 31, 2012, smart meter depreciation expense of \$6,361,000 [2011 - \$6,361,000] were deferred which would have been expensed under US GAAP for unregulated businesses. In the absence of rate regulation, for the year ended December 31, 2012, depreciation expense would have been \$6,361,000 higher [2011 - \$6,361,000 higher].

For the year ended December 31, 2012, smart meter customer revenues of \$5,889,000 were deferred [2011 - \$5,866,000]. In the absence of rate regulation, for the year ended December 31, 2012, revenue would have been \$5,889,000 higher [2011 - \$5,866,000 higher].

c) Regulatory Assets Recovery Account

The Regulatory Assets Recovery Account ["RARA"] consists of balances of regulatory assets or regulatory liabilities approved for disposition by the OEB through rate riders. The RARA is subject to carrying charges following the OEB prescribed methodology and related rates.

On April 9, 2010, the OEB approved the disposition of net regulatory liabilities of \$68,140,000, consisting of credit balances for settlement variances and income and other taxes variances of \$58,225,000 and \$11,900,000, respectively, and intangible assets debit balance of \$1,985,000, over a two-year period commencing on May 1, 2010 and ending on April 30, 2012.

On October 29, 2010, the OEB approved the disposition of regulatory assets of \$5,296,000, for amounts in connection with the contact voltage remediation activities, for the period commencing on November 1, 2010 and ending on April 30, 2012.

On February 22, 2011, the OEB approved the disposition of the Late Payment Penalties Settlement regulatory asset of \$7,526,000, over a 21-month period commencing on August 1, 2011 and ending on April 30, 2013.

On July 7, 2011, the OEB approved the disposition of net regulatory liabilities of \$8,572,000, consisting of credit balances for settlement variances, income and other taxes variances and 2008 RARA residual of \$7,460,000, \$3,373,000, and \$789,000, respectively, and an International Financial Reporting Standards ["IFRS"] cost debit balance of \$3,050,000, over a nine-month period commencing on August 1, 2011 and ending on April 30, 2012.

d) Settlement Variances

This account is comprised of the variances between amounts charged by LDC to customers, based on regulated rates, and the corresponding cost of non-competitive electricity service incurred by LDC. The settlement variances relate primarily to service charges, non-competitive electricity charges and the global adjustment. Accordingly, LDC has deferred the variances between the costs incurred and the related recoveries in accordance with the criteria set out in the accounting principles prescribed by the OEB.

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The balance for settlement variances continues to be calculated and attracts carrying charges in accordance with the OEB's direction. For the year ended December 31, 2012, settlement variances of \$12,249,000 were disposed through rate adjustments [2011 - \$34,938,000].

e) Deferred Income Taxes

This regulatory liability account relates to the expected future electricity distribution rate reduction for customers arising from timing differences in the recognition of deferred income tax assets [note 4[o]].

As at December 31, 2012, LDC recorded a deferred income tax asset and a corresponding regulatory liability of \$193,276,000 [December 31, 2011 - \$200,436,000] with respect to its rate-regulated activities that will be included in the rate-setting process.

f) Income and Other Taxes Variance Account

The income and other taxes variance regulatory liability account relates to the differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in the rate adjustment model. As at December 31, 2012, the balance in this account consisted of an over-recovery from customers of \$2,398,000 [December 31, 2011 - \$2,365,000].

10. OTHER ASSETS

Other long-term assets consist of the following:

	2012 \$	2011 \$
Prepaid expenses	7,191	7,279
Deferred financing costs	907	52
	8,098	7,331

11. RESTRUCTURING

In the first quarter of 2012, the Corporation's Board of Directors approved a workforce restructuring program aimed at reducing operating expenditures for LDC. The program was approved following the decision by the OEB to deny the request of LDC to set its electricity distribution rates for 2012, 2013 and 2014 under the COS framework. In preparing its revised application using the IRM framework, LDC concluded that significant cost reductions were necessary to manage its business within the confines of the expected allowed electricity distribution rates provided by the IRM framework [note 3[a]]. The main component of these operating cost reduction initiatives was a workforce restructuring program, which included the severance of management employees and a voluntary exit incentive program for targeted unionized positions.

For the year ended December 31, 2012, the costs incurred as a result of these operating cost reduction initiatives amounted to \$27,796,000 and were comprised of ongoing termination charges of \$23,668,000 and one-time termination incentive charges of \$4,128,000, of which \$11,954,000 remains unpaid as at December 31, 2012.

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12. LONG-TERM DEBT

Long-term debt consists of the following:

	2012 \$	2011 \$
Notes payable to related party:		
6.16% Long-term note payable to the Corporation due May 6, 2013	179,835	179,456
5.20% Long-term note payable to the Corporation due November 14, 2017	244,316	244,186
4.54% Long-term note payable to the Corporation due November 12, 2019	243,948	243,814
5.59% Long-term note payable to the Corporation due May 21, 2040	198,727	198,708
3.59% Long-term note payable to the Corporation due November 18, 2021	298,352	298,119
6.16% Promissory note payable to the Corporation due May 6, 2013	245,058	245,058
6.16% Promissory note payable to the Corporation due on demand	45,000	—
3.32% Promissory note payable to the Corporation due on the earlier of demand and January 1, 2022	15,000	—
3.09% Promissory note payable to TH Energy due on the earlier of demand and July 1, 2022	14,013	—
Total notes payable to related party	1,484,249	1,409,341
Less: Current portion of long-term notes payable	179,835	—
Less: Current portion of promissory notes payable	319,071	—
Long-term debt	985,343	1,409,341
Comprising:		
Long-term notes payable to related party	985,343	1,164,283
Promissory note payable to related party	—	245,058

All long-term debt of LDC ranks equally.

a) *Long-term notes payable to the Corporation*

Long-term notes payable to the Corporation are comprised of the following:

[i] \$180,000,000, which bears interest at a rate of 6.16% per annum, with a maturity date of May 6, 2013, extendable upon mutual consent.

[ii] \$245,058,000, which bears interest at a rate of 5.20% per annum, with a maturity date of November 14, 2017, extendable upon mutual consent.

[iii] \$245,058,000, which bears interest at a rate of 4.54% per annum, with a maturity date of November 12, 2019, extendable upon mutual consent.

[iv] \$200,000,000, which bears interest at a rate of 5.59% per annum, with a maturity date of May 21, 2040, extendable upon mutual consent.

[v] \$300,000,000, which bears interest at a rate of 3.59% per annum, with a maturity date of November 18, 2021, extendable upon mutual consent.

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b) Promissory notes payable to the Corporation

On July 1, 1999, LDC issued a promissory note to the City ["Initial Note"] in the principal amount of \$947,000,000 in partial consideration for the assets in respect of the electricity distribution system transferred by the Toronto Hydro-Electric Commission and the City to LDC effective July 1, 1999. The Initial Note was non-interest bearing until December 31, 1999 and interest bearing thereafter at the rate of 6% per annum. Pursuant to the terms of By-law No. 374-1999 of the City made under section 145 of the Electricity Act, the principal amount of the Initial Note was adjusted effective January 1, 2000 to \$980,231,000 to reflect the deemed debt to equity structure of LDC permitted by the OEB. At the same time, the Initial Note was replaced by a promissory note ["Replacement Note"] issued by LDC, which was interest bearing at the rate of 6.8% per annum. At December 31, 2002, the Replacement Note was payable on the earlier of demand and December 31, 2003.

Concurrent with the closing of the Corporation's debenture offering on May 7, 2003, the City transferred the Replacement Note to the Corporation in consideration for the issuance by the Corporation to the City of a new promissory note in the principal amount of \$980,231,000. Following the issuance of the new promissory note to the City, on May 7, 2003, LDC issued a promissory note payable on demand to the Corporation in the principal amount of \$980,231,000.

On September 5, 2006, LDC amended and restated the promissory note payable to the Corporation effective May 1, 2006 by fixing the interest rate at 6.16% and establishing an agreed repayment schedule. LDC is required to pay the principal amount of the note as follows: \$245,058,000 on the last business day before each of December 31, 2007, December 31, 2009, December 31, 2011 and on May 6, 2013. LDC made the first three scheduled payments on the respective due dates. Interest is calculated and payable quarterly in arrears on the last business day of March, June, September and December of each year.

On January 1, 2012, LDC issued a promissory note to the Corporation for general purposes. The principal amount of the promissory note is \$45,000,000, which bears interest at a rate of 6.16% per annum, payable on demand. Interest is calculated and payable semi-annually in arrears on July 1 and January 1 of each year.

On January 1, 2012, LDC issued a promissory note to the Corporation for general purposes. The principal amount of the promissory note is \$15,000,000, which bears interest at a rate of 3.32% per annum, payable on the earlier of demand and January 1, 2022. Interest is calculated and payable semi-annually in arrears on July 1 and January 1 of each year.

c) Promissory note payable to TH Energy

On July 1, 2012, LDC issued a promissory note to TH Energy in the principal amount of \$14,013,000 [note 19], which bears interest at a rate of 3.09% per annum, payable on the earlier of demand and July 1, 2022. Interest is calculated and payable semi-annually in arrears on January 1 and July 1 of each year.

13. EMPLOYEE FUTURE BENEFITS

Pension

LDC provides a pension plan for its full-time employees through OMERS. Details of the plan are as follows:

Pension Plan	Funded Status as at December 31, 2012	Contributions	
		2012 \$	2011 \$
OMERS	86%	16,374	13,813

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The OMERS plan assets are pooled together to provide benefits to plan participants and the plan assets are not segregated in separate accounts for each member entity. As at December 31, 2012, the OMERS plan financial statements disclosed an actuarial deficit of approximately \$9,900,000,000, which is being addressed through increases in contribution rates for participating employers and employees. For the year ended December 31, 2012, the total contributions of all participating employers and employees were approximately \$3,200,000,000. LDC's contributions represent less than five percent of total contributions to the plan.

For 2012, OMERS contribution rates were 8.3% up to the year's maximum pensionable earnings ["YMPE"] and 12.8% over YMPE for normal retirement age of 65 [2011 - 7.4% up to YMPE and 10.7% over YMPE for normal retirement age of 65].

As at December 31, 2012, OMERS had approximately 266,000 active members, of which approximately 1,700 members had a current relationship with LDC.

Post-retirement benefits other than pension

a) Benefit Obligations

	2012 \$	2011 \$
Balance, beginning of year	244,326	198,630
Adjustment due to reorganization	781	2,143
Service cost	5,035	3,820
Interest cost	11,454	11,307
Benefits paid	(7,960)	(7,383)
Actuarial loss	254	35,809
Balance, end of year	253,890	244,326

b) Amounts recognized in regulatory assets

	2012 \$	2011 \$
Actuarial loss	61,477	63,698
Prior service cost	22	1,087
Total recognized in regulatory assets [note 9]	61,499	64,785

As at December 31, 2012, the estimated actuarial loss and prior service cost that are expected to be amortized from regulatory asset to net periodic benefit cost in 2013 are \$2,064,000 and \$2,000, respectively.

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c) Components of net periodic benefit costs

	2012 \$	2011 \$
Service cost	5,035	3,820
Interest cost	11,454	11,307
Amortization of actuarial loss	3,146	787
Amortization of prior service cost	840	873
Net periodic benefit cost	20,475	16,787
Capitalized as part of property, plant and equipment	7,305	6,758
Charged to operations	13,170	10,029

d) Expected benefit payments

The following benefit payments (net of recoveries from related companies), which reflect expected future service, as appropriate, are expected to be paid over the next five years, and in the aggregate for the five fiscal years thereafter:

	Post-retirement Benefits \$
2013	10,015
2014	8,061
2015	8,263
2016	8,940
2017	9,384
2018-2022	55,001

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e) *Significant assumptions*

	2012 %	2011 %
Accrued benefit obligation as at December 31:		
Discount rate	4.25	4.75
Rate of compensation increase	4.00	4.00
Benefit costs for years ended December 31:		
Discount rate	4.75	5.75
Rate of compensation increase	4.00	4.00
Assumed health care cost trend rates as at December 31:		
Rate of increase in dental costs assumed for next year	4.00	4.00
Rate of increase in medical costs assumed for next year		
For pre July 2000 retirements	6.50	7.00
For other retirements	8.00	8.50
Rate that medical cost trend rate gradually declines to		
For pre July 2000 retirements	5.00	5.00
For other retirements	5.00	5.00
Year that the medical cost trend rate reaches the ultimate trend rate		
For pre July 2000 retirements	2016	2016
For other retirements	2019	2019

f) *Sensitivity analysis*

Assumed health and dental care cost trend rates have a significant effect on the amounts reported for health and dental care plans. A one-percentage-point change in assumed health and dental care cost trend rates would have the following effects for 2012:

	Increase \$	Decrease \$
Total of current service and interest cost (at 4.75%)	2,483	(2,181)
Accrued benefit obligation as at December 31, 2012 (at 4.25%)	32,347	(28,380)

Assumed interest rates have a significant effect on the amounts reported for the total accrued benefit obligation and expense. A one-percentage-point change in assumed interest rates would have the following effects:

	Increase \$	Decrease \$
Accrued benefit obligation as at December 31, 2012	(39,382)	48,344
Estimated net periodic benefit cost for fiscal 2013	(2,563)	4,629

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14. ASSET RETIREMENT OBLIGATIONS

The reconciliation between the opening and closing ARO liability balances is as follows:

	2012 \$	2011 \$
Balance, beginning of year	4,831	4,939
ARO liabilities settled in the year	(313)	(688)
Accretion expense	170	168
Revision in estimated cash flows	316	412
Balance, end of year	5,004	4,831

15. FINANCIAL INSTRUMENTS

a) *Recognition and measurement*

The fair values of cash and cash equivalents, net accounts receivable, unbilled revenue, accounts payable and accrued liabilities, and customers' advance deposits approximate their carrying values as at December 31, 2012 and December 31, 2011 [note 4[j]].

The carrying value and fair value of LDC's other financial instruments consist of the following:

	2012 \$		2011 \$	
	Carrying value	Fair value ⁽¹⁾	Carrying value	Fair value ⁽¹⁾
Obligations under capital lease	11,235	11,235	13,172	13,172
Long-term notes payable to the Corporation				
6.16% due May 6, 2013	179,835	182,999	179,456	190,682
5.20% due November 14, 2017	244,316	278,314	244,186	278,458
4.54% due November 12, 2019	243,948	274,786	243,814	270,077
5.59% due May 21, 2040	198,727	256,357	198,708	244,838
3.59% due November 18, 2021	298,352	316,935	298,119	306,680
Promissory note payable to the Corporation due May 6, 2013	245,058	249,174	245,058	259,650
Promissory note payable to the Corporation due on demand	45,000	45,754	—	—
Promissory note payable to the Corporation due on the earlier of demand and January 1, 2022	15,000	15,489	—	—
Promissory note payable to TH Energy due on the earlier of demand and July 1, 2022	14,013	14,043	—	—

⁽¹⁾ The fair value measurement of financial instruments for which the fair value has been disclosed is included in Level 2 of the fair value hierarchy.

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b) Financial Risks

The following is a discussion of financial risks and related mitigation strategies that have been identified by LDC for financial instruments. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks listed.

LDC's financial activities provide for a variety of financial risks, particularly credit risk, interest rate risk and liquidity risk.

Credit risk

LDC is exposed to credit risk from financial instruments as a result of the risk of counterparties defaulting on their obligations. LDC monitors and limits its exposure to credit risk on a continuous basis.

LDC's credit risk associated with accounts receivable is primarily related to electricity bill payments from customers. LDC has approximately 719,000 customers, the majority of which are residential. LDC collects security deposits from certain customers in accordance with direction provided by the OEB. As at December 31, 2012, LDC held security deposits in the amount of \$46,838,000 [December 31, 2011 - \$56,038,000], of which \$25,666,000 [December 31, 2011 - \$22,700,000] were related to security deposits on Offers to Connect to guarantee the payment of additional costs relating to expansion projects.

LDC did not have any single customer that generated more than 10% of total revenues for the years ended December 31, 2012 and December 31, 2011.

Credit risk associated with accounts receivable is as follows:

	2012 \$	2011 \$
Total accounts receivable	196,509	204,266
Less: Allowance for doubtful accounts	(10,568)	(12,810)
Total accounts receivable, net	185,941	191,456
Of which:		
Outstanding for not more than 30 days	164,523	163,675
Outstanding for more than 30 days and not more than 120 days	18,214	24,671
Outstanding for more than 120 days	13,772	15,920
Less: Allowance for doubtful accounts	(10,568)	(12,810)
Total accounts receivable, net	185,941	191,456

Reconciliation between the opening and closing allowance for doubtful accounts balances is as follows:

	2012 \$	2011 \$
Balance, beginning of year	(12,810)	(11,736)
Provision for doubtful accounts	(6,590)	(10,158)
Write-offs	9,242	9,741
Recoveries	(410)	(657)
Balance, end of year	(10,568)	(12,810)

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Unbilled revenue represents amounts for which LDC has a contractual right to receive cash through future billings and are unbilled at period-end. As at December 31, 2012, total unbilled revenue was \$274,272,000 [December 31, 2011 - \$262,289,000]. Unbilled revenue is considered current.

As at December 31, 2012, there were no significant concentrations of credit risk with respect to any class of financial assets or counterparties. LDC's maximum exposure to credit risk is equal to the carrying value of its financial assets.

Interest rate risk

LDC is exposed to interest rate risk through holding certain financial instruments, and short-term borrowings which may be obtained under the Corporation's revolving credit facility may expose LDC to fluctuations in short-term interest rates (borrowings in the form of prime rate loans in Canadian dollars and Bankers' Acceptance and letters of credit). LDC attempts to minimize interest rate risk by borrowing in long-term fixed rate debt, and by extending or shortening the term of its short-term money market investments by assessing the monetary policy stance of the Bank of Canada, while ensuring that all payment obligations are met on an ongoing basis. The fee payable for bankers' acceptances and letters of credit is based on a margin determined by reference to the Corporation's credit rating.

Cash balances, which are not required to meet day-to-day obligations of LDC, are either held in bank accounts or invested in Canadian money market instruments, exposing LDC to fluctuations in short-term interest rates. These fluctuations could impact the level of interest income earned by LDC.

As at December 31, 2012, LDC has limited exposure to interest rate risk since its significant obligations are either non-interest bearing or bear fixed interest rates, its financial assets are predominately short-term in nature and mostly non-interest bearing, and its revenue is governed by a specified rate of return pricing structure set by the OEB. LDC estimates that a 100 basis point increase (decrease) in short-term interest rates, with all other variables held constant, would result in a decrease (increase) of approximately \$200,000 per annum to net financing charges.

LDC is also exposed to fluctuations in interest rates for the valuation of its post-retirement benefit obligations [note 13[f]].

Liquidity risk

LDC is exposed to liquidity risk related to commitments associated with financial instruments. LDC monitors and manages its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. LDC's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing net financing charges. LDC has access to credit facilities and borrowings through the Corporation and monitors cash balances daily to ensure that sufficient levels of liquidity are on hand to meet financial commitments as they come due.

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Liquidity risks associated with financial commitments are as follows:

December 31, 2012						
	2013 \$	2014 \$	2015 \$	2016 \$	2017 \$	Due after 5 years \$
Financial liabilities						
Accounts payable and accrued liabilities	377,948	—	—	—	—	—
Obligations under capital lease	2,338	2,329	2,322	2,310	2,310	1,157
Long-term notes payable to the Corporation						
6.16% due May 6, 2013	180,000	—	—	—	—	—
5.20% due November 14, 2017	—	—	—	—	245,058	—
4.54% due November 12, 2019	—	—	—	—	—	245,058
5.59% due May 21, 2040	—	—	—	—	—	200,000
3.59% due November 18, 2021	—	—	—	—	—	300,000
Promissory note payable to the Corporation due May 6, 2013	245,058	—	—	—	—	—
Promissory note payable to the Corporation due on demand	45,000	—	—	—	—	—
Promissory note payable to the Corporation due on the earlier of demand and January 1, 2022	15,000	—	—	—	—	—
Promissory note payable to TH Energy due on the earlier of demand and July 1, 2022	14,013	—	—	—	—	—
Interest payments on long-term notes payable and promissory notes payable	56,612	45,819	45,819	45,819	45,819	316,881
	935,969	48,148	48,141	48,129	293,187	1,063,096

Hedging and Derivative risk

As at December 31, 2012 and December 31, 2011, LDC had not entered into hedging and derivative financial instruments.

Foreign exchange risk

As at December 31, 2012, LDC had limited exposure to the changing values of foreign currencies. While LDC purchases goods and services which are payable in US dollars, and purchases US currency to meet the related payables commitments when required, the impact of these transactions is not material to the financial statements.

16. FINANCIAL GUARANTEES

As at December 31, 2012, \$48,388,000 [December 31, 2011 - \$45,000,000] was utilized under the Corporation's demand credit facility in the form of letters of credit to satisfy the prescribed prudential requirements of LDC with the IESO for the purchase of electricity. An additional amount of \$761,000 was utilized for the Ministry of Finance.

17. INCOME TAXES

LDC's effective tax rate for the year ended December 31, 2012 was 3.62% [2011 - 6.52%]. Income tax expense for the year ended December 31, 2012 was \$3,125,000 [2011 - \$6,509,000]. The effective tax rate and income tax

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expense for the year ended December 31, 2012 was lower than the year ended December 31, 2011 due to a reduction in the statutory tax rate from 28.25% to 26.50% and changes in permanent and temporary differences between accounting and tax treatments.

Income tax expense differs from the amount that would have been recorded using the combined statutory Canadian federal and Ontario income tax rate. Reconciliation of income tax expense computed at the statutory income tax rate to the income tax provision is set out below:

Statements of Net Income and Comprehensive Income

	2012 \$	2011 \$
Rate reconciliation		
Income before income taxes	86,314	99,840
Statutory Canadian federal and provincial income tax rate	26.50%	28.25%
Expected income tax expense	22,873	28,205
Temporary differences not benefited	(16,133)	(16,032)
Impact of change in expected future tax rate on existing deferred income tax balances	(923)	—
Other	(2,692)	(5,664)
Income tax expense	3,125	6,509
Effective tax rate	3.62%	6.52%
Components of income tax expense		
Current tax	6,011	8,753
Deferred income tax related to the origination and reversal of temporary differences	(245)	279
Non-refundable ITCs	(2,641)	(2,523)
Income tax expense	3,125	6,509

Balance Sheets

Significant components of LDC's deferred tax assets are as follows:

	2012 \$	2011 \$
Property, plant and equipment and intangible assets	82,604	100,933
Regulatory adjustments	51,218	50,109
Post-retirement benefits liability	50,667	44,093
Other taxable temporary differences	8,753	5,022
Deferred income tax assets	193,242	200,157

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A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2012 \$	2011 \$
Balance, beginning of year	7,045	(574)
Increases for tax positions taken in the current year	248	374
Increases for tax positions taken in prior years	—	6,633
Decreases for tax positions taken in prior years	(38)	—
Settlements with tax authorities	(1,981)	612
Reductions resulting from the expiry of limitation periods	—	—
Balance, end of year	5,274	7,045

As at December 31, 2012, \$5,274,000 of unrecognized tax benefits [December 31, 2011 - \$7,045,000] would have a favourable effect on the effective tax rate, if recognized. No interests and penalties have been accrued, since LDC is of the view that none are expected to be payable. During the next 12 months, unrecognized tax benefits are not expected to significantly change.

As at December 31, 2012, LDC's tax years still open to examination by taxing authorities include 2007 and subsequent years. Other than in respect of the fair market revaluation of LDC's assets on October 1, 2001 pursuant to Section 7 of Ontario Regulation 162/01 of the Electricity Act, tax years prior to 2007 are closed to further examination.

18. SHARE CAPITAL

Share capital consists of the following:

	2012 \$	2011 \$
Authorized		
The authorized share capital of LDC consists of an unlimited number of common shares		
Issued and outstanding		
1,000 common shares	556,278	527,817

On January 1, 2012, LDC amalgamated with 1798594 Ontario Inc., a wholly-owned entity of the Corporation, with an initial share capital of \$1,000 and a further share capital of \$28,460,000 associated with the transfer of certain electricity distribution assets [note 19], whose shares were cancelled upon completion of the amalgamation.

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19. RELATED PARTIES

For LDC, transactions with related parties include transactions with the City, the Corporation and TH Energy. All transactions with related parties are in the ordinary course of business and measured at exchange amounts and normal trade terms.

2012	City \$	Corporation \$	TH Energy \$
Revenues	210,835	—	—
Operating expenses (recoveries) and capital expenditures	26,232	3,035	(1,530)
Net financing charges	—	75,303	433
Accounts receivable	5,603	—	14,271
Unbilled revenue	17,016	—	—
Other Assets	7,279	—	—
Accounts payable and accrued liabilities	38,013	11,426	433
Short-term notes and promissory notes payable	—	484,893	14,013
Long-term notes payable	—	985,343	—
Advance deposits	8,926	—	—

2011	City \$	Corporation \$	TH Energy \$
Revenues	194,671	—	—
Operating expenses (recoveries) and capital expenditures	28,946	2,837	(1,850)
Net financing charges	—	77,609	—
Accounts receivable	6,761	—	10,494
Unbilled revenue	12,439	—	—
Other Assets	7,279	—	—
Accounts payable and accrued liabilities	24,235	7,926	—
Long-term notes and promissory note payable	—	1,409,341	—
Advance deposits	8,714	—	—

Revenues represent amounts charged to the City primarily for electricity, street lighting and ancillary services. Operating expenses and capital expenditures represent amounts charged by the City for purchased road cut repairs, property taxes and other services, and the Corporation for purchased corporate and management services. Operating expense recoveries represent amounts charged to TH Energy for the provision of goods and services. Net financing charges represent interest charged by the Corporation and TH Energy on the notes and promissory notes payable [note 12].

Accounts receivable represent receivables from the City primarily for electricity and ancillary services, and TH Energy for the provision of goods and services, including consolidated billing services. Unbilled revenue represents receivables from the City related to the provision of electricity not yet billed. Other assets represent amounts for prepaid land leases from the City. Accounts payable and accrued liabilities represent amounts payable to the City relating to road cut repairs and other services, as well as funds received from the City for the construction of electricity distribution assets. Included in the Accounts payable and accrued liabilities are amounts payable to the Corporation for purchased corporate and management services and interest accruing on notes and promissory notes payable to the Corporation and TH Energy. Notes and promissory notes payable represent amounts borrowed from the Corporation and TH Energy [note 12]. Advance deposits represent funds received from the City for future expansion projects.

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On January 1, 2012, certain electricity distribution assets of TH Energy were transferred to LDC through a newly created wholly-owned legal entity (1798594 Ontario Inc.) of the Corporation. Immediately thereafter, the new legal entity was amalgamated with LDC. The transfer was completed for a purchase price of \$28,460,000, with a post closing adjustment of \$14,013,000. The transfer was initially funded with share capital issued by the new wholly-owned legal entity to the Corporation. Subsequently, LDC issued an intercompany promissory note payable to TH Energy for the increase in the purchase price.

20. COMMITMENTS

Future capital commitments and operating lease obligations

As at December 31, 2012, the future minimum annual lease payments under property operating leases and future commitments with remaining terms from one to five years and thereafter were as follows:

	Future capital commitments ⁽²⁾	Operating lease obligations and other
	\$	\$
2013	15,278	9,091
2014	—	8,999
2015	—	8,052
2016	—	6,666
2017	—	1,992
Thereafter	—	—
Total amount of future minimum payments ⁽¹⁾	15,278	34,800

⁽¹⁾ Refer to note 15 for repayments of long-term debt excluded from the table above.

⁽²⁾ Reflect estimated capital contributions payable to Hydro One Networks Inc. under the Toronto Midtown Transmission Reinforcement Project.

LDC has the option to renew its two major property operating leases at the end of the current lease term for an additional five years at the then fair rental value.

Operating lease expense for the year ended December 31, 2012 was \$6,547,000 [2011 - \$5,271,000].

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Capital lease obligations

As at December 31, 2012, the future minimum annual lease payments under capital leases with remaining lease terms from one to five years and thereafter were as follows:

	\$
2013	2,338
2014	2,329
2015	2,322
2016	2,310
2017	2,310
Thereafter	1,157
Total amount of future minimum lease payments	12,766
Less: interest and executory costs	1,531
	11,235
Current portion included in Other liabilities	1,850
Long-term portion included in Other liabilities	9,385

21. CONTINGENCIES

a) Legal Proceedings

In the ordinary course of business, LDC is subject to various litigation and claims with customers, suppliers, former employees and other parties. On an ongoing basis, LDC assesses the likelihood of any adverse judgments or outcomes as well as potential ranges of probable costs and losses. A determination of the provision required, if any, for these contingencies is made after an analysis of each individual issue. The provision may change in the future due to new developments in each matter or changes in approach, such as a change in settlement strategy. LDC is subject to various legal actions that arise in the normal course of business and if damages were awarded under these actions, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with these actions.

Christian Helm Class Action

On December 6, 2010, a statement of claim in a proposed class action was issued against LDC. The claim sought general and special damages in the amount of \$100,000,000 for disgorgement of unjust gains allegedly resulting from the receipt of interest on overdue accounts in contravention of the *Interest Act* (Canada). On April 30, 2012, a settlement reached by the parties was approved by Order of the Ontario Superior Court of Justice. Pursuant to the terms of the Order, LDC was required to pay the amount of \$5,836,000 plus costs in settlement of all claims, substantially all of which had been paid as at December 31, 2012. LDC accrued a liability to cover the expected settlement in 2010. The action has been dismissed, and the claims by all class members have been released.

2 Secord Avenue

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of \$30,000,000 as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence and third party claim have been served by LDC and a third party defence and counterclaim against LDC seeking damages in the amount of \$51,000,000 have been filed. A certification order has been issued. Affidavits of

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documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with the action.

On December 20, 2010, LDC was served with a statement of claim by the City seeking damages in the amount of \$2,000,000 as a result of the fire at 2 Secord Avenue. A statement of defence and a third party claim have been served. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with the action.

By order of the court dated January 24, 2012, the above actions and a smaller non-class action commenced in April 2009 involving the same incident will be tried at the same time or consecutively.

2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of \$30,000,000 as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action seeks damages in the amount of \$10,000,000 from LDC. Both actions are at a preliminary stage and the certification hearing has yet to occur. Statements of defence to the main action and to the third party claim have not been filed. Accordingly, given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with these actions.

Another third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice seeking damages in the amount of \$30,000,000 as compensation for damages allegedly suffered as a result of the fire at 2369 Lakeshore Boulevard West. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action sought damages in the amount of \$400,000 from LDC. LDC has filed a statement of defence, crossclaim and counterclaim. Examinations for discovery have not taken place, notwithstanding a court ordered timetable to have them completed by February 29, 2012. By order dated December 5, 2012, these actions were dismissed by the court for delay.

On August 29, 2011, LDC was served with a statement of claim by the owner of the building and the property management company for the building seeking damages in the amount of \$2,000,000 as a result of the fire at 2369 Lakeshore Boulevard West. LDC has filed a statement of defence and counterclaim. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with the action.

b) OEB PILs Proceeding

The OEB conducted a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for certain Municipal Electricity Utilities ["MEUs"]. On June 24, 2011, the OEB issued its decision for these MEUs and provided guidelines for the calculation and further disposition of the balances accumulated in the PILs regulatory variance accounts. Subsequent to this decision, the OEB issued interrogatories and decisions for other MEUs.

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LDC has reviewed the balances of its PILs regulatory variance accounts and applied the guidelines provided by the OEB. As at December 31, 2012, LDC estimated its liability at approximately \$7,048,000. This balance has been recorded in LDC's financial statements. LDC has applied for disposition of the balance as part of its pending IRM/ICM Application filed on May 10, 2012. The amount to be approved by the OEB will be based on the OEB's interpretation and application of its guidelines and the final balance which is yet to be approved by the OEB could differ materially from LDC's estimation of its liability.

c) Payments in Lieu of Additional Municipal and School Taxes

The Ministry of Finance had issued assessments in respect of payments in lieu of additional municipal and school taxes under section 92 of the Electricity Act that were in excess of the amounts LDC believed were payable. The dispute arose as a result of inaccurate information incorporated into Ontario Regulation 224/00. LDC worked with the Ministry of Finance to resolve this issue, and as a result the Ministry of Finance issued Ontario Regulation 423/11 on August 31, 2011. The new regulation revoked Ontario Regulation 224/00 and corrected inaccurate information retroactively to 1999.

In May 2012, the Ministry of Finance completed its reassessment as a consequence of the change in regulation. The impact of the reassessment issued was favourable to LDC.

22. NON-CASH WORKING CAPITAL BALANCES

Changes in non-cash working capital provided (used) cash as follows:

	2012 \$	2011 \$
Accounts receivable	5,515	(5,101)
Unbilled revenue	(11,983)	20,852
Income tax receivable	3,974	(6,154)
Inventories	(664)	610
Other current assets	(276)	(599)
Accounts payable and accrued liabilities	(21,487)	37,086
Restructuring accrual	11,954	—
Deferred conservation credit	6,298	13,316
Other current liabilities	(332)	(489)
	(7,001)	59,521

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23. US GAAP TRANSITION

Publicly accountable enterprises in Canada were required to adopt IFRS for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. On September 10, 2010, the Accounting Standards Board granted an optional one-year deferral for IFRS adoption for entities subject to rate regulation. The Corporation elected to take the optional one-year deferral of its adoption of IFRS. In the absence of a definitive plan to consider the issuance of a rate-regulated accounting standard by the International Accounting Standards Board, the Corporation decided to evaluate the option of adopting US GAAP effective January 1, 2012 as an alternative to IFRS. On July 21, 2011, the Ontario Securities Commission granted the Corporation an exemption to allow the Corporation to file financial statements under US GAAP for the years commencing on or after January 1, 2012 but before January 1, 2015. On August 26, 2011, the Board of Directors of the Corporation approved the adoption of US GAAP for financial reporting purposes for the year beginning on January 1, 2012. As a wholly-owned subsidiary, LDC elected to follow the Corporation and adopted US GAAP for financial reporting purposes for the year beginning on January 1, 2012.

These are LDC's first annual financial statements prepared in accordance with US GAAP. The accounting policies set out in note 4 have been applied consistently in preparing the financial statements for the year ended December 31, 2012 and the comparative periods.

LDC has adjusted amounts reported previously in its financial statements prepared in accordance with Canadian GAAP. For reporting purposes, the transition date to US GAAP is January 1, 2011, which is the commencement of the 2011 comparative period to LDC's 2012 financial statements. An explanation of how the transition from Canadian GAAP to US GAAP has affected LDC's financial statements is set out in the following tables and accompanying notes.

Given the Corporation's exemption to file under US GAAP up to December 31, 2014 by the Ontario Securities Commission, the Corporation is actively monitoring developments by the International Accounting Standards Board on rate-regulated accounting should a future IFRS conversion be required. Although the conversion of LDC's general purpose financial statements to IFRS was suspended in 2011, the IFRS conversion work is being managed in such a way that if a future transition to IFRS is required, it can be effectively accomplished.

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The reconciliation of the January 1, 2011 balance sheet from Canadian GAAP to US GAAP is as follows:

BALANCE SHEET				
[in thousands of Canadian dollars]				
As at January 1, 2011	Notes	Canadian GAAP \$	Transitional Adjustments \$	US GAAP \$
ASSETS				
Current				
Regulatory assets	A	—	3,555	3,555
Other	A	657,135	1,710	658,845
Total current assets		657,135	5,265	662,400
Regulatory assets	A	85,113	29,224	114,337
Other		2,383,017	—	2,383,017
Total assets		3,125,265	34,489	3,159,754
LIABILITIES AND SHAREHOLDER'S EQUITY				
Current				
Customers' advance deposits	B	—	50,630	50,630
Post-retirement benefits	A	—	7,415	7,415
Regulatory liabilities	A	—	36,654	36,654
Other	A, B	630,430	(20,187)	610,243
Total current liabilities		630,430	74,512	704,942
Customers' advance deposits	B	45,462	(31,840)	13,622
Post-retirement benefits	A	166,790	25,822	192,612
Regulatory liabilities	A	273,706	(34,005)	239,701
Other		1,116,215	—	1,116,215
Total liabilities		2,232,603	34,489	2,267,092
Total shareholder's equity		892,662	—	892,662
Total liabilities and shareholder's equity		3,125,265	34,489	3,159,754

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The reconciliation of the December 31, 2011 balance sheet from Canadian GAAP to US GAAP is as follows:

BALANCE SHEET				
[in thousands of Canadian dollars]				
As at December 31, 2011	Notes	Canadian GAAP \$	Transitional Adjustments \$	US GAAP \$
ASSETS				
Current				
Other		540,468	—	540,468
Total current assets		540,468	—	540,468
Regulatory assets	A	77,322	65,716	143,038
Other		2,654,763	—	2,654,763
Total assets		3,272,553	65,716	3,338,269
LIABILITIES AND SHAREHOLDER'S EQUITY				
Current				
Customers' advance deposits	B	—	40,238	40,238
Post-retirement benefits	A	—	7,915	7,915
Regulatory liabilities	A	—	7,293	7,293
Other	A, B	438,507	(23,280)	415,227
Total current liabilities		438,507	32,166	470,673
Customers' advance deposits	B	35,930	(20,130)	15,800
Post-retirement benefits	A	176,370	60,041	236,411
Regulatory liabilities	A	210,280	(6,361)	203,919
Other		1,425,473	—	1,425,473
Total liabilities		2,286,560	65,716	2,352,276
Total shareholder's equity		985,993	—	985,993
Total liabilities and shareholder's equity		3,272,553	65,716	3,338,269

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

December 31, 2012

[all tabular amounts in thousands of Canadian dollars]

The reconciliation of net income from Canadian GAAP to US GAAP for the year ended December 31, 2011 is as follows:

RECONCILIATION OF NET INCOME FROM CANADIAN GAAP TO US GAAP		
[in thousands of Canadian dollars]		
	Notes	2011 \$
Net income, Canadian GAAP		93,331
Revenues	C	14,212
Operating expenses	C, D	(16,735)
Income tax recovery	D	2,523
Net income, US GAAP		93,331

Notes to the transitional adjustments

A. Post-retirement benefits

Under Canadian GAAP, unamortized actuarial gains and losses and unamortized prior service costs are not recorded on the balance sheets. Under US GAAP, all actuarial gains and losses and prior service costs are fully recognized in OCI in the period in which they arise and are presented within equity as Accumulated Other Comprehensive Income ["AOCI"]. Due to the rate-regulated nature of LDC's business, the impact to AOCI on transition and the impact to OCI on a go-forward basis will be reclassified to a regulatory asset account [note 9[a]]. This reclassification results in the full recognition of the benefit obligation as a liability on LDC's balance sheets and no balance reported in OCI and AOCI. A portion of the benefit obligation will also be presented as a current liability on the balance sheets. The current portion is the amount of the actuarial present value of benefits included in the benefit obligation which is expected to be paid in the next 12 months.

B. Customers' advance deposits

Under US GAAP, deposits that are due on demand or will be due on demand within one year from the end of the reporting period have been reclassified as current liabilities.

C. Demand billable income and expenses

Under US GAAP, associated costs related to demand billable income have been reclassified on the statements of net income and comprehensive income. There is no impact to the overall net income.

D. Income tax recovery

Under Canadian GAAP, all ITCs are recognized as a reduction of the related expenditure. Under US GAAP, the benefits of the refundable apprenticeship and co-operative ITCs are recognized as a reduction of the related expenditure. All other ITCs are recorded as a reduction of income tax expense in the current period to the extent that realization of such benefits is more likely than not.

Financial Statements

Toronto Hydro-Electric System Limited

DECEMBER 31, 2013 and 2012

See attached Glossary for abbreviations used in the audited financial statements.



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INDEPENDENT AUDITORS' REPORT

To the Shareholder of Toronto Hydro-Electric System Limited

We have audited the accompanying financial statements of Toronto Hydro-Electric System Limited, which comprise the balance sheets as at December 31, 2013 and December 31, 2012, the statements of net income and comprehensive income, shareholder's equity and cash flows for the years ended December 31, 2013 and December 31, 2012, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with United States Generally Accepted Accounting Principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Toronto Hydro-Electric System Limited as at December 31, 2013 and December 31, 2012 and its statements of net income and comprehensive income, shareholder's equity and cash flows for the years ended December 31, 2013 and December 31, 2012 in accordance with United States Generally Accepted Accounting Principles.

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Canada

March 19, 2014

Toronto Hydro-Electric System Limited

BALANCE SHEETS

[in thousands of dollars]

As at December 31	2013 \$	2012 \$
ASSETS		
Current		
Cash and cash equivalents	15,677	67,258
Accounts receivable, net of allowance for doubtful accounts [note 15[b]]	199,023	185,941
Unbilled revenue [note 15[b]]	326,111	274,272
Income tax receivable	342	4,710
Inventories [note 5]	8,566	7,555
Regulatory assets [note 9]	7,060	1,658
Other assets [note 6]	8,854	4,680
Total current assets	565,633	546,074
Property, plant and equipment, net [note 7]	2,640,028	2,504,428
Intangible assets, net [note 8]	171,489	134,080
Regulatory assets [note 9]	234,424	119,556
Other assets [note 10]	8,008	8,098
Deferred income tax assets [note 17]	155,867	193,242
Total assets	3,775,449	3,505,478
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Advance from related party [note 19]	150,000	-
Accounts payable and accrued liabilities [note 15[b]]	455,752	377,948
Restructuring accrual [note 11]	-	11,954
Customers' advance deposits	37,293	40,048
Deferred conservation credit	20,020	19,908
Post-retirement benefits [note 13]	8,003	9,925
Other liabilities [note 20]	2,100	1,850
Regulatory liabilities [note 9]	2,516	-
Notes payable to related parties [notes 12 and 19]	60,000	498,906
Total current liabilities	735,684	960,539
Notes payable to related parties [notes 12 and 19]	1,433,199	985,343
Customers' advance deposits	7,356	6,790
Post-retirement benefits [note 13]	230,789	243,965
Other liabilities [note 20]	8,175	9,385
Regulatory liabilities [note 9]	180,617	196,809
Asset retirement obligations [note 14]	6,247	5,004
Total liabilities	2,602,067	2,407,835
Commitments, contingencies and subsequent events [notes 2, 20 and 21]		
Shareholder's equity		
Share capital [note 18]	556,278	556,278
Retained earnings	604,347	528,608
Contributed surplus	12,757	12,757
Total shareholder's equity	1,173,382	1,097,643
Total liabilities and shareholder's equity	3,775,449	3,505,478

The accompanying notes are an integral part of the financial statements.

Toronto Hydro-Electric System Limited

STATEMENTS OF NET INCOME AND COMPREHENSIVE INCOME

[in thousands of dollars]

Year ended December 31	2013 \$	2012 \$
Revenues		
Sale of electricity	3,145,455	2,799,404
Other income	42,288	41,057
	3,187,743	2,840,461
Costs		
Purchased power	2,567,512	2,275,209
Operating expenses	262,304	236,386
Depreciation and amortization [notes 7, 8 and 9]	171,475	140,352
	3,001,291	2,651,947
Income before the following:	186,452	188,514
Net financing charges [note 22]	(68,870)	(76,209)
Gain on disposals of property, plant and equipment	1,280	1,805
Restructuring costs [note 11]	-	(27,796)
Income before income taxes	118,862	86,314
Income tax expense [note 17]	3,123	3,125
Net income and comprehensive income	115,739	83,189

STATEMENTS OF SHAREHOLDER'S EQUITY

[in thousands of dollars]

Year ended December 31	2013 \$	2012 \$
Share capital [note 18]	556,278	556,278
Retained earnings, beginning of year	528,608	445,419
Net income	115,739	83,189
Dividends [notes 18 and 19]	(40,000)	-
Retained earnings, end of year	604,347	528,608
Contributed surplus	12,757	12,757
Total shareholder's equity	1,173,382	1,097,643

The accompanying notes are an integral part of the financial statements.

Toronto Hydro-Electric System Limited

STATEMENTS OF CASH FLOWS

[in thousands of dollars]

Year ended December 31	2013 \$	2012 \$
OPERATING ACTIVITIES		
Net income	115,739	83,189
Adjustments for non-cash items		
Depreciation and amortization [notes 7, 8 and 9]	171,475	140,352
Post-retirement benefits	7,620	12,850
Deferred income taxes [note 17]	(48)	(245)
Gain on disposals of property, plant and equipment	(1,280)	(1,805)
Other	715	815
Net change in regulatory assets and liabilities [note 9]	(19,518)	11,295
Net change in other non-current assets and liabilities	187	(956)
Changes in non-cash working capital balances [note 23]	(32,540)	5,130
Net cash provided by operating activities	242,350	250,625
INVESTING ACTIVITIES		
Purchase of property, plant and equipment [note 23]	(355,232)	(302,198)
Purchase of intangible assets [note 8]	(54,455)	(42,057)
Proceeds on disposals of property, plant and equipment	1,663	2,665
Net cash used in investing activities	(408,024)	(341,590)
FINANCING ACTIVITIES		
Common shares issued [note 19]	-	28,461
Increase in advance from related party [note 19]	150,000	-
Increase in notes payable to related parties [note 12]	447,306	74,013
Decrease in notes payable to related parties [note 12]	(439,071)	-
Decrease in customers' advance deposits	(2,189)	(9,200)
Repayment of capital lease liability	(1,953)	(1,795)
Dividends paid [notes 18 and 19]	(40,000)	-
Net cash provided by financing activities	114,093	91,479
Net increase (decrease) in cash and cash equivalents during the year	(51,581)	514
Cash and cash equivalents, beginning of year	67,258	66,744
Cash and cash equivalents, end of year	15,677	67,258
Supplementary cash flow information		
Total interest paid	72,062	72,998
Total income taxes recovered	(3,106)	(1,200)

The accompanying notes are an integral part of the financial statements.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

December 31, 2013 and 2012

[all tabular amounts in thousands of Canadian dollars]

1. INCORPORATION

On June 23, 1999, LDC was incorporated under the *Business Corporations Act* (Ontario), and is wholly-owned by the Corporation. The incorporation was required in accordance with the provincial government's Electricity Act.

LDC distributes electricity to customers located in the City and is subject to rate regulation. LDC is also engaged in the delivery of CDM activities.

2. BASIS OF PRESENTATION

These audited financial statements of LDC have been prepared in accordance with US GAAP with respect to the preparation of annual financial information, and are presented in Canadian dollars.

LDC has evaluated the events and transactions occurring after the balance sheet date through March 19, 2014 when LDC's financial statements were available to be issued after the approval by LDC's Board of Directors, and identified the events and transactions which required recognition in the financial statements and/or disclosure in the notes to the financial statements [notes 3, 4, 9, 13, 20 and 21].

3. REGULATION

In April 1999, the Government of Ontario began restructuring Ontario's electricity industry. Under regulations passed pursuant to the restructuring, LDC and other electricity distributors purchase electricity from the wholesale market administered by the IESO and recover the costs of electricity and certain other costs at a later date in accordance with procedures mandated by the OEB.

The OEB has regulatory oversight of electricity matters in Ontario. The OEB Act sets out the OEB's authority to issue a distribution licence that must be obtained by owners or operators of an electricity distribution system in Ontario. The OEB prescribes licence requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for distribution and other activities, and requirements for rate-setting and other legal filings.

The OEB's authority and responsibilities include the power to approve and fix rates for the transmission and distribution of electricity, the responsibility to provide rate protection for rural or remote electricity customers, and the responsibility for ensuring that electricity distribution companies fulfill their obligations to connect and service customers.

LDC is required to charge its customers for the following amounts (all of which, other than distribution rates, represent a pass-through of amounts payable to third parties):

- *Commodity Charge* – The commodity charge represents the market price of electricity consumed by customers and is passed through the IESO to operators of generating stations. It includes the global adjustment, which represents the difference between the market price of electricity and the rates paid to regulated and contracted generators.
- *Retail Transmission Rate* – The retail transmission rate represents the costs incurred in respect of the transmission of electricity from generating stations to local distribution networks. Retail transmission rates are passed through to operators of transmission facilities.
- *WMS Charge* – The WMS charge represents various wholesale market support costs, such as the cost of the IESO to administer the wholesale electricity system, operate the electricity market, and maintain reliable operation of the provincial grid. Wholesale charges are passed through to the IESO.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

December 31, 2013 and 2012

[all tabular amounts in thousands of Canadian dollars]

- *Distribution Rate* – The distribution rate is designed to recover the costs incurred by LDC in delivering electricity to customers, including the OEB-allowed cost of capital. Distribution rates are regulated by the OEB and are comprised of fixed and variable (usage-based) components, based on a forecast of LDC's customers and load.

LDC is required to satisfy and maintain prudential requirements with the IESO, which include credit support with respect to outstanding market obligations in the form of letters of credit, cash deposits or guarantees from third parties with prescribed credit ratings.

a) Electricity Distribution Rates

Regulatory developments in Ontario's electricity industry, including current and possible future consultations between the OEB and interested stakeholders, may affect LDC's electricity distribution rates and other permitted recoveries in the future.

On May 10, 2012, LDC filed an application for electricity distribution rates for 2012, 2013, and 2014 using the IRM framework, including the filing of an ICM application [the "IRM/ICM Application"].

On October 31, 2012, LDC submitted an update to its IRM/ICM Application modifying the requested capital expenditures for 2012 and 2013 to \$283,000,000 and \$579,100,000, respectively, and requesting that consideration for 2014 be deferred to a second phase of the proceeding, once LDC had received a decision from the OEB in respect of phase one. On November 3, 2012, the OEB accepted LDC's request for a two-phase proceeding: phase one comprising LDC's 2012 and 2013 work program proposals and phase two comprising LDC's 2014 work program proposal.

On April 2, 2013, the OEB issued a partial decision and order for phase one of the proceeding comprising LDC's 2012 and 2013 work program proposals. The OEB's decision determined that eligible capital funding under the ICM framework was to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to \$203,330,000 for 2012 and \$484,220,000 for 2013. New rates became effective June 1, 2013. In 2015, LDC will be allowed to seek recovery for capital spent in 2012 and 2013 that has not yet been approved by the OEB in the current ICM decision due to the standard operation of the regulatory model.

On August 1, 2013, LDC filed an application with the OEB requesting approval for the disposition of balances in its smart meter deferral account related to smart meter installations in 2008, 2009 and 2010. In the application, LDC requested two new rate riders effective May 1, 2014. The first rate rider relates to the recovery of \$23,927,000, which represents the cumulative revenue requirement net of recoveries from an existing smart meter rate rider. This existing smart meter rate rider would be discontinued when the new rate riders become effective. The second rate rider relates to the recovery of \$9,631,000, which represents the forecasted 2014 incremental revenue requirement until LDC may be permitted to transfer the smart meter assets into rate base.

On August 19, 2013, LDC submitted an update to its IRM/ICM Application regarding its 2014 work program proposal. The filed update incorporates the OEB's guidance on the ICM methodology provided in the April 2, 2013 partial decision and order with respect to phase one of this proceeding. In phase two, LDC sought approval for total capital expenditures amounting to \$398,780,000 for 2014.

On December 18, 2013, LDC filed a settlement agreement with the OEB, which allowed for the entirety of LDC's requested 2014 capital program. On December 19, 2013, the OEB approved this settlement agreement. Consistent with the April 2, 2013 partial decision and order with respect to phase one, eligible capital funding under the ICM framework is to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to \$398,780,000 for 2014.

On January 16, 2014, the OEB approved LDC's requested disposition of the smart meter deferral account balances, permitting the recovery of \$23,927,000 and \$9,631,000 through two separate rate riders effective May 1, 2014 [note 9[c]].

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

December 31, 2013 and 2012

[all tabular amounts in thousands of Canadian dollars]

b) CDM Activities

On March 31, 2010, the Minister of Energy and Infrastructure of Ontario, under the guidance of sections 27.1 and 27.2 of the OEB Act, directed the OEB to establish CDM targets to be met by electricity distributors. Accordingly, on November 12, 2010, the OEB amended LDC's distribution licence to require LDC, as a condition of its licence, to achieve 1,304 GWh of energy savings and 286 MW of summer peak demand savings, over the period beginning January 1, 2011 through December 31, 2014.

Effective January 1, 2011, LDC entered into an agreement with the OPA in the amount of approximately \$50,000,000 to deliver CDM programs extending from January 1, 2011 to December 31, 2014. As at December 31, 2013, LDC received approximately \$45,919,000 [December 31, 2012 - \$35,366,000] from the OPA for the delivery of CDM programs. All programs to be delivered are fully funded and paid in advance by the OPA. Amounts received but not yet spent are presented under current liabilities as deferred conservation credit. Upon the expiration of the agreement, LDC is required to repay to the OPA any excess funding received for program administration less any cost efficiency incentives. These programs are expected to support the achievement of the mandatory CDM targets described above.

On December 21, 2012, the Minister of Energy of Ontario issued a direction to the OPA under subsection 25.32(4.1) of the Electricity Act to extend the funding time period for OPA-contracted province-wide CDM initiatives under the Green Energy Act framework to December 31, 2015.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Regulation

The following regulatory treatments have resulted in accounting treatments which differ from US GAAP for enterprises operating in an unregulated environment:

Regulatory Assets and Liabilities

LDC has determined that its assets and liabilities arising from rate-regulated activities qualify for the application of regulatory accounting treatment in accordance with FASB ASC 980 – "Regulated Operations", which includes accounting principles prescribed by the OEB in the "Accounting Procedures Handbook for Electricity Distributors". Under RRA, the timing and recognition of certain expenses and revenues may differ from those otherwise expected under US GAAP in order to appropriately reflect the economic impact of regulatory decisions regarding LDC's regulated revenues and expenditures. These timing differences are recorded as regulatory assets and regulatory liabilities on LDC's balance sheets and represent existing rights and obligations regarding cash flows expected to be recovered from or refunded to customers, based on decisions and approvals by the OEB. Regulatory assets and liabilities can be recognized for rate-setting and financial reporting purposes only if the OEB directs the relevant regulatory treatment or if future OEB direction is judged to be probable. In the event that the disposition of these balances was assessed to no longer be probable, the balances would be recorded in LDC's statements of net income and comprehensive income in the period that the assessment is made. The measurement of regulatory assets and liabilities is subject to certain estimates and assumptions, including assumptions made in the interpretation of the OEB's regulations and decisions.

Regulatory assets and liabilities are classified as current if they are expected to be recovered from, or refunded to, customers within 12 months after each reporting period. All other regulatory asset and liability balances are classified as long-term on the balance sheets.

Allowance for funds used during construction

The OEB provides for the inclusion of an AFUDC when capitalizing construction-in-progress assets, until such time as the asset is substantially complete. A concurrent credit of the same amount is made to net financing charges when the allowance is capitalized. The interest rate for capitalization is prescribed by the OEB and modified on a

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

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[all tabular amounts in thousands of Canadian dollars]

periodic basis, and is applied to the balance of the construction-in-progress assets on a simple interest basis. The interest rate for capitalization for the period from January 1, 2013 to September 30, 2013 was 3.23%, and from October 1, 2013 to December 31, 2013 was 3.70% [January 1, 2012 to March 31, 2012 - 3.92%; April 1, 2012 to September 30, 2012 - 3.51%; October 1, 2012 to December 31, 2012 - 3.23%]. AFUDC is included in PP&E and intangible assets for financial reporting purposes, charged to operations through depreciation and amortization expense over the useful lives of the related assets and recovered through future revenue.

b) Cash and cash equivalents

Cash and cash equivalents include cash in bank accounts and short-term investments with terms to maturity of 90 days or less from their date of acquisition.

c) Accounts receivable

Accounts receivable are recorded at the invoiced amount and overdue amounts bear interest at OEB-approved rates. The carrying amount of accounts receivable is reduced through an allowance for doubtful accounts and the amount of the related impairment loss is recognized in the statements of net income and comprehensive income. Subsequent recoveries of receivables previously provisioned and written off are credited to the statements of net income and comprehensive income. Management estimates uncollectible accounts receivable after considering historical loss experience and the characteristics of existing accounts.

d) Inventories

Inventories consist primarily of small consumable materials mainly related to the maintenance of the electricity distribution infrastructure. LDC classifies all major construction related components of its electricity distribution system infrastructure to PP&E. As prescribed by the OEB, these items are depreciated when they are acquired. Inventories are carried at the lower of cost and market, with cost determined on an average cost basis net of a provision for obsolescence.

e) Property, plant and equipment

PP&E are stated at cost. In accordance with group depreciation practices, assets in a group are not removed from the accounts on disposition and instead depreciation continues to be recorded until the asset group is fully depreciated. Readily identifiable assets are removed from the accounts at retirement or disposition. The cost of PP&E represents the original cost, consisting of direct materials and labour, contracted services, AFUDC, and overhead directly attributable to the capital project.

PP&E relating to eligible capital expenditures approved under the ICM framework for the 2012 and 2013 work program proposals are reclassified from construction in progress to regulatory assets once an asset is determined to be in-service, as directed by the OEB. The assets are then depreciated in the regulatory asset account over the estimated useful lives previously specified for PP&E. Upon final approval by the OEB and inclusion in LDC's rate base, the assets will be transferred back to PP&E.

Capital contributions received are used to finance additions to PP&E. According to the accounting principles prescribed by the OEB, capital contributions received are treated as a credit to PP&E. The amount is subsequently depreciated by a charge to accumulated depreciation and a credit to depreciation expense at an equivalent rate to that used for the depreciation of the related PP&E.

Depreciation is provided on a straight-line basis over the estimated useful lives at the following annual rates:

Distribution lines	2.0% to 5.0%
Transformers	3.3% to 5.0%
Meters	2.5% to 6.7%

Toronto Hydro-Electric System Limited

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[all tabular amounts in thousands of Canadian dollars]

Stations	2.5% to 10.0%
Buildings	1.3% to 5.0%
Rolling stock	12.5% to 25.0%
Other capital assets	4.0% to 20.0%
Equipment and tools	10.0% to 16.7%
Computer hardware	16.7% to 25.0%
Assets under capital lease	14.3% to 25.0%
Communications	10.0% to 20.0%

Construction in progress relates to assets not currently in use and therefore is not depreciated.

In the event that facts and circumstances indicate that PP&E may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the asset are compared to the carrying amount of the asset to determine if a write-down is required. The impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value, which is determined by the estimated future discounted cash flows.

f) Intangible assets

Effective January 1, 2012, LDC revised its estimate of useful life of its Customer Care and Billing Customer Information System from five years to ten years as a result of an analysis completed related to the useful life assessment. This change has been accounted for on a prospective basis in the financial statements effective January 1, 2012. The change in estimate reduced amortization expense by approximately \$4,000,000 for the year ended December 31, 2012 with an offsetting increase in the carrying value of intangible assets. The change in estimate will decrease future amortization expense by \$4,000,000 per year over the term of the original useful life with no impact to the final year of the original useful life, and thereafter increase future amortization expense by \$4,000,000 per year.

Intangible assets are stated at cost. Amortization is provided on a straight-line basis over the estimated useful lives at the following annual rates:

Computer software	10.0% to 25.0%
Contributions	4.0%

Software in development and contributions for work in progress relate to assets not currently available for use and therefore are not amortized. Contributions represent payments made to Hydro One Networks Inc. for dedicated infrastructure in order to receive connections to transmission facilities.

In the event that facts and circumstances indicate that intangible assets may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the asset are compared to the carrying amount of the asset to determine if a write-down is required. The impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value, which is determined by the estimated future discounted cash flows.

g) Restructuring

Restructuring charges are recorded based upon planned employee termination dates, site closure and consolidation plans, and contract terminations. Restructuring charges can include severance costs to eliminate a specified number of employee positions, infrastructure charges to vacate facilities and consolidate operations, and contract cancellation costs. The timing of associated cash payments is dependent upon the type of restructuring charge and can extend over a multi-year period.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

December 31, 2013 and 2012

[all tabular amounts in thousands of Canadian dollars]

h) Revenue recognition

Revenue from the sale of electricity is recorded on the basis of cyclical billings and includes an estimated amount for electricity delivered and not yet billed, the amount of which is impacted by energy demand, customer class usage patterns and composition, and weather conditions. Revenue related to eligible capital expenditures under the ICM framework is recognized on the basis of in-service assets.

Other income, which includes revenues from electricity distribution related services and revenues from demand billable activities, is recognized as the services are rendered.

In the course of its operations, LDC collects HST from its customers. When customers are billed, a current liability for HST is recognized which corresponds to the revenue derived from the services provided by LDC. When expenses are incurred by LDC, a current asset for HST is recorded which corresponds to the expenditures derived from the goods or services received by LDC. LDC's revenues and expenses exclude HST. This net asset or liability is settled with the appropriate government authority.

i) Financial instruments

At inception, all financial instruments which meet the definition of a financial asset or financial liability are recorded at fair value, unless fair value cannot be reliably determined. Gains and losses related to the measurement of financial instruments are reported in the statements of net income and comprehensive income. Subsequent measurement of each financial instrument will depend on the balance sheet classification elected by LDC. The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between willing parties.

The following summarizes the accounting classification LDC has elected to apply to each of its significant categories of financial instruments:

Cash equivalents and short-term investments	Held for Trading
Accounts receivable and unbilled revenue	Loans and Receivables
Advance from related party	Other Financial Liabilities
Accounts payable and accrued liabilities	Other Financial Liabilities
Obligations under capital lease	Other Financial Liabilities
Customers' advance deposits	Other Financial Liabilities
Notes payable to related parties	Other Financial Liabilities

LDC uses the following methods and assumptions to estimate the fair value of each class of financial instruments for which carrying amounts are included in the balance sheets:

- Cash equivalents, comprising short-term investments, are classified as "Held for Trading" and are measured at fair value. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Accounts receivable and unbilled revenue are classified as "Loans and Receivables" and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Advance from related party is classified as "Other Financial Liabilities" and is initially measured at fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amount approximates fair value because of the short maturity of this instrument.

Toronto Hydro-Electric System Limited

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[all tabular amounts in thousands of Canadian dollars]

- Accounts payable and accrued liabilities are classified as “Other Financial Liabilities” and are initially measured at fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Obligations under capital lease are classified as “Other Financial Liabilities” and are initially measured at fair value. Subsequent measurements are based on a discounted cash flow analysis and approximate the carrying value as management believes that the fixed interest rates are representative of current market rates.
- Customers’ advance deposits are classified as “Other Financial Liabilities” and are initially measured at fair value. Subsequent measurements are recorded at cost plus accrued interest. The carrying amounts approximate fair value because of the short maturity of the current portion, and the long-term portion approximates the carrying value, taking into account interest accrued on the outstanding balance.
- Notes payable to related parties are classified as “Other Financial Liabilities” and are initially measured at fair value. The carrying amounts are carried at amortized cost, based on an initial fair value as determined at the time using quoted market price for similar debt instruments. The fair value of the notes payable is calculated by discounting the related cash flows at the estimated yield to maturity of similar instruments [note 15[a]].

j) Fair value measurements

LDC utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A fair value hierarchy exists that prioritizes observable and unobservable inputs used to measure fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect LDC’s assumptions with respect to how market participants would price an asset or liability. The fair value hierarchy includes three levels of inputs that may be used to measure fair value:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis;
- Level 2: Other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly or indirectly; and
- Level 3: Unobservable inputs, supported by little or no market activity, used to measure the fair value of the assets or liabilities to the extent that observable inputs are not available.

k) Employee future benefits

Multi-employer pension plan

LDC’s full-time employees participate in a pension plan through OMERS. OMERS is a multi-employer, contributory, defined benefit pension plan established in 1962 by Ontario for employees of municipalities, local boards and school boards. Both participating employers and employees are required to make plan contributions based on participating employees’ contributory earnings. The OMERS plan is accounted for as a defined contribution plan where LDC recognizes the expense related to this plan as contributions are made, since it is not practicable to determine LDC’s portion of pension obligations or the fair value of plan assets. LDC is not responsible for any other contractual obligations other than the contributions.

Post-retirement benefits other than pension

LDC has a number of unfunded benefit plans providing post-retirement benefits (other than pension) to its employees. LDC pays certain medical, dental and life insurance benefits under unfunded defined benefit plans on

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behalf of its retired employees. LDC pays accumulated sick leave credits, up to certain established limits based on service, in the event of retirement, termination or death of certain employees.

LDC periodically measures its accumulated benefit obligation for accounting purposes as at December 31 of the applicable year. The latest actuarial valuation was performed as at January 1, 2012.

The cost of providing benefits under the defined benefit plans is determined using the projected unit credit method and based on assumptions that reflect management's best estimate. All actuarial gains and losses and prior service costs are recognized in OCI as they arise and subsequently reclassified to a regulatory asset on the balance sheets. This results in the full recognition of the benefit obligation as a liability on the balance sheets.

Actuarial gains and losses are amortized into net periodic benefit cost for the current period when the net cumulative unrecognized actuarial gains or losses in the regulatory asset at the end of the previous reporting period exceed 10% of the accumulated benefit obligation at that date. These gains or losses are recognized over the expected average remaining service period of active employees participating in the plans.

The prior service costs in the regulatory asset are recognized as an expense on a straight-line basis over the average remaining service period of employees active at the date of amendment.

The effects of a curtailment loss are recognized in the statements of net income and comprehensive income when its occurrence is probable and reasonably estimable. The effects of a curtailment gain are recognized in the statements of net income and comprehensive income when the related employees terminate or the plan suspension or amendment is adopted. The effects of a settlement gain or loss are recognized in the statements of net income and comprehensive income in the period in which a settlement occurs.

l) Asset retirement obligations

LDC recognizes a liability for the future removal and handling costs for contamination in distribution equipment and for the future environmental remediation of certain properties. Initially, the liability is measured at present value and the amount of the liability is added to the carrying amount of the related asset. In subsequent periods, the capitalized amount is depreciated over the useful life of the related asset and the liability is adjusted quarterly for the discount applied upon initial recognition of the liability ["accretion expense"] and for changes in the underlying assumptions. The liability is recognized when the ARO is incurred and when the fair value can be reasonably estimated.

LDC has not recorded a liability related to certain AROs as a reasonable estimate of fair value could not be made. LDC does not recognize an ARO for active properties that support LDC's distribution operations since it cannot reasonably determine the amount of any remediation costs related to possible contamination, and a reliable estimate cannot be made until environmental site assessments have been completed. LDC expects to use the majority of its installed assets in perpetuity. If, at some future date, a particular asset is shown not to meet the perpetuity assumption, it will be reviewed to determine if an ARO exists.

m) Customers' advance deposits

Security deposits from electricity customers are cash collections to guarantee the payment of electricity bills. The electricity customer security deposits liability includes related interest amounts owed to the customers with the debit charged to net financing charges. Deposits that are refundable upon demand are classified as a current liability.

Security deposits on Offers to Connect are cash collections from specific customers to guarantee the payment of additional costs relating to expansion projects. This liability includes related interest amounts owed to the customers with the debit charged to net financing charges. Deposits are classified as a current liability when LDC no longer has an unconditional right to defer payment of the liability for at least 12 months after the reporting period.

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n) Income taxes

Under the Electricity Act, LDC is required to make PILs to the Ontario Electricity Financial Corporation. These payments are calculated in accordance with the ITA and the TA as modified by regulations made under the Electricity Act and related regulations. This effectively results in LDC paying taxes similar to what would be imposed under the Federal and Ontario Tax Acts.

LDC uses the liability method of accounting for income taxes. Under the liability method, current income taxes payable are recorded based on taxable income. LDC recognizes deferred income tax assets and liabilities for the future tax consequences of events that have been included in the financial statements or income tax returns. Deferred income tax assets and liabilities are determined based on the difference between the carrying value of assets and liabilities on the balance sheets and their respective tax basis, using the tax rates enacted by the balance sheet date that are in effect for the year in which the differences are expected to reverse. Tax benefits associated with income tax positions taken, or expected to be taken, in a tax return are recorded only when it is more likely than not that they will be realized, and are measured at the largest amount of the benefit that has a likelihood greater than 50 percent of being realized upon settlement. Deferred income tax assets are evaluated and unless realization is considered more likely than not, a valuation allowance is established.

ASC 980 requires the recognition of deferred income tax assets and liabilities and related regulatory liabilities and assets for the amount of deferred income taxes expected to be refunded to, or recovered from, customers in future electricity distribution rates. These amounts include a gross up to reflect the income tax benefits associated with reduced revenues resulting from the realization of deferred income tax assets. Deferred income taxes that are not included in the rate-setting process are charged or credited to the statements of net income and comprehensive income.

The benefits of the refundable apprenticeship and co-operative ITCs are credited against the related expense in the statements of net income and comprehensive income. All other types of ITCs are recorded as a reduction to income tax expense in the current period to the extent that realization of such benefit is more likely than not.

o) Use of estimates

The preparation of LDC's financial statements in accordance with US GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the year. The estimates are based on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Significant areas requiring the use of management estimates relate to unbilled revenue, regulatory assets and liabilities, AROs, post-retirement benefits, income taxes (including deferred income taxes), and revenue recognition. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Ministry of Energy of Ontario, or the Ministry of Finance of Ontario.

p) Adoption of New Accounting Pronouncements

In December 2011, the FASB issued ASU No. 2011-11, "Balance Sheet (Topic 210): *Disclosures about Offsetting Assets and Liabilities*". The amendments require an entity to disclose both gross and net information about financial instruments and transactions eligible for offset in the balance sheets. ASU No. 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Retrospective application is required. The ASU No. 2013-01, "Balance Sheet (Topic 210): *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*", was issued in January 2013 to amend the scope of ASU No. 2011-11 to clarify that the disclosure requirements are limited to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions that are either offset in the balance sheets or subject to enforceable master netting arrangements

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or similar agreements. The adoption of these amendments did not have an impact on LDC's balance sheets and related disclosures.

q) Future Accounting Pronouncements

On July 21, 2011, the OSC granted an exemption to allow the Corporation to prepare its financial statements in accordance with US GAAP for its fiscal years beginning on or after January 1, 2012 but before January 1, 2015. In the absence of the exemption, the Corporation would have previously been required to adopt IFRS on January 1, 2012. Accordingly, LDC decided to adopt US GAAP at the time to mirror the decision of the Corporation. On March 19, 2014, the Board of Directors of the Corporation approved the adoption of IFRS for the year beginning on January 1, 2015 due to the pending expiration of the exemption. Since the Corporation is converting to IFRS, on March 19, 2014 the Board of Directors of LDC also approved the adoption of IFRS for the year beginning on January 1, 2015. Accordingly, LDC's financial statements for 2015 are expected to be prepared in accordance with IFRS and applied retrospectively to LDC's opening IFRS statement of financial position as at January 1, 2014.

LDC has an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its financial statements. LDC believes that the impact on its financial statements could be material.

5. INVENTORIES

Inventories consist of the following:

	2013 \$	2012 \$
Fuses	2,498	2,137
Consumables, tools and other maintenance items	2,024	1,968
Drums and reels	1,473	1,115
Other	2,571	2,335
	8,566	7,555

For the year ended December 31, 2013, LDC recognized operating expenses of \$6,936,000 related to inventory used to service electrical distribution assets [2012 - \$6,934,000].

6. CURRENT PORTION OF OTHER ASSETS

Current portion of other assets consists of the following:

	2013 \$	2012 \$
Prepaid expenses	8,546	4,369
Deferred financing costs	308	311
	8,854	4,680

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7. PROPERTY, PLANT AND EQUIPMENT

PP&E consist of the following:

	2013			2012		
	Cost \$	Accumulated depreciation \$	Net book value \$	Cost \$	Accumulated depreciation \$	Net book value \$
Land	16,740	—	16,740	16,747	—	16,747
Distribution lines	3,064,167	1,519,944	1,544,223	2,930,296	1,460,979	1,469,317
Transformers	702,027	396,012	306,015	672,981	377,900	295,081
Meters	199,634	60,506	139,128	243,152	133,789	109,363
Stations	291,699	154,017	137,682	286,229	145,601	140,628
Buildings	172,306	76,793	95,513	160,368	69,248	91,120
Rolling stock	72,865	50,282	22,583	73,239	43,834	29,405
Other capital assets	73,420	51,728	21,692	70,291	47,561	22,730
Equipment and tools	47,711	36,191	11,520	45,611	33,936	11,675
Computer hardware	56,337	45,138	11,199	50,511	40,003	10,508
Assets under capital lease	13,723	4,836	8,887	13,538	2,948	10,590
Communications	33,092	28,498	4,594	32,082	26,597	5,485
Construction in progress	320,252	—	320,252	291,779	—	291,779
	5,063,973	2,423,945	2,640,028	4,886,824	2,382,396	2,504,428

For the year ended December 31, 2013, AFUDC in the amount of \$1,306,000 [2012 - \$994,000] was capitalized to PP&E and credited to net financing charges.

For the year ended December 31, 2013, capital contributions in the amount of \$27,501,000 [2012 - \$21,309,000] were credited to PP&E.

For the year ended December 31, 2013, LDC recorded depreciation expense of \$144,375,000 [2012 - \$119,393,000], of which \$1,977,000 [2012 - \$1,985,000] related to assets under capital lease and \$21,537,000 [2012 - \$nil] related to smart meter depreciation that had been deferred [note 9[c]].

8. INTANGIBLE ASSETS

Intangible assets consist of the following:

	2013			2012		
	Cost \$	Accumulated amortization \$	Net book value \$	Cost \$	Accumulated amortization \$	Net book value \$
Computer software	268,389	198,816	69,573	242,254	174,410	67,844
Contributions	22,181	3,077	19,104	19,649	2,175	17,474
Software in development	11,700	—	11,700	14,210	—	14,210
Contributions for work in progress	71,112	—	71,112	34,552	—	34,552
	373,382	201,893	171,489	310,665	176,585	134,080

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Contributions for work in progress relate to payments made by LDC for connection projects to increase electricity distribution system capacity.

For the year ended December 31, 2013, AFUDC in the amount of \$2,016,000 [2012 - \$1,331,000] was capitalized to intangible assets and credited to net financing charges.

For the year ended December 31, 2013, LDC recorded amortization expense on intangible assets of \$25,308,000 [2012 - \$20,959,000], of which \$7,196,000 [2012 - \$nil] related to smart meter software amortization that had been deferred [note 9[c]].

Estimated future amortization expense related to intangible assets recorded as at December 31, 2013 is as follows:

	\$
2014	19,306
2015	18,524
2016	17,029
2017	14,698
2018	10,748

9. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

	2013 \$	2012 \$
ICM	151,930	—
Post-retirement benefits	38,781	61,499
Smart meters	25,230	55,599
Stranded meters	16,877	—
Settlement variances	8,227	1,071
RARA	—	2,466
Other	439	579
Total regulatory assets	241,484	121,214
Less: Current portion of regulatory assets	7,060	1,658
Long-term portion of regulatory assets	234,424	119,556

Regulatory liabilities consist of the following:

	2013 \$	2012 \$
Deferred income taxes	155,853	193,276
Revision of prior year tax position	19,421	—
RARA	4,277	—
Income and other taxes variance account	2,432	2,398
Other	1,150	1,135
Total regulatory liabilities	183,133	196,809
Less: Current portion of regulatory liabilities	2,516	—
Long-term portion of regulatory liabilities	180,617	196,809

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For the year ended December 31, 2013, LDC disposed of approved net regulatory assets amounting to \$153,000 through permitted distribution rate adjustments [2012 – approved net regulatory liabilities of \$8,838,000].

The regulatory assets and liabilities of LDC consist of the following:

a) Incremental Capital Module

The ICM regulatory asset account relates to the partial decision and order from the OEB for LDC's 2012 and 2013 work program proposals and the associated rate rider, which became effective June 1, 2013 [note 3[a]]. As directed by the OEB, this account is comprised of the cost of the eligible in-service capital expenditures under ICM, offset by the amount collected through the rate rider. This account is also adjusted by the amount recognized into revenues related to the eligible in-service capital expenditures and their associated depreciation.

For the year ended December 31, 2013, eligible in-service capital expenditures of \$159,672,000 [2012 - \$nil] were reclassified from PP&E to regulatory assets. As a non-cash transaction, this has been excluded from the statements of cash flows. As at December 31, 2013, eligible in-service capital expenditures, net of accumulated depreciation, totalling \$157,880,000, were recorded in regulatory assets [December 31, 2012 - \$nil]. In the absence of rate regulation, PP&E would have been \$157,880,000 higher as at December 31, 2013 [December 31, 2012 - \$nil impact].

For the year ended December 31, 2013, LDC recorded depreciation expenses of \$1,792,000 [2012 - \$nil] related to the eligible in-service capital expenditures.

For the year ended December 31, 2013, the revenues related to the eligible in-service capital expenditures were \$6,707,000 [2012 - \$nil]. In the absence of rate regulation, for the year ended December 31, 2013, revenues would have been \$5,925,000 higher [2012 - \$nil impact].

b) Post-Retirement Benefits

This regulatory asset account relates to the expected future electricity distribution charges to customers arising from timing differences in the recognition of actuarial losses and prior service costs of other post-retirement benefits. In the absence of rate regulation, these amounts would be recorded in OCI and accumulated other comprehensive income. The amount is amortized over the same period as the corresponding actuarial losses and prior service costs. The period in which recovery is expected cannot be determined at this time.

c) Smart Meters and Stranded Meters

The smart meters and stranded meters regulatory asset accounts relate to Ontario's decision to install smart meters throughout Ontario. LDC substantially completed its smart meter project as at December 31, 2010. In connection with this initiative, the OEB ordered LDC to record all expenditures and related revenues from 2008 to 2010 to a regulatory asset account and allowed LDC to keep the net book value of the stranded meters in PP&E. Effective January 1, 2011, LDC has recorded post-2010 smart meter costs in PP&E and intangible assets as a regular distribution activity as directed by the OEB. On August 1, 2013, LDC filed an application with the OEB requesting approval for the disposition of balances in its smart meter deferral account related to smart meter installations in 2008, 2009 and 2010, and incremental revenue related to these assets. On January 16, 2014, the OEB approved LDC's request for incremental revenue and disposition of the smart meter deferral account balances [note 3[a]].

The OEB ruling on smart meters also permitted the recovery in principle of LDC's allowed cost of capital on smart meters since 2008, with a rate order issued to this effect. Accordingly, a new regulatory asset of \$25,230,000 has been created to reflect the future amount to be recovered through rates, with a related amount recorded in revenue. For the year ended December 31, 2013, LDC ceased to defer operating and depreciation expenses related to the deployment of the 2008 to 2010 smart meters and recognized revenues as approved by the OEB, resulting in a decrease in the smart meters regulatory asset of \$25,025,000, an increase in PP&E of \$45,720,000, an increase in intangible assets of \$1,066,000, an increase in revenues of \$57,482,000, an increase in operating expenses of

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\$7,105,000, an increase in depreciation and amortization expenses of \$28,733,000 and a decrease in net financing charges of \$117,000.

The net book value of stranded meters related to the deployment of smart meters has been reclassified from PP&E to regulatory assets, resulting in an increase in regulatory assets of \$17,362,000 and a decrease in PP&E of \$17,362,000 as at December 31, 2013. Salvage proceeds of \$485,000 have been applied to reduce the stranded meters regulatory asset account. LDC expects to apply to the OEB for recovery of the remaining stranded meters costs as part of its 2015 electricity distribution rates application.

In the absence of rate regulation, for the year ended December 31, 2013, revenues relating to smart meters and stranded meters would be \$51,474,000 lower [2012 - \$5,889,000 higher], operating expenses would be \$7,105,000 lower [2012 - \$nil impact] and depreciation and amortization expenses would be \$25,461,000 lower [2012 - \$3,518,000 higher].

d) Settlement Variances

This account is comprised of the variances between amounts charged by LDC to customers, based on regulated rates, and the corresponding cost of non-competitive electricity service incurred by LDC. The settlement variances relate primarily to service charges, non-competitive electricity charges and the global adjustment. Accordingly, LDC has deferred the variances between the costs incurred and the related recoveries in accordance with the criteria set out in the accounting principles prescribed by the OEB. The balance for settlement variances continues to be calculated and attracts carrying charges in accordance with the OEB's direction.

For the year ended December 31, 2013, settlement variances included in the RARA of \$nil were disposed through rate adjustments [2012 - \$12,249,000].

e) Regulatory Assets Recovery Account

The RARA consists of balances of regulatory assets or regulatory liabilities approved for disposition by the OEB through rate riders. The RARA is subject to carrying charges following the OEB-prescribed methodology and related rates.

On February 22, 2011, the OEB approved the disposition of the Late Payment Penalties Settlement regulatory asset of \$7,526,000, over a 21-month period commencing on August 1, 2011 and ending on April 30, 2013.

On April 2, 2013, the OEB approved the disposition of net regulatory liabilities of \$6,509,000, primarily consisting of PILs regulatory variance accounts, over an 11-month period commencing on June 1, 2013 and ending on April 30, 2014.

f) Deferred Income Taxes

This regulatory liability account relates to the expected future electricity distribution rate reduction for customers arising from timing differences in the recognition of deferred income tax assets [note 4[n]].

As at December 31, 2013, LDC recorded a deferred income tax asset and a corresponding regulatory liability of \$155,853,000 [December 31, 2012 - \$193,276,000] with respect to its rate-regulated activities that will be included in the rate-setting process.

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g) Revision of Prior Year Tax Position

The revision of prior year tax position regulatory liability account relates to a favourable change to certain prior year tax positions based on reassessments received and in process, not reflected in electricity distribution rates charged to customers. As at December 31, 2013, the balance in this account consisted of an over-recovery of PILs from customers of \$19,421,000 [December 31, 2012 - \$nil].

h) Income and Other Taxes Variance Account

The income and other taxes variance regulatory liability account relates to the differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in applications for electricity distribution rates. As at December 31, 2013, the balance in this account consisted of an over-recovery of PILs from customers of \$2,432,000 [December 31, 2012 - \$2,398,000].

10. OTHER ASSETS

Other long-term assets consist of the following:

	2013 \$	2012 \$
Prepaid expenses	7,103	7,191
Deferred financing costs	905	907
	8,008	8,098

11. RESTRUCTURING

In the first quarter of 2012, the Corporation's Board of Directors approved a workforce restructuring program aimed at reducing operating expenditures for LDC. The program was approved following the decision by the OEB to deny the request of LDC to set its electricity distribution rates for 2012, 2013 and 2014 under the cost of service framework. In preparing its revised application using the IRM framework, LDC concluded that significant cost reductions were necessary to manage its business within the confines of the expected allowed electricity distribution rates provided by the IRM framework [note 3[a]]. The main component of these operating cost reduction initiatives was a workforce restructuring program, which included the severance of management employees and a voluntary exit incentive program for targeted unionized positions.

For the year ended December 31, 2013, the costs incurred as a result of these operating cost reduction initiatives amounted to \$nil [2012 - \$27,796,000] and were comprised of ongoing termination charges of \$nil and one-time termination incentive charges of \$nil [2012 - \$23,668,000 and \$4,128,000, respectively], of which \$nil remains unpaid as at December 31, 2013 [December 31, 2012 - \$11,954,000].

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12. NOTES PAYABLE TO RELATED PARTIES

Notes payable to related parties consist of the following:

	2013 \$	2012 \$
Notes payable to related parties:		
6.16% Long-term note payable to the Corporation due May 6, 2013	—	180,000
5.20% Long-term note payable to the Corporation due November 14, 2017	245,058	245,058
4.54% Long-term note payable to the Corporation due November 12, 2019	245,058	245,058
5.59% Long-term note payable to the Corporation due May 21, 2040	200,000	200,000
3.59% Long-term note payable to the Corporation due November 18, 2021	300,000	300,000
2.96% Long-term note payable to the Corporation due April 10, 2023	250,000	—
4.01% Long-term note payable to the Corporation due April 9, 2063	200,000	—
6.16% Long-term note payable to the Corporation due May 6, 2013	—	245,058
6.16% Demand note payable to the Corporation due on demand	45,000	45,000
3.32% Demand note payable to the Corporation due on the earlier of demand and January 1, 2022	15,000	15,000
3.09% Demand note payable to TH Energy due on the earlier of demand and July 1, 2022	—	14,013
Total notes payable to related parties	1,500,116	1,489,187
Less: Unamortized discount/premium	6,917	4,938
Less: Current portion of notes payable to related parties	60,000	498,906
Long-term portion of notes payable to related parties	1,433,199	985,343

All notes payable to related parties of LDC rank equally.

On April 9, 2013, LDC issued a promissory note to the Corporation. The principal amount of the promissory note is \$250,000,000, which bears interest at a rate of 2.96% per annum payable on April 10, 2023. Interest is calculated and payable semi-annually in arrears on October 10 and April 10 of each year.

On April 9, 2013, LDC issued a promissory note to the Corporation. The principal amount of the promissory note is \$200,000,000, which bears interest at a rate of 4.01% per annum payable on April 9, 2063. Interest is calculated and payable semi-annually in arrears on October 9 and April 9 of each year.

The net proceeds of the promissory notes were mainly used to repay LDC's notes payable to the Corporation which matured on May 6, 2013.

13. EMPLOYEE FUTURE BENEFITS

Pension

LDC's full-time employees participate in a pension plan through OMERS. The plan assets are pooled together to provide benefits to plan participants and are not segregated in separate accounts for each member entity. As at December 31, 2013, the OMERS plan was 88% funded, with a funding deficit of approximately \$8,600,000,000. For the year ended December 31, 2013, the total contributions of all participating employers and employees were approximately \$3,500,000,000. For the year ended December 31, 2013, LDC's contributions were \$18,102,000 [2012 - \$16,374,000], representing less than five percent of total contributions to the plan.

For 2013, OMERS contribution rates were 9.0% up to the year's maximum pensionable earnings ["YMPE"] and 14.6% over YMPE for normal retirement age of 65 [2012 - 8.3% up to YMPE and 12.8% over YMPE for normal retirement age of 65].

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As at December 31, 2012, OMERS had approximately 266,000 active members. As at December 31, 2013, approximately 1,500 members [December 31, 2012 – 1,700] had a current relationship with LDC.

Post-retirement benefits other than pension

a) Benefit Obligations

	2013 \$	2012 \$
Balance, beginning of year	253,890	244,326
Service cost	4,816	5,035
Interest cost	10,570	11,454
Benefits paid	(10,432)	(8,069)
Actuarial (gain) loss	(20,230)	254
Transfer from related parties	178	890
Balance, end of year	238,792	253,890

On February 13, 2014, LDC's unionized workforce ratified a collective agreement to expire at the end of January 2018. The agreement does not contain terms that create a post-retirement benefits liability in respect of past service.

b) Amounts recognized in regulatory assets

	2013 \$	2012 \$
Actuarial loss	38,767	61,477
Prior service cost	14	22
Total recognized in regulatory assets [note 9]	38,781	61,499

As at December 31, 2013, the estimated actuarial loss and prior service cost that are expected to be amortized from regulatory asset to net periodic benefit cost in 2014 are \$909,000 and \$nil, respectively.

c) Components of net periodic benefit costs

	2013 \$	2012 \$
Service cost	4,816	5,035
Interest cost	10,570	11,454
Amortization of actuarial loss	2,064	3,146
Amortization of prior service cost	2	840
Net periodic benefit cost	17,452	20,475
Capitalized as part of PP&E	6,623	7,305
Charged to operations	10,829	13,170

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d) *Expected benefit payments*

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid over the next five years, and in the aggregate for the five fiscal years thereafter:

	Post-retirement Benefits \$
2014	8,191
2015	8,403
2016	9,090
2017	9,541
2018	10,112
2019-2023	59,394

e) *Significant assumptions*

	2013 %	2012 %
Accrued benefit obligation as at December 31:		
Discount rate	4.75	4.25
Benefit costs for years ended December 31:		
Discount rate	4.25	4.75
Assumed health care cost trend rates as at December 31:		
Rate of increase in dental costs assumed for next year	4.00	4.00
Rate of increase in medical costs assumed for next year		
For pre July 2000 retirements	6.00	6.50
For other retirements	7.50	8.00
Rate that medical cost trend rate gradually declines to		
For pre July 2000 retirements	5.00	5.00
For other retirements	5.00	5.00
Year that the medical cost trend rate reaches the ultimate trend rate		
For pre July 2000 retirements	2016	2016
For other retirements	2019	2019

f) *Sensitivity analysis*

Assumed medical and dental care cost trend rates have a significant effect on the amounts reported for medical and dental care plans. A one-percentage-point change in assumed medical and dental care cost trend rates would have the following effects for 2013:

	Increase \$	Decrease \$
Total of current service and interest cost (at 4.25%)	2,327	(2,046)
Accrued benefit obligation as at December 31, 2013 (at 4.75%)	30,388	(26,664)

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NOTES TO FINANCIAL STATEMENTS

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Assumed interest rates have a significant effect on the amounts reported for the total accrued benefit obligation and expense. A one-percentage-point change in assumed interest rates would have the following effects:

	Increase \$	Decrease \$
Accrued benefit obligation as at December 31, 2013	(37,041)	45,469
Estimated net periodic benefit cost for 2014	(1,713)	2,937

14. ASSET RETIREMENT OBLIGATIONS

The reconciliation between the opening and closing ARO liability balances is as follows:

	2013 \$	2012 \$
Balance, beginning of year	5,004	4,831
ARO liabilities settled in the year	(573)	(313)
Accretion expense	177	170
Revision in estimated cash flows	1,639	316
Balance, end of year	6,247	5,004

15. FINANCIAL INSTRUMENTS

a) *Recognition and measurement*

As at December 31, 2013 and December 31, 2012, the fair values of cash and cash equivalents, net accounts receivable, unbilled revenue, advance from related party, and accounts payable and accrued liabilities approximate their carrying values due to the short maturity of these instruments [note 4[i]]. The fair values of customers' advance deposits approximate their carrying values taking into account interest accrued on the outstanding balance. Obligations under capital lease are measured based on a discounted cash flow analysis and approximate the carrying value as management believes that the fixed interest rates are representative of current market rates.

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The carrying value and fair value of LDC's notes payable consist of the following:

	2013 \$		2012 \$	
	Carrying value	Fair value ⁽¹⁾	Carrying value	Fair value ⁽¹⁾
Long-term notes payable to the Corporation				
6.16% due May 6, 2013	—	—	179,835	182,999
5.20% due November 14, 2017	244,453	269,601	244,316	278,314
4.54% due November 12, 2019	244,089	265,186	243,948	274,786
5.59% due May 21, 2040	198,747	226,700	198,727	256,357
3.59% due November 18, 2021	298,511	302,837	298,352	316,935
2.96% due April 10, 2023	248,701	232,888	—	—
4.01% due April 9, 2063	198,698	172,863	—	—
6.16% due May 6, 2013	—	—	245,058	249,174
Demand note payable to the Corporation due on demand	45,000	45,000	45,000	45,754
Demand note payable to the Corporation due on the earlier of demand and January 1, 2022	15,000	15,000	15,000	15,489
Demand note payable to TH Energy due on the earlier of demand and July 1, 2022	—	—	14,013	14,043

⁽¹⁾ The fair value measurement of financial instruments for which the fair value has been disclosed is included in Level 2 of the fair value hierarchy.

b) Financial Risks

The following is a discussion of financial risks and related mitigation strategies that have been identified by LDC for financial instruments. This is not an exhaustive list of all risks, nor will the mitigation strategies eliminate all risks listed.

LDC is exposed to a variety of financial risks, particularly credit risk, interest rate risk and liquidity risk.

Credit risk

LDC is exposed to credit risk as a result of the risk of counterparties defaulting on their obligations. LDC's exposure to credit risk primarily relates to accounts receivable and unbilled revenue. LDC monitors and limits its exposure to credit risk on a continuous basis.

LDC's credit risk associated with accounts receivable is primarily related to electricity bill payments from customers. LDC has approximately 730,000 customers. LDC obtains security instruments from certain customers in accordance with direction provided by the OEB. As at December 31, 2013, LDC held security deposits in the amount of \$44,649,000 [December 31, 2012 - \$46,838,000], of which \$22,211,000 [December 31, 2012 - \$25,666,000] were related to security deposits on Offers to Connect to guarantee the payment of additional costs relating to expansion projects. As at December 31, 2013, there were no significant concentrations of credit risk with respect to any customer.

LDC did not have any single customer that generated more than 10% of total revenues for the years ended December 31, 2013 and December 31, 2012.

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Credit risk associated with accounts receivable and unbilled revenue is as follows:

	2013 \$	2012 \$
Unbilled revenue	326,111	274,272
Accounts receivable		
Outstanding for not more than 30 days	175,124	164,523
Outstanding for more than 30 days and not more than 120 days	22,791	18,214
Outstanding for more than 120 days	11,874	13,772
Less: Allowance for doubtful accounts	(10,766)	(10,568)
Total accounts receivable, net	199,023	185,941
Total accounts receivable and unbilled revenue	525,134	460,213

Reconciliation between the opening and closing allowance for doubtful accounts balances is as follows:

	2013 \$	2012 \$
Balance, beginning of year	(10,568)	(12,810)
Provision for doubtful accounts	(7,805)	(6,590)
Write-offs	8,130	9,242
Recoveries	(523)	(410)
Balance, end of year	(10,766)	(10,568)

Unbilled revenue represents amounts for which LDC has a contractual right to receive cash through future billings and are unbilled at period-end. Unbilled revenue is considered current and no allowance for doubtful accounts had been provided as at December 31, 2013 and December 31, 2012.

The credit risk related to cash, cash equivalents and investments is mitigated by LDC's treasury policies on assessing and monitoring the credit exposures of counterparties. LDC's maximum exposure to credit risk is approximately equal to the carrying value of its financial assets.

Interest rate risk

LDC is exposed to fluctuations in interest rates for the valuation of its post-retirement benefit obligations [note 13[f]]. LDC is also exposed to short-term interest rate risk on the net of cash and cash equivalents, advances from related party, and customers' advance deposits. LDC manages interest rate risk by monitoring the mix of fixed and floating rate instruments, and taking action as necessary to maintain an appropriate balance. Advances from related party bear interest based on the prevailing market conditions at the time of issuance.

As at December 31, 2013, aside from the valuation of its post-retirement benefit obligations, LDC was exposed to interest rate risk predominately from advances from the Corporation, while most of its remaining obligations were either non-interest bearing or bear fixed interest rates, and its financial assets were predominately short-term in nature and mostly non-interest bearing. LDC estimates that a 100 basis point increase (decrease) in short-term interest rates, with all other variables held constant, would result in an increase (decrease) of approximately \$1,800,000 to annual net financing charges.

Liquidity risk

LDC is exposed to liquidity risk related to its ability to fund its obligations as they become due. LDC monitors and manages its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. LDC has access to credit facilities and borrowings through the Corporation and monitors cash balances daily. LDC's

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[all tabular amounts in thousands of Canadian dollars]

objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing net financing charges.

Liquidity risks associated with financial commitments are as follows:

December 31, 2013						
	Due within 1 year \$	Due within 2 years \$	Due within 3 years \$	Due within 4 years \$	Due within 5 years \$	Due after 5 years \$
Financial liabilities						
Advance from related party	150,000	—	—	—	—	—
Accounts payable and accrued liabilities	455,752	—	—	—	—	—
Obligations under capital lease	2,537	2,537	2,537	2,537	1,270	—
Long-term notes payable to the Corporation						
5.20% due November 14, 2017	—	—	—	245,058	—	—
4.54% due November 12, 2019	—	—	—	—	—	245,058
5.59% due May 21, 2040	—	—	—	—	—	200,000
3.59% due November 18, 2021	—	—	—	—	—	300,000
2.96% due April 10, 2023	—	—	—	—	—	250,000
4.01% due April 9, 2063	—	—	—	—	—	200,000
Demand note payable to the Corporation due on demand	45,000	—	—	—	—	—
Demand note payable to the Corporation due on the earlier of demand and January 1, 2022	15,000	—	—	—	—	—
Interest payments on long-term notes payable and demand notes payable ⁽¹⁾	50,466	61,239	61,239	61,239	48,496	673,996
	718,755	63,776	63,776	308,834	49,766	1,869,054

⁽¹⁾ The “Due within 1 year” column excludes \$10,773,000 of interest on long-term notes payable and demand notes payable that was accrued as at December 31, 2013.

Foreign exchange risk

As at December 31, 2013, LDC had limited exposure to the changing values of foreign currencies. While LDC purchases goods and services which are payable in US dollars, and purchases US currency to meet the related commitments when required, the impact of these transactions is not material to the financial statements.

16. FINANCIAL ASSISTANCE

As at December 31, 2013, \$48,388,000 [December 31, 2012 - \$48,388,000] was utilized under the Corporation’s demand credit facility in the form of letters of credit to satisfy the prescribed prudential requirements of LDC with the IESO for the purchase of electricity. As at December 31, 2013, an additional amount of \$761,000 [December 31, 2012 - \$761,000] was utilized for the Ministry of Finance of Ontario, and \$905,000 [December 31, 2012 - \$nil] was utilized to satisfy requirements of the City in relation to Copeland Station.

17. INCOME TAXES

LDC’s effective tax rate for the year ended December 31, 2013 was 2.63% [2012 – 3.62%]. Income tax expense for the year ended December 31, 2013 was \$3,123,000 [2012 - \$3,125,000]. The effective tax rate and income tax

Toronto Hydro-Electric System Limited

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[all tabular amounts in thousands of Canadian dollars]

expense for the year ended December 31, 2013 were lower than those for the year ended December 31, 2012 due to changes in permanent and temporary differences between accounting and tax treatments.

Income tax expense differs from the amount that would have been recorded using the combined statutory Canadian federal and Ontario income tax rate. Reconciliation of income tax expense computed at the statutory income tax rate to the income tax provision is set out below:

Statements of Net Income and Comprehensive Income

	2013 \$	2012 \$
Rate reconciliation		
Income before income taxes	118,862	86,314
Statutory Canadian federal and provincial income tax rate	26.50%	26.50%
Expected income tax expense	31,498	22,873
Temporary differences not benefited	(20,186)	(16,133)
Change in unrecognized tax benefits	(5,051)	(1,771)
Impact of change in expected future tax rate on existing deferred income tax balances	—	(923)
Other	(3,138)	(921)
Income tax expense	3,123	3,125
Effective tax rate	2.63%	3.62%
Components of income tax expense		
Current tax	5,265	6,011
Deferred income tax related to the origination and reversal of temporary differences	(48)	(245)
Non-refundable ITCs	(2,094)	(2,641)
Income tax expense	3,123	3,125

Balance Sheets

Significant components of LDC's deferred income tax assets are as follows:

	2013 \$	2012 \$
PP&E and intangible assets	64,518	82,604
Post-retirement benefits liability	53,003	50,667
Regulatory adjustments	41,301	51,218
Other taxable temporary differences	(2,955)	8,753
Deferred income tax assets	155,867	193,242

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[all tabular amounts in thousands of Canadian dollars]

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2013 \$	2012 \$
Balance, beginning of year	5,274	7,045
Increases for tax positions taken in the current year	18	248
Decreases for tax positions taken in prior years	(1,603)	(38)
Settlements with tax authorities	(3,466)	(1,981)
Balance, end of year	223	5,274

As at December 31, 2013, \$223,000 of unrecognized tax benefits [December 31, 2012 - \$5,274,000] would have a favourable effect on the effective tax rate, if recognized. No interest and penalties have been accrued, since LDC is of the view that none are expected to be payable. During the next 12 months, unrecognized tax benefits are not expected to significantly change.

As at December 31, 2013, LDC's tax years currently open to examination by tax authorities include 2007 and subsequent years. Other than in respect of the fair market revaluation of LDC's assets on October 1, 2001 pursuant to Section 7 of Ontario Regulation 162/01 of the Electricity Act, tax years prior to 2007 are closed to further examination.

18. SHARE CAPITAL

Share capital consists of the following:

	2013 \$	2012 \$
Authorized		
The authorized share capital of LDC consists of an unlimited number of common shares without par value		
Issued and outstanding		
1,000 common shares	556,278	556,278

Dividends

For the year ended December 31, 2013, the Board of Directors of LDC declared and paid dividends totalling \$40,000,000 [2012 - \$nil] to the Corporation.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

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[all tabular amounts in thousands of Canadian dollars]

19. RELATED PARTY TRANSACTIONS

For LDC, transactions with related parties include transactions with the City, which wholly owns the Corporation, the Corporation and TH Energy, a wholly-owned subsidiary of the Corporation. All transactions with related parties are conducted on terms similar to those offered to unrelated parties.

2013	City \$	Corporation \$	TH Energy \$
Revenues	235,846	—	340
Operating expenses (recoveries) and capital expenditures	31,859	3,137	(863)
Net financing charges	—	69,136	270
Dividends	—	40,000	—
Accounts receivable	2,131	—	—
Unbilled revenue	19,425	—	—
Advance from related party	—	150,000	—
Accounts payable and accrued liabilities	45,152	11,565	—
Current portion of notes payable to related parties	—	60,000	—
Long-term portion of notes payable to related parties	—	1,433,199	—
Advance deposits	8,816	—	—

2012	City \$	Corporation \$	TH Energy \$
Revenues	210,835	—	324
Operating expenses (recoveries) and capital expenditures	26,232	3,035	(1,029)
Net financing charges	—	75,303	433
Accounts receivable	5,603	—	14,271
Unbilled revenue	4,350	—	9,268
Accounts payable and accrued liabilities	38,013	11,426	433
Current portion of notes payable to related parties	—	484,893	14,013
Long-term portion of notes payable to related parties	—	985,343	—
Advance deposits	8,926	—	—

Revenues represent amounts charged to the City primarily for electricity, street lighting and ancillary services, and TH Energy for demand billable services. Operating expenses and capital expenditures represent amounts charged by the City for purchased road cut repairs, property taxes and other services, and the Corporation for purchased corporate and management services. Operating expense recoveries represent amounts charged to TH Energy for the provision of goods and services. Net financing charges represent interest charged by the Corporation and TH Energy on the advances and notes payable [note 12]. Dividends are paid to the Corporation [note 18].

Accounts receivable represent receivables from the City primarily for electricity and ancillary services, and TH Energy for the provision of goods and services, including electricity billing activities. Unbilled revenue represents receivables from the City and TH Energy related to electricity provided and not yet billed. Advance from related party represents amounts payable to the Corporation for short-term borrowings obtained under the Corporation's revolving credit facility and commercial paper program. Accounts payable and accrued liabilities represent amounts payable to the City related to road cut repairs and other services, as well as amounts received from the City for the construction of electricity distribution assets. Included in the accounts payable and accrued liabilities are amounts payable to the Corporation for purchased corporate and management services and interest accruing on the notes payable to the Corporation and TH Energy. Notes payable to related parties represent amounts borrowed from the Corporation and TH Energy [note 12]. Advance deposits represent amounts received from the City for future expansion projects.

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[all tabular amounts in thousands of Canadian dollars]

On January 1, 2012, certain electricity distribution assets of TH Energy were transferred to LDC through a newly created wholly-owned legal entity (1798594 Ontario Inc.) of the Corporation. Immediately thereafter, the new legal entity was amalgamated with LDC. The transfer was completed for a purchase price of \$28,460,000, with a post closing adjustment of \$14,013,000. The transfer was initially funded with share capital issued by the new wholly-owned legal entity to the Corporation. Subsequently, LDC issued an intercompany note payable to TH Energy for the increase in the purchase price. On August 16, 2013, the principal amount of the note was repaid to TH Energy.

20. COMMITMENTS

Operating leases and capital projects

As at December 31, 2013, the future minimum annual payments under property operating leases, capital projects and other commitments with remaining terms from one to five years and thereafter were as follows:

	Operating leases \$	Capital projects (2) and other \$
2014	6,175	79,797
2015	6,186	2,772
2016	5,784	—
2017	2,123	—
2018	—	—
Thereafter	—	—
Total amount of future minimum payments (1)	20,268	82,569

(1) Refer to note 15 for repayments of notes payable and advance from related party excluded from the table above.

(2) Reflects capital project commitments for construction services and estimated capital contributions, with the majority related to Copeland Station.

LDC has the option to renew its two major property operating leases at the end of the current lease term for an additional five years at the then fair rental value.

Operating lease expense for the year ended December 31, 2013 was \$6,132,000 [2012 - \$6,547,000].

Subsequent to December 31, 2013, LDC entered into capital commitments of approximately \$21,000,000 for capital contributions payable to Hydro One Networks Inc. over the next year in respect of Copeland Station.

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Capital leases

As at December 31, 2013, the future minimum annual lease payments under capital leases with remaining lease terms from one to five years and thereafter were as follows:

	\$
2014	2,537
2015	2,537
2016	2,537
2017	2,537
2018	1,270
Thereafter	—
Total amount of future minimum lease payments	11,418
Less: interest and executory costs	1,143
	10,275
Current portion included in Other liabilities	2,100
Long-term portion included in Other liabilities	8,175

21. CONTINGENCIES

a) Legal Proceedings

In the ordinary course of business, LDC is subject to various legal actions and claims with customers, suppliers, former employees and other parties. On an ongoing basis, LDC assesses the likelihood of any adverse judgments or outcomes as well as potential ranges of probable costs and losses. A determination of the provision required, if any, for these contingencies is made after an analysis of each individual issue. The provision may change in the future due to new developments in each matter or changes in approach, such as a change in settlement strategy. If damages were awarded under these actions, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with these actions.

2 Secord Avenue

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of \$30,000,000 as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence and third party claim have been served by LDC and a third party defence and counterclaim against LDC seeking damages in the amount of \$51,000,000 have been filed. A certification order has been issued. Affidavits of documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. A mediation took place on January 15, 2014 and the parties have agreed to settle the action of the class plaintiffs by the payment by LDC of the total amount of \$6,527,000, including all taxes and legal fees, subject to approval by the Ontario Superior Court of Justice. LDC will make a claim under its liability insurance which LDC believes will cover the settlement payment. A settlement approval hearing will be scheduled. If the settlement is approved by the court, the main actions commenced by the class plaintiffs will be dismissed without costs, however the claims, counterclaims and third party claims amongst the various defendants to the class action will continue. Given the preliminary status of the remaining unsettled actions, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with the action.

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On December 20, 2010, LDC was served with a statement of claim by the City seeking damages in the amount of \$2,000,000 as a result of the fire at 2 Secord Avenue. A statement of defence and a third party claim have been served. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with the action.

By order of the court dated January 24, 2012, the above actions and a smaller non-class action commenced in April 2009 involving the same incident will be tried at the same time or consecutively.

2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of \$30,000,000 as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action seeks general damages in the amount of \$10,000,000 and special damages in the amount of \$20,000,000 from LDC. The proposed class action is at a preliminary stage. The plaintiff cancelled its certification motion set for November 2013 and advised it intends to reschedule. Cross-examinations for a certification motion have commenced, but have not been completed. Statements of defence to the main action and to the third party claim have not been filed. Given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with these actions.

On August 29, 2011, LDC was served with a statement of claim by the owner of the building and the property management company for the building seeking damages in the amount of \$2,000,000 as a result of the fire at 2369 Lakeshore Boulevard West. LDC has filed a statement of defence and counterclaim. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of LDC. If damages were awarded, LDC would make a claim under its liability insurance which LDC believes would cover any damages which may become payable by LDC in connection with the action.

b) OEB PILs Proceeding

The OEB conducted a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for certain MEUs. On June 24, 2011, the OEB issued its decision for these MEUs and provided guidelines for the calculation and further disposition of the balances accumulated in the PILs regulatory variance accounts.

LDC reviewed the balance of its PILs regulatory variance accounts and applied the guidelines provided by the OEB. LDC applied for disposition of the balance as part of its IRM/ICM Application filed on May 10, 2012. The OEB issued its decision and order on April 2, 2013 approving the disposition of the balance. The impact was recorded previously in LDC's financial statements.

Toronto Hydro-Electric System Limited

NOTES TO FINANCIAL STATEMENTS

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[all tabular amounts in thousands of Canadian dollars]

22. NET FINANCING CHARGES

Net financing charges consist of the following:

	2013 \$	2012 \$
Interest income	2,196	895
Interest expense		
Long-term debt ⁽¹⁾	(70,359)	(76,596)
Other interest	(4,029)	(2,833)
AFUDC	3,322	2,325
	(68,870)	(76,209)

⁽¹⁾ Includes amortization of debt issuance costs, premiums and discounts.

23. STATEMENTS OF CASH FLOWS

Changes in non-cash working capital provided/(used) cash as follows:

	2013 \$	2012 \$
Accounts receivable	(13,082)	5,515
Unbilled revenue	(51,839)	(11,983)
Income tax receivable	4,368	3,974
Inventories	(1,011)	(664)
Other current assets	(4,174)	(276)
Accounts payable and accrued liabilities	44,845	(9,356)
Restructuring accrual	(11,954)	11,954
Deferred conservation credit	112	6,298
Other current liabilities	195	(332)
	(32,540)	5,130

The reconciliation between total additions to PP&E and the amount presented on the statements of cash flows after factoring in the non-cash additions is as follows:

	2013 \$	2012 \$
Purchase of PP&E, cash basis	355,232	302,198
Net change in accruals related to PP&E	32,959	(12,131)
Capital lease additions	305	—
ARO additions	1,669	377
Capitalized overhead costs	2,315	1,620
Total additions to PP&E	392,480	292,064

Toronto Hydro-Electric System Limited

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24. Comparative Figures

Certain comparative figures have been reclassified from financial statements previously presented to conform to the presentation of the 2013 financial statements. During the fourth quarter of 2013, LDC changed its presentation of the statements of cash flows for the net change in regulatory assets and liabilities from investing activities to operating activities. Prior year comparatives have been retrospectively reclassified with \$14,581,000 previously presented as investing activities for the year ended December 31, 2012 reclassified to operating activities.

1 **RECONCILIATIONS**

2
3 In accordance with section 2.4.3 of the OEB's Filing Requirements (July 17, 2013), this
4 schedule provides reconciliations of the financial results shown in the Audited Financial
5 Statements with the regulatory financial results filed under Section 2.1.13 of the OEB's
6 Reporting and Record Keeping Requirements for years 2011 through 2013:

- 7
8 • Appendix A: 2011 Reconciliation;
9 • Appendix B: 2012 Reconciliation; and
10 • Appendix C: 2013 Reconciliation.

Toronto Hydro-Electric System Limited
Balance Sheet
As at December 31, 2011

	THESL Consolidated Audited 2011 (\$,000s) (1)	Unregulated Business (\$,000s) (2)	Consolidation Adjustment (\$,000s) (3)	Calculated THESL Regulated Business (\$,000s) (4)=(1)-(2)-(3)	RRR Filing (\$) (5)	RRR Filing (\$,000s) (6)	Difference (\$,000s) (7)=(4)-(6)	Notes
ASSETS								
Current								
Cash and cash equivalents	66,744	7,321		59,423	59,422,805	59,423	-0	
Accounts receivable, net of allowance for doubtful accounts	191,456	5,161	-1,429	187,724	187,724,625	187,725	-0	
Unbilled revenue	262,289	509		261,780	261,780,195	261,780	0	
Payment in lieu of corporate taxes receivable	8,684			8,684	8,683,707	8,684	0	
Inventories	6,891			6,891	6,890,804	6,891	0	
Prepaid expenses	4,404	6		4,398	4,397,765	4,398	0	
Total current assets	540,468	12,997	-1,429	528,900	528,899,900	528,900	0	
Property, plant and equipment, net	2,334,293	5,921		2,328,372	2,328,371,937	2,328,372	0	
Intangible assets, net	112,982			112,982	112,982,478	112,982	-0	
Regulatory assets	77,322			77,322	78,439,717	78,440	-1,118	1
Other assets	7,331			7,331	7,331,033	7,331	-0	
Future income tax assets	200,157			200,157	200,156,608	200,157	-0	
Total assets	3,272,553	18,918	-1,429	3,255,064	3,256,181,673	3,256,182	-1,118	
LIABILITIES AND SHAREHOLDER'S EQUITY								
Current								
Accounts payable and accrued liabilities	402,607	6,655	-1,429	397,380	397,380,282	397,380	0	
Other liabilities	22,290			22,290	22,289,527	22,290	0	
Deferred revenue	13,610	12,808		802	802,067	802	-0	
Total current liabilities	438,507	19,464	-1,429	420,472	420,471,876	420,472	0	
Long-term liabilities								
Notes payable to related party	1,164,283			1,164,283	1,164,282,775	1,164,283	0	
Promissory note payable to related party	245,058			245,058	245,057,739	245,058	0	
Post-employment benefits	176,370	811		175,559	175,559,000	175,559	0	
Regulatory liabilities	210,280			210,280	210,280,354	210,280	-0	
Other liabilities	11,301			11,301	11,300,728	11,301	0	
Asset retirement obligations	4,831			4,831	4,831,066	4,831	-0	
Customers' advance deposits	35,930			35,930	35,930,309	35,930	-0	
Total long-term liabilities	1,848,053	811	0	1,847,242	1,847,241,969	1,847,242	0	
Total liabilities	2,286,560	20,275	-1,429	2,267,714	2,267,713,845	2,267,714	0	
Shareholder's equity								
Share capital	527,817	0		527,817	527,816,668	527,817	0	
Retained earnings	445,419	-1,357		446,776	447,893,769	447,894	-1,118	1
Contributed surplus	12,757			12,757	12,757,392	12,757	-0	
Total shareholder's equity	985,993	-1,357	0	987,350	988,467,829	988,468	-1,118	
Total liabilities and shareholder's equity	3,272,553	18,918	-1,429	3,255,064	3,256,181,674	3,256,182	-1,118	

Notes:

Note 1: HST Adjustment: In the Financial statement, THESL has booked the HST to the HST / OVAT Input Tax Credits (ITCs) variance account with offset entry to distribution revenue. For RRR Reporting, THESL has booked HST to the HST / OVAT Input Tax Credits (ITCs) variance account with offset entry to HST/OVAT Contra Account account as per the OEB guidelines. The adjustment entry is, HST/OVAT Contra Account (Dr.) \$1,118k, Distribution Revenue (Cr.) \$367k, Misc. Interest (Cr.) \$15k and Retained Earning (Cr.) 736k.

Toronto Hydro-Electric System Limited
Statements of Income
Year ended December 31, 2011

	THESL Consolidated Audited 2011 (\$,000s) (1)	Unregulated Business (\$,000s) (2)	Consolidation Adjustment (\$,000s) (3)	Calculated THESL Regulated Business (\$,000s) (4)=(1)-(2)-(3)	RRR Filing (\$) (5)	RRR Filing (\$,000s) (6)	Difference (\$,000s) (7)=(4)-(6)	Notes
Revenues								
Sale of electricity	2,766,714			2,766,714	2,365,031,768	2,365,032	401,682	1 & 2
Other income	24,931	665		24,266	27,316,805	27,317	-3,050	4
	2,791,645	665	0	2,790,980	2,392,348,573	2,392,349	398,632	
Costs								
Purchased power	2,236,541			2,236,541	1,834,492,283	1,834,492	402,049	2
Operating expenses	235,643	1,881		233,762	239,201,377	239,201	-5,438	3 & 4
Depreciation and amortization	146,505	67		146,438	146,438,503	146,439	-0	
	2,618,689	1,947	0	2,616,742	2,220,132,162	2,220,132	396,610	
Income before the following:	172,956	-1,283	0	174,239	172,216,411	172,217	2,022	
Net financing charges	-74,478	25		-74,503	-72,098,869	-72,099	-2,404	1 & 3
Gain on disposals of property, plant and equipment	3,885			3,885	3,885,315	3,885	-0	
Income before provision for payments in lieu of corporate taxes	102,363	-1,258	0	103,621	104,002,857	104,003	-382	
Provision for payments in lieu of corporate taxes	9,032			9,032	9,031,912	9,032	0	
Net income	93,331	-1,258	0	94,589	94,970,945	94,971	-382	

Notes:
Note 1: HST Adjustment: In the Financial statement, THESL has booked the HST to the HST / OVAT Input Tax Credits (ITCs) variance account with offset entry to distribution revenue. For RRR Reporting, THESL has booked HST to the HST / OVAT Input Tax Credits (ITCs) variance account with offset entry to HST/OVAT Contra Account account as per the OEB guidelines. The adjustment entry is, HST/OVAT Contra Account (Dr.) \$1,118k, Distribution Revenue (Cr.) \$367k, Misc. Interest (Cr.) \$15k and Retained Earning (Cr.) 736k.

Note 2: Global Adjustment (GA): Per Corporate Accounting Policy "GA Charge for Regulated Price Plan (RPP) Customers", for regulatory reporting COP expense and COP revenue shall exclude the GA COP charge for RPP customers. The adjustment is a decrease to COP expense and a decrease to COP revenue in the amount of \$402,049k.

Note 3: \$2,388k towards Financing Cost (\$1,967k) and interest on customer advance deposits (\$421k) are reclass to OM&A for the RRR.

Note 4: Special Purpose Charge (SPC): In the Audited Financial Statements (AFS) THESL had (\$3,050k) as SPC recovered balances. For the purpose of OEB RRR filing, the SPC recovery is booked in OEB account 4324 "Special Purpose Charge Recovery" and the SPC expense is booked in OEB account 5681 "Special purpose charge expense".

Toronto Hydro-Electric System Limited
Balance Sheet
As at December 31, 2012

	THESL Consolidated Audited 2012 (\$,000s) (1)	Unregulated Business (\$,000s) (2)	Consolidation Adjustment (\$,000s) (3)	Calculated THESL Regulated Business (\$,000s) (4)=(1)-(2)-(3)	RRR Filing (\$) (5)	RRR Filing (\$,000s) (6)	Difference (\$,000s) (7)=(4)-(6)	Notes
ASSETS								
Current								
Cash and cash equivalents	67,258	10,654		56,604	56,603,702	56,604	-0	
Accounts receivable, net of allowance for doubtful accounts	185,941	4,834	-1,237	182,344	182,343,659	182,344	0	
Unbilled revenue	274,272	390		273,882	273,882,054	273,882	-0	
Income tax receivable	4,710			4,710	4,710,484	4,710	-0	
Inventories	7,555			7,555	7,555,372	7,555	-0	
Regulatory assets	1,658			1,658	1,658,482	1,658	-0	
Other assets	4,680			4,680	4,679,517	4,680	0	
Total current assets	546,074	15,879	-1,237	531,433	531,433,271	531,433	-0	
Property, plant and equipment, net	2,504,428	49,663		2,454,765	2,454,764,876	2,454,765	0	
Intangible assets, net	134,080			134,080	134,080,101	134,080	-0	
Regulatory assets	119,556			119,556	120,690,375	120,690	-1,134	1
Other assets	8,098			8,098	8,097,653	8,098	0	
Deferred income tax assets	193,242			193,242	193,241,713	193,242	0	
Total assets	3,505,478	65,542	-1,237	3,441,174	3,442,307,988	3,442,308	-1,134	
LIABILITIES AND SHAREHOLDER'S EQUITY								
Current								
Accounts payable and accrued liabilities	377,948	4,835	-1,238	374,351	374,351,769	374,352	-0	
Restructuring accrual	11,954	9		11,945	11,945,063	11,945	-0	
Customers' advance deposits	40,048			40,048	40,048,468	40,048	-0	
Deferred conservation credit	19,908	19,111		797	797,028	797	0	
Post-retirement benefits	9,925	19		9,906	9,906,000	9,906	0	
Other liabilities	1,850			1,850	1,849,683	1,850	0	
Notes payable to related party	179,835			179,835	179,834,837	179,835	0	
Promissory notes payable to related party	319,071	14,013		305,058	305,057,739	305,058	0	
Total current liabilities	960,539	37,987	-1,238	923,790	923,790,588	923,791	-0	
Notes payable to related party	985,343			985,343	985,342,797	985,343	0	
Customers' advance deposits	6,790			6,790	6,789,737	6,790	0	
Post-retirement benefits	243,965	1,090		242,875	242,875,000	242,875	-0	
Other liabilities	9,385			9,385	9,384,708	9,385	0	
Regulatory liabilities	196,809			196,809	196,808,949	196,809	0	
Asset retirement obligations	5,004			5,004	5,004,223	5,004	-0	
Total liabilities	2,407,835	39,077	-1,238	2,369,996	2,369,996,002	2,369,996	0	
Shareholder's equity								
Share capital	556,278	28,461		527,817	527,816,668	527,817	0	
Retained earnings	528,608	-1,996		530,604	531,737,926	531,738	-1,134	1
Contributed surplus	12,757			12,757	12,757,392	12,757	-0	
Total shareholder's equity	1,097,643	26,465	0	1,071,178	1,072,311,986	1,072,312	-1,134	
Total liabilities and shareholder's equity	3,505,478	65,541	-1,238	3,441,175	3,442,307,988	3,442,308	-1,133	

Notes:
HST Adjustment: In the Financial statement, THESL has booked the HST to the HST / OVAT Input Tax Credits (ITCs) variance account with offset entry to interest expenses. For RRR Reporting, THESL has booked HST to the HST / OVAT Input Tax Credits (ITCs) variance account with offset entry to HST/OVAT Contra Account account as per the OEB guidelines. The amount for 2011 is \$1,118k and 2012 is \$16k. The adjustment entry is, HST/OVAT Contra Account (Dr.) \$1,134k, Misc. Interest (Cr.) \$16k and Retained Earning (Cr.) 1,118k.

Toronto Hydro-Electric System Limited
Statements of Net Income and Comprehensive Income
Year ended December 31, 2012

	THESL Consolidated Audited 2012 (\$,000s) (1)	Unregulated Business (\$,000s) (2)	Consolidation Adjustment (\$,000s) (3)	Calculated THESL Regulated Business (\$,000s) (4)=(1)-(2)-(3)	RRR Filing (\$) (5)	RRR Filing (\$,000s) (6)	Difference (\$,000s) (7)=(4)-(6)	Notes
Revenues								
Sale of electricity	2,799,404			2,799,404	2,313,394,881	2,313,395	486,009	2
Other income	41,057	6,056		35,001	17,424,906	17,425	17,576	3
	2,840,461	6,056	0	2,834,405	2,330,819,787	2,330,820	503,585	
Costs								
Purchased power	2,275,209			2,275,209	1,789,200,443	1,789,200	486,009	2
Operating expenses	236,386	4,436		231,950	214,373,410	214,373	17,576	3
Depreciation and amortization	140,352	1,843		138,509	138,508,981	138,509	0	
	2,651,947	6,278	0	2,645,668	2,142,082,834	2,142,083	503,585	
Income before the following:	188,514	-222	0	188,736	188,736,952	188,737	-0	
Net financing charges	-76,209	-272		-75,937	-75,921,365	-75,921	-16	1
Gain on disposals of property, plant and equipment	1,805			1,805	1,804,779	1,805	0	
Restructuring costs	-27,796	-146		-27,650	-27,650,803	-27,651	0	
Income before income taxes	86,314	-640	0	86,954	86,969,563	86,969	-16	
Income tax expense	3,125			3,125	3,125,406	3,125	-0	
Net income and comprehensive income	83,189	-640	0	83,829	83,844,157	83,844	-16	

Notes:

Note 1: HST Adjustment: In the Financial statement, THESL has booked the HST to the HST / OVAT Input Tax Credits (ITCs) variance account with offset entry to interest expenses. For RRR Reporting, THESL has booked HST to the HST / OVAT Input Tax Credits (ITCs) variance account with offset entry to HST/OVAT Contra Account account as per the OEB guidelines. The amount for 2011 is \$1,118k and 2012 is \$16k. The adjustment entry is, HST/OVAT Contra Account (Dr.) \$1,134k, Misc. Interest (Cr.) \$16k and Retained Earning (Cr.) 1,118k.

Note 2: Global Adjustment (GA): Per Corporate Accounting Policy "GA Charge for Regulated Price Plan (RPP) Customers", for regulatory reporting COP expense and COP revenue shall exclude the GA COP charge for RPP customers. The "adjustment" is a decrease to COP expense and a decrease to COP revenue in the amount of \$486,009k.

Note 3: Demand Billable Charges: As per USGAAP, THESL book demand billable charges on gross based while for RRR it is shown on net bases.

Toronto Hydro-Electric System Limited
Balance Sheet
As at December 31, 2013

	THESL Consolidated Audited 2013 (\$,000s) (1)	Unregulated Business (\$,000s) (2)	Consolidation Adjustment (\$,000s) (3)	Calculated THESL Regulated Business (\$,000s) (4)=(1)-(2)-(3)	RRR Filing (\$) (5)	RRR Filing (\$,000s) (6)	Difference (\$,000s) (7)=(4)-(6)	Notes
ASSETS								
Current								
Cash and cash equivalents	15,677	1,673		14,004	14,003,466	14,003	0	
Accounts receivable, net of allowance for doubtful accounts	199,023	449	-238	198,812	198,811,870	198,812	0	
Unbilled revenue	326,111	743		325,368	325,368,045	325,368	0	
Income tax receivable	342			342	341,830	342	0	
Inventories	8,566			8,566	8,566,175	8,566	-0	
Regulatory assets	7,060			7,060	7,060,239	7,060	-0	
Other assets	8,854			8,854	8,853,920	8,854	0	
Total current assets	565,633	2,865	-238	563,006	563,005,543	563,006	0	
Property, plant and equipment, net	2,640,028	48,949		2,591,079	2,591,078,651	2,591,079	0	
Intangible assets, net	171,489			171,489	171,489,231	171,489	-0	
Regulatory assets	234,424			234,424	204,279,550	204,280	30,144	1
Other assets	8,008			8,008	8,008,086	8,008	-0	
Deferred income tax assets	155,867			155,867	155,867,403	155,867	-0	
Total assets	3,775,449	51,814	-238	3,723,873	3,693,728,464	3,693,728	30,144	
LIABILITIES AND SHAREHOLDER'S EQUITY								
Current								
Advance from related party	150,000			150,000	150,000,000	150,000	0	
Accounts payable and accrued liabilities	455,752	4,188	-238	451,802	471,222,890	471,223	-19,421	2
Customers' advance deposits	37,293			37,293	37,293,279	37,293	-0	
Deferred conservation credit	20,020	19,851		169	169,269	169	-0	
Post-retirement benefits	8,003	21		7,982	7,982,000	7,982	0	
Other liabilities	2,100			2,100	2,099,943	2,100	0	
Regulatory liabilities	2,516			2,516	2,516,195	2,516	-0	
Notes payable to related parties	60,000			60,000	60,000,000	60,000	0	
Total current liabilities	735,684	24,060	-238	711,862	731,283,576	731,284	-19,421	
Notes payable to related parties	1,433,199			1,433,199	1,433,199,461	1,433,199	-0	
Customers' advance deposits	7,356			7,356	7,355,554	7,356	0	
Post-retirement benefits	230,789	1,058		229,731	229,731,000	229,731	0	
Other liabilities	8,175			8,175	8,174,873	8,175	0	
Regulatory liabilities	180,617			180,617	160,001,344	160,001	20,616	3
Asset retirement obligations	6,247			6,247	6,247,281	6,247	-0	
Total liabilities	2,602,067	25,118	-238	2,577,187	2,575,993,089	2,575,993	1,194	
Shareholder's equity								
Share capital	556,278	28,461		527,817	527,816,668	527,817	0	
Retained earnings	604,347	-1,764		606,111	577,161,314	577,161	28,950	4
Contributed surplus	12,757			12,757	12,757,392	12,757	-0	
Total shareholder's equity	1,173,382	26,697	0	1,146,685	1,117,735,375	1,117,735	28,950	
Total liabilities and shareholder's equity	3,775,449	51,814	-238	3,723,873	3,693,728,464	3,693,728	30,144	

Toronto Hydro-Electric System Limited
Balance Sheet
As at December 31, 2013

Notes:

Note 1: Difference in "Regulatory assets" of \$30,144: Calculated Audited Financial Statement (AFS) Regulated balance of \$234,424 & RRR balance of \$204,280, a difference of (\$30,144), as follows:

a. A "Smart meter recovery" regulatory asset (RA) was booked for AFS, and is not considered a regulatory asset for purposes of RRR reporting:	-25,230
b. Incremental Capital Model (ICM) revenue and depreciation expense contra account RA were booked for the AFS, and this not considered a regulatory asset for purposes of RRR reporting:	-4,914
Total difference:	<u>-30,144</u>

Note 2: Difference in "Accounts payable and accrued liabilities" of \$19,421: Calculated AFS Regulated balance of (\$451,802) & RRR balance of (\$471,223), a difference of \$19,421, as follows:

a. A "Revision of prior year tax position" regulatory liability (RL) was booked for AFS, and is not considered a regulatory liability for purposes of RRR reporting: For RRR Reporting, the amount was transferred to OEB account 2220 "Miscellaneous Current and Accrued Liabilities" from Regulatory Liabilities.	<u>19,421</u>
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Note 3: Difference in "Regulatory liabilities" of (\$20,616): Calculated AFS Regulated balance of (\$180,617) & RRR balance of (\$160,001), a difference of (\$20,616), as follows:

a. A Revision of prior year tax position" regulatory liability (RL) was booked for AFS, and is not considered a regulatory liability for purposes of RRR reporting: For RRR Reporting, the amount was transferred to OEB account 2220 "Miscellaneous Current and Accrued Liabilities" from Regulatory Liabilities.	-19,421
b. HST Contra account adjustment: In prior years' AFS, THESL has booked to the OEB account 1592, "PILs and Tax Variances for 2006 and Subsequent Years, Sub-account HST / OVAT Input Tax credits (ITCs)" the ITC savings arising from the elimination of Provincial Sales Tax and implementation of the HST on July 1, 2010. For AFS purposes, the offsetting entry was booked to the income statement rather the regulatory sub-account established, a contra account within Account 1592, "PILs and Tax Variances for 2006 and subsequent years - HST/OVAT Contra Account" of Account 1592. The following adjustment has been made to the AFS to reflect for RRR Reporting the amount in the above mentioned contra account: The adjustment entry is, HST/OVAT Contra Account (Dr.) \$1,150k, Misc. Interest (Cr.) \$16k and Retained Earnings (Cr.) 1,134k.	-1,150
c. For RRR reporting, THESL has written-off to Distribution revenue a credit amount of \$44, which was included in regulatory liabilities in the AFS. The amount does not represent a regulatory liability for RRR reporting:	-44
Total difference:	<u>-20,616</u>

Note 4: Difference in "Retained Earnings" of (\$28,950): Calculated AFS Regulated balance of (\$606,111) & RRR balance of (\$577,161), a difference of (\$28,950). Adjustments have been made to certain AFS income statement items to arrive at the RRR reporting as follows:

a. Reduction to AFS Distribution revenue booked for Smart Meter "net revenue requirement" on the disposition of Account 1555 "Smart Meter Capital & Recovery" and 1556 "Smart Meter OM&A Variance account" balances. The amount shall be booked to Distribution revenue for RRR reporting, to OEB account 4080 as the amount is billed to THESL customers in the future:	-25,230
b. Reverse the ICM revenue and related depreciation expense booked in 2013 in the AFS. This ICM revenue and depreciation expense shall be booked for RRR reporting in the future under regulatory prescribed ICM accounting treatment:	-4,914
c. HST Contra account adjustment: In prior years' AFS, THESL has booked to the OEB account 1592, "PILs and Tax Variances for 2006 and Subsequent Years, Sub-account HST / OVAT Input Tax credits (ITCs)" the ITC savings arising from the elimination of Provincial Sales Tax and implementation of the HST on July 1, 2010. For AFS purposes, the offsetting entry was booked to the income statement rather the regulatory sub-account established, a contra account within Account 1592, "PILs and Tax Variances for 2006 and subsequent years - HST/OVAT Contra Account" of Account 1592. The following adjustment has been made to the AFS to reflect for RRR Reporting the amount in the above mentioned contra account: The adjustment entry is, HST/OVAT Contra Account (Dr.) \$1,150k, Misc. Interest (Cr.) \$16k and Retained Earnings (Cr.) 1,134k.	1,150
d. For RRR reporting, THESL has written-off to Distribution revenue a credit amount of \$44, which was included in regulatory liabilities in the AFS. The amount does not represent a regulatory liability for RRR reporting:	44
Total difference:	<u>-28,950</u>

Toronto Hydro-Electric System Limited
Statements of Net Income and Comprehensive Income
Year ended December 31, 2013

	THESL Consolidated Audited 2013 (\$,000s) (1)	Unregulated Business (\$,000s) (2)	Consolidation Adjustment (\$,000s) (3)	Calculated THESL Regulated Business (\$,000s) (4)=(1)-(2)-(3)	RRR Filing (\$) (5)	RRR Filing (\$,000s) (6)	Difference (\$,000s) (7)=(4)-(6)	Notes
Revenues								
Sale of electricity	3,145,455			3,145,455	3,080,217,018	3,080,217	65,238	1
Other income	42,288	6,246		36,042	27,801,322	27,801	8,240	2
	3,187,743	6,246	0	3,181,497	3,108,018,340	3,108,018	73,478	
Costs								
Purchased power	2,567,512			2,567,512	2,534,165,407	2,534,165	33,346	3
Operating expenses	262,304	3,888		258,416	250,176,410	250,176	8,240	4
Depreciation and amortization	171,475	1,988		169,487	167,694,704	167,695	1,792	5
	3,001,291	5,875	0	2,995,415	2,952,036,520	2,952,037	43,378	
Income before the following:	186,452	371	0	186,081	155,981,820	155,981	30,100	
Net financing charges	-68,870	-139		-68,731	-68,715,187	-68,715	-16	6
Gain on disposals of property, plant and equipment	1,280			1,280	1,279,608	1,280	0	
Income before income taxes	118,862	232	0	118,631	88,546,241	88,546	30,085	
Income tax expense	3,123			3,123	3,122,853	3,123	0	
Net income and comprehensive income	115,739	232	0	115,508	85,423,388	85,423	30,085	

Toronto Hydro-Electric System Limited
Statements of Net Income and Comprehensive Income
Year ended December 31, 2013

Notes:

Note 1: Difference in "Sale of electricity" of (\$65,238): Calculated Audited Financial Statement (AFS) Regulated balance of (\$3,145,455) & RRR balance of (\$3,080,217), a difference of (\$65,238), as follows:

a. A "Smart meter recovery" regulatory asset (RA) was booked for AFS, with the offsetting entry to Distribution revenue. This is not considered a regulatory asset for purposes of RRR reporting, and the RA and related distribution revenue have been reversed for RRR reporting:	-\$25,230
b. For RRR Reporting, THESL booked to "Cost of Power revenue" and "COP expense" the amount of the IESO settlement invoices charge type 142, in the amounts of \$33,346 and (\$33,346), respectively.	-\$33,346
For the AFS, THESL does not book IESO settlement invoices charge type 142 to either COP revenue or COP expense.	
c. An Incremental Capital Model (ICM) revenue contra account Regulatory Asset (RA) was booked for the AFS, with an offsetting entry to Distribution revenue. This is not considered a regulatory asset for purposes of RRR reporting. The RA and related Distribution revenue have been reversed for RRR reporting:	-\$6,706
d. For RRR reporting, THESL has written-off to Distribution revenue a credit amount of \$44, which was included in regulatory liabilities in the AFS. The amount does not represent a regulatory liability for RRR reporting:	\$44
Total difference:	<u>-\$65,238</u>

Note 2: Difference in "Other income" of (\$8,240): Calculated AFS Regulated balance of (\$36,042) & RRR balance of (\$27,802), a difference of (\$8,240), as follows:

a. Demand Billable Charges: As per USGAAP, THESL booked demand billable charges on a gross basis while for RRR it is reported on a net basis:	-\$12,194
b. Smart Metering Entity charge: As per USGAAP, THESL books the Smart Metering entity revenue and charge on a net basis, while for RRR it is booked on a gross basis, in the prescribed regulatory accounts 4076 "Billed Smart Metering Entity Charge" and 4751 "Charges Smart Metering Entity Charge":	\$3,954
Total difference:	<u>-\$8,240</u>

Note 3: Difference in "Purchased power" of \$33,346: Calculated AFS Regulated balance of \$2,567,512 & RRR balance of \$2,534,165 a difference of \$33,346, as follows:

a. For RRR Reporting we booked to "Cost of Power revenue" and "COP expense" the amount of the IESO settlement invoices charge type 142, in the amounts of \$33,346 and (\$33,346), respectively.	
For the AFS, THESL does not book IESO settlement invoices charge type 142 to either COP revenue or COP expense:	<u>\$33,346</u>

Note 4: Difference in "Operating expenses" of \$8,240: Calculated AFS Regulated balance of \$258,416 and RRR balance of \$250,176, a difference of \$8,240, as follows:

a. Demand Billable Charges: As per USGAAP, THESL booked demand billable charges on a gross basis while for RRR it is reported on a net basis:	\$12,194
b. Smart Metering Entity charge: As per USGAAP, THESL books the Smart Metering entity revenue and charge on a net basis, while for RRR it is booked on a gross basis, in the prescribed regulatory accounts 4076 "Billed Smart Metering Entity Charge" and 4751 "Charges Smart Metering Entity Charge":	-\$3,954
Total difference:	<u>\$8,240</u>

Note 5: Difference in "Depreciation and amortization" of \$1,792: Calculated AFS Regulated balance of \$169,487 & RRR balance of \$167,695, a difference of \$1,792, as follows:

a. An Incremental Capital Model (ICM) depreciation contra account Regulatory Asset (RA) was booked for the AFS, with an offsetting entry to Depreciation expense. This is not considered a regulatory asset for purposes of RRR reporting. The RA and related depreciation expense have been reversed for RRR reporting:	<u>\$1,792</u>
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Note 6: Difference in "Net Financing Charges" of \$16: Calculated AFS Regulated balance of \$68,731 & RRR balance of \$68,715, a difference of \$16, as follows:

a. HST Contra account adjustment: In prior years' AFS, THESL has booked to the OEB account 1592, "PILS and Tax Variances for 2006 and Subsequent Years, Sub-account HST / OVAT Input Tax credits (ITCs)" the ITC savings arising from the elimination of Provincial Sales Tax and implementation of the HST on July 1, 2010.	<u>\$16</u>
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For AFS purposes, the offsetting entry was booked to the income statement rather the regulatory sub-account established, a contra account within Account 1592, "PILS and Tax Variances for 2006 and subsequent years - HST/OVAT Contra Account" of Account 1592.

The following adjustment has been made to the AFS to reflect for RRR Reporting the amount in the above mentioned contra account:

The adjustment entry is, HST/OVAT Contra Account (Dr.) \$1,150k, Misc. Interest (Cr.) \$16k and Retained Earnings (Cr.) 1,134k.



MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE
THREE MONTHS AND YEARS ENDED
DECEMBER 31, 2013 AND 2012

Executive Summary

- Net income for the three months and year ended December 31, 2013 was \$29.2 million and \$121.2 million, compared to net income of \$22.8 million and \$86.0 million for the comparable periods in 2012;
- capital expenditures were primarily related to the renewal of the electricity infrastructure of LDC and were \$151.6 million and \$450.3 million for the three months and year ended December 31, 2013, compared to \$108.5 million and \$292.4 million for the comparable periods in 2012;
- on December 19, 2013, the OEB approved a settlement agreement filed by LDC to allow for the entirety of LDC's requested 2014 capital program;
- on January 16, 2014, the OEB approved LDC's requested disposition of the smart meter deferral account balances, permitting the recovery of \$23.9 million and \$9.6 million through two separate rate riders effective May 1, 2014;
- in December 2013, the Ice Storm caused damage to the above-ground infrastructure of the Corporation's electricity distribution system resulting in power outages throughout the City;
- on May 22, 2013, the Corporation celebrated the official groundbreaking at Copeland Station, and construction continued during the year;
- on December 17, 2013, the Corporation launched a commercial paper program allowing up to \$400.0 million of unsecured short-term promissory notes to be issued in various maturities of no more than one year; and
- on April 9, 2013, the Corporation issued \$250.0 million of 2.91% senior unsecured debentures due April 10, 2023 ("Series 8") and \$200.0 million of 3.96% senior unsecured debentures due April 9, 2063 ("Series 9"). The net proceeds of the above debentures, together with borrowings under the Corporation's revolving credit facility, were used to repay the Corporation's \$225.0 million of 6.11% senior unsecured debentures ("Series 1") and \$245.1 million of 6.11% senior unsecured debentures ("Series 5") which matured on May 7, 2013 and May 6, 2013, respectively.

Introduction

The following MD&A should be read in conjunction with:

- the audited consolidated financial statements and accompanying notes of the Corporation as at and for the years ended December 31, 2013 and 2012 (the "Consolidated Financial Statements"); and
- the audited consolidated financial statements and accompanying notes of the Corporation as at and for the years ended December 31, 2012 and 2011.

Copies of these documents are available on the System for Electronic Document Analysis and Retrieval website at www.sedar.com.

The Corporation's above noted annual consolidated financial statements have been prepared in accordance with US GAAP and are presented in Canadian dollars (see "Significant Accounting Policies" below). The OSC granted an exemption to allow the Corporation to file financial statements under US GAAP for the years commencing on or after January 1, 2012 but before January 1, 2015.

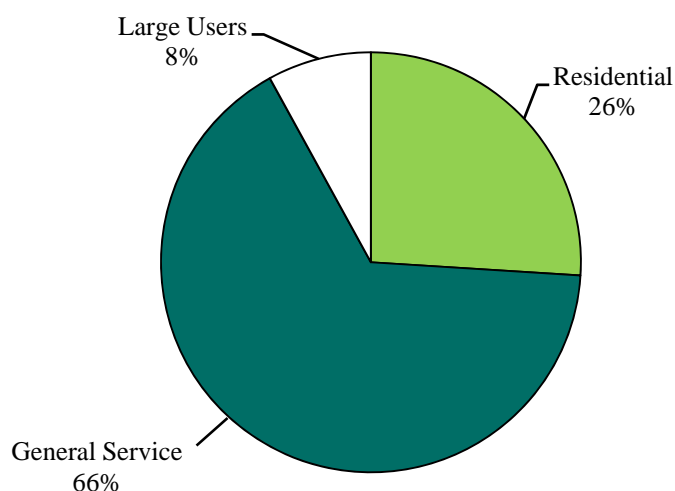
Business of Toronto Hydro Corporation

The Corporation is a holding company which wholly owns two subsidiaries:

- LDC - which distributes electricity and engages in CDM activities; and
- TH Energy - which provides street lighting services.

The principal business of the Corporation and its subsidiaries is the distribution of electricity by LDC. LDC owns and operates an electricity distribution system, which delivers electricity to approximately 730,000 customers located in the City. The City is the sole shareholder of the Corporation. LDC is the largest municipal electricity distribution company in Canada and distributes approximately 18% of the electricity consumed in Ontario. The business of LDC is regulated by the OEB, which has broad powers relating to licensing, standards of conduct and service, and the regulation of electricity distribution rates charged by LDC and other electricity distributors in Ontario. For the year ended December 31, 2013, LDC earned electricity revenues of \$3,145.5 million. As illustrated in the accompanying chart, 66% of the revenues were earned from general service users¹, 26% from residential service users², and 8% from large users³.

LDC Electricity Revenues by Class %
Year Ended December 31, 2013



¹ "General Service" means a service supplied to premises other than those receiving "Residential Service" and "Large Users" and typically includes small businesses and bulk-metered multi-unit residential establishments. This service is provided to customers with a monthly peak demand of 5,000 kW or less averaged over a twelve-month period.

² "Residential Service" means a service that is for domestic or household purposes, including single family or individually metered multi-family units and seasonal occupancy.

³ "Large Users" means a service provided to a customer with a monthly peak demand of 5,000 kW or more averaged over a twelve-month period.

Electricity Distribution – Industry Overview

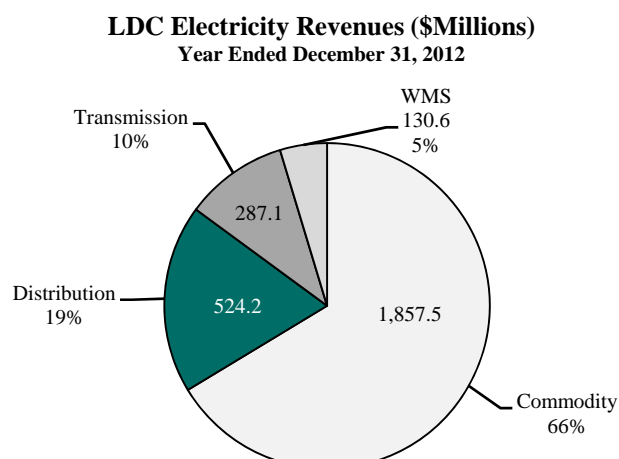
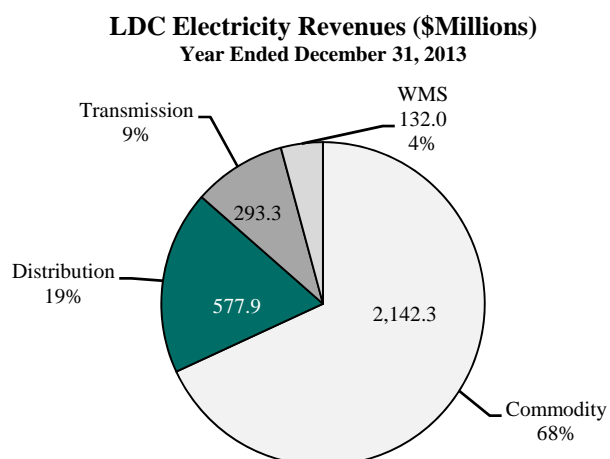
In April 1999, the Government of Ontario began restructuring Ontario's electricity industry. Under regulations passed pursuant to the restructuring, LDC and other electricity distributors purchase electricity from the wholesale market administered by the IESO and recover the costs of electricity and certain other costs at a later date in accordance with procedures mandated by the OEB.

The OEB has regulatory oversight of electricity matters in Ontario. The OEB Act sets out the OEB's authority to issue a distribution licence that must be obtained by owners or operators of an electricity distribution system in Ontario. The OEB prescribes licence requirements and conditions including, among other things, specified accounting records, regulatory accounting principles, separation of accounts for distribution and other activities, and requirements for rate-setting and other legal filings.

The OEB's authority and responsibilities include the power to approve and fix rates for the transmission and distribution of electricity, the responsibility to provide rate protection for rural or remote electricity customers, and the responsibility for ensuring that electricity distribution companies fulfill their obligations to connect and service customers.

LDC is required to charge its customers for the following amounts (all of which, other than distribution rates, represent a pass-through of amounts payable to third parties):

- *Commodity Charge* – The commodity charge represents the market price of electricity consumed by customers and is passed through the IESO to operators of generating stations. It includes the global adjustment, which represents the difference between the market price of electricity and the rates paid to regulated and contracted generators.
- *Retail Transmission Rate* – The retail transmission rate represents the costs incurred in respect of the transmission of electricity from generating stations to local distribution networks. Retail transmission rates are passed through to operators of transmission facilities.
- *WMS Charge* – The WMS charge represents various wholesale market support costs, such as the cost of the IESO to administer the wholesale electricity system, operate the electricity market, and maintain reliable operation of the provincial grid. Wholesale charges are passed through to the IESO.
- *Distribution Rate* – The distribution rate is designed to recover the costs incurred by LDC in delivering electricity to customers, including the OEB-allowed cost of capital. Distribution rates are regulated by the OEB and are comprised of fixed and variable (usage-based) components, based on a forecast of LDC's customers and load.



The electricity revenues for the year ended December 31, 2013 were \$3,145.5 million compared to \$2,799.4 million for the comparable period in 2012. The increase in electricity revenues for the year ended December 31, 2013 was primarily due to an increase in the commodity charges by the IESO related to higher global adjustment and average energy prices in 2013 compared to 2012 (\$284.8 million) and an increase in LDC's distribution revenue for 2013 (\$53.7 million) (see "Net Revenues" below in the section entitled "Results of Operations – 2013 compared to 2012").

LDC is required to satisfy and maintain prudential requirements with the IESO, which include credit support with respect to outstanding market obligations in the form of letters of credit, cash deposits or guarantees from third parties with prescribed credit ratings.

The Corporation is exempt from tax under the ITA if not less than 90% of the capital of the Corporation is owned by the City and not more than 10% of the income of the Corporation is derived from activities carried on outside the municipal geographical boundaries of the City. In addition, the Corporation's subsidiaries are also exempt from tax under the ITA provided that all of their capital is owned by the Corporation and not more than 10% of their respective income is from activities carried on outside the municipal geographical boundaries of the City. A corporation exempt from tax under the ITA is also exempt from tax under the TA.

The Corporation and each of its subsidiaries are MEUs for purposes of the PILs regime contained in the Electricity Act. The Electricity Act provides that a MEU that is exempt from tax under the ITA and the TA is required to make, for each taxation year, a PILs payment to the Ontario Electricity Financial Corporation in an amount equal to the tax that it would be liable to pay under the ITA and the TA if it were not exempt from tax. The PILs regime came into effect on October 1, 2001, at which time the Corporation and each of its subsidiaries were deemed to have commenced a new taxation year for purposes of determining their respective liabilities for PILs payments.

Corporate Strategy

The Corporation's vision is to "continuously maximize customer and stakeholders' satisfaction by being safe, reliable and environmentally responsible at optimal costs". The Corporation has an ERM framework that helps determine whether the Corporation is well positioned to achieve its strategic objectives. The ERM framework provides a consistent, disciplined methodology for controlling risk by identifying, assessing, managing, monitoring and reporting risks for the Corporation.

The Corporation is focused on the following four strategic pillars:

People – the Corporation aims to maintain an engaged, healthy, productive, and safe workforce to meet changing business requirements, as it strives to:

- Provide a healthy and safe workplace
- Develop a skilled and knowledgeable workforce
- Keep its workforce engaged

The Corporation will continue to strengthen its already strong safety culture through various internal initiatives in order to achieve world-class results. The Corporation is committed to employee safety and will remain persistent in its efforts to mitigate the risk of injury to its workforce. This will be accomplished through ongoing safety inspections, audits, annual policy review and the continuation of the safety programs and standards. The Corporation will continue to use the internal responsibility system to reinforce the importance of safety in the workplace.

Financial – the Corporation aims to meet the financial objectives of its shareholder, as it strives to:

- Provide a fair return to the shareholder
- Continue to increase shareholder value

The Corporation has provided its shareholder with an annual increase in economic value over the last decade. To meet financial objectives of the shareholder, the Corporation seeks to increase shareholder value and is committed to provide a fair return to its shareholder in the future. Along with excellence in corporate financing and financial management, the Corporation will strive to maintain an investment grade credit rating.

Operations – the Corporation aims to improve reliability through sustainable system management, as it strives to:

- Keep the lights on
- Keep the system safe
- Build a grid that supports a modern Toronto

The Corporation is engaging in resource and capital-intensive programs to improve capacity, reliability and quality. The capital program will replace aging assets and accommodate next generation technology to suit the regulatory trends that incent the increased use of distributed generation.

Customer – the Corporation aims to provide value to customers, as it strives to:

- Make it easy to work with
- Help conserve energy
- Provide innovative tools and technology

The Corporation is looking at ways to improve the level of satisfaction that customers experience, whether it is through education and awareness programs, interaction with call centre representatives, their account managers or over the internet. The Corporation continues to undertake initiatives and invest in technology and processes to improve the customer experience. In turn, this focus on customer service will provide long-term value for money.

Performance Measurement

The Corporation measures its performance in relation to the achievement of its strategic objectives by using a balanced scorecard approach. KPIs are monitored throughout the year and appropriate actions are taken as required. The definitions of the 2013 KPIs associated with the previously mentioned four strategic pillars are as follows:

Strategic Pillars	Performance Measure	Definition
People	Safety	<ul style="list-style-type: none"> Number of recordable injuries x 200,000 / exposure hours.
	Employee Engagement	<ul style="list-style-type: none"> Average number of employee engagement sessions per employee per year, including corporate-wide, divisional and departmental.
Financial	Net Income	<ul style="list-style-type: none"> Net income per the Corporation's consolidated financial statements.
Operations	System Average Interruption Duration Index	<ul style="list-style-type: none"> Measure of the annual system average interruption duration per customers served, not including MED.
	System Average Interruption Frequency Index	<ul style="list-style-type: none"> Measure of the frequency of service interruptions per customers served, not including MED.
	Worst Performing Feeders	<ul style="list-style-type: none"> Total number of feeders experiencing seven or more sustained outages in a year, with outages defined as interruptions greater than one minute.
	LDC Regulated Capital	<ul style="list-style-type: none"> Achievement of LDC capital work program as approved by the Board of Directors.
Customer	Conservation Demand Management	<ul style="list-style-type: none"> Annual summer peak demand savings through year over year megawatt reduction.
	Enhanced Customer Engagement	<ul style="list-style-type: none"> Increase in customer self-serve transactions / engagements using various self-serve options.
	Call Centre Service Response	<ul style="list-style-type: none"> Average of call centre responses within thirty seconds.

Capability to Deliver Results

The Corporation strives to manage its performance and deliver results. In 2013, the Corporation exceeded all of its corporate and divisional objectives represented by its KPIs. The Corporation's ability to deliver results in each of its strategic pillars is limited by risks inherent in its regulatory environment, business, workforce and in the economic environment. These risks are discussed under the section "Risk Management and Risk Factors" in this MD&A.

Selected Consolidated Financial Data

Consolidated Statements of Net Income and Comprehensive Income Three months ended December 31 (in thousands of Canadian dollars, except for per share amounts, unaudited)

	2013 \$	2012 \$	Change \$	2011 ¹ \$
Revenues	819,669	691,847	127,822	694,284
Costs				
Purchased power	627,015	551,267	75,748	542,510
Operating expenses	79,319	65,107	14,212	66,880
Depreciation and amortization	66,631	35,900	30,731	43,984
	772,965	652,274	120,691	653,374
Income before the following:	46,704	39,573	7,131	40,910
Net financing charges	(15,074)	(18,640)	3,566	(19,506)
Gain on disposals of PP&E	162	1,805	(1,643)	(1,135)
Income before income taxes	31,792	22,738	9,054	20,269
Income tax expense (recovery)	2,572	(104)	2,676	3,041
Net income and comprehensive income	29,220	22,842	6,378	17,228
Basic and fully diluted net income per share	29,220	22,842	6,378	17,228

¹ The Corporation's consolidated financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. Selected financial information from comparative consolidated financial statements for 2011 have been adjusted retroactively from the consolidated financial statements previously filed to conform to the presentation of the Corporation's 2012 and 2013 consolidated financial statements prepared in accordance with US GAAP.

Consolidated Statements of Net Income and Comprehensive Income
Year ended December 31
(in thousands of Canadian dollars, except for per share amounts)

	2013	2012	Change	2011¹
	\$	\$	\$	\$
Revenues	3,202,793	2,852,477	350,316	2,823,470
Costs				
Purchased power	2,567,512	2,275,209	292,303	2,236,541
Operating expenses	271,958	245,173	26,785	262,241
Depreciation and amortization	172,756	141,572	31,184	151,022
	3,012,226	2,661,954	350,272	2,649,804
Income before the following:	190,567	190,523	44	173,666
Net financing charges	(66,273)	(73,977)	7,704	(75,324)
Gain on disposals of PP&E	1,280	1,805	(525)	3,885
Restructuring costs	-	(27,796)	27,796	-
Income before income taxes	125,574	90,555	35,019	102,227
Income tax expense	4,333	4,565	(232)	6,295
Net income and comprehensive income	121,241	85,990	35,251	95,932
Basic and fully diluted net income per share	121,241	85,990	35,251	95,932

¹ The Corporation's consolidated financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. Selected financial information from comparative consolidated financial statements for 2011 have been adjusted retroactively from the consolidated financial statements previously filed to conform to the presentation of the Corporation's 2012 and 2013 consolidated financial statements prepared in accordance with US GAAP.

Condensed Consolidated Balance Sheet Data
(in thousands of Canadian dollars)

	As at December 31 2013 \$	As at December 31 2012 \$
Current assets	555,314	552,292
Non-current assets	3,242,217	2,987,062
Total assets	3,797,531	3,539,354
Current liabilities	696,417	937,514
Non-current liabilities	1,882,596	1,461,568
Total liabilities	2,579,013	2,399,082
Shareholder's equity	1,218,518	1,140,272
Total liabilities and shareholder's equity	3,797,531	3,539,354

Results of Operations – 2013 compared to 2012

Net Income

Net income for the three months and year ended December 31, 2013 was \$29.2 million and \$121.2 million compared to \$22.8 million and \$86.0 million for the comparable periods in 2012.

The increase in net income for the three months ended December 31, 2013 was primarily due to higher net revenues (\$52.1 million) and lower net financing charges (\$3.6 million). These favourable variances were partially offset by a higher depreciation expense (\$30.7 million), higher operating expenses (\$14.2 million), a higher income tax expense (\$2.7 million), and lower gains on disposals of surplus properties (\$1.6 million).

The increase in net income for the year ended December 31, 2013 was primarily due to higher net revenues (\$58.0 million), restructuring costs recognized in the first quarter of 2012 (\$27.8 million) related to the cost reduction initiatives at LDC (see “Restructuring Costs” below), lower net financing charges (\$7.7 million), and lower income tax expense (\$0.2 million). These favourable variances were partially offset by a higher depreciation expense (\$31.2 million), higher operating expenses (\$26.8 million), and lower gains on disposals of surplus properties (\$0.5 million).

Ice Storm

In December 2013, the Ice Storm caused damage to the above-ground infrastructure of the Corporation's electricity distribution system. Approximately 300,000 customers lost power for periods of up to eight days, though strenuous efforts resulted in 75% power restoration within 48 hours. As a result, the Corporation 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, of which \$3.6 million were capitalized to PP&E and \$10.2 million were charged to operating expenses. In addition, potential distribution revenue of approximately \$0.9 million was lost due to the power outage. The Corporation decided not to file a special application with the OEB to seek recovery of incremental operating expenses for the Ice Storm as it was able to absorb the impact from other favourable variances.

Smart Meters

On August 1, 2013, LDC filed an application with the OEB requesting approval for the disposition of balances in its smart meter deferral account related to smart meter installations in 2008, 2009 and 2010, and incremental revenue related to these assets. On January 16, 2014, the OEB approved LDC's request for incremental revenue and disposition of the smart meter deferral account balances.

The OEB ruling on smart meters also permitted the recovery in principle of LDC's allowed cost of capital on smart meters since 2008, with a rate order issued to this effect. Accordingly, a new regulatory asset of \$25.2 million has been created to reflect the future amount to be recovered through rates, with a related amount recorded in revenue. For the year ended December 31, 2013, LDC ceased to defer operating and depreciation expenses related to the deployment of the 2008 to 2010 smart meters and recognized revenues as approved by the OEB, resulting in a decrease in the smart meters regulatory asset of \$25.0 million, an increase in PP&E of \$45.7 million, an increase in intangible assets of \$1.1 million, an increase in revenues of \$57.5 million, an increase in operating expenses of \$7.1 million, and an increase in depreciation and amortization expenses of \$28.7 million. See note 9 (c) to the Consolidated Financial Statements for further details.

Net Revenues

Net revenues for the three months and year ended December 31, 2013 were \$192.7 million and \$635.3 million compared to \$140.6 million and \$577.3 million for the comparable periods in 2012 (see “Non-GAAP Financial Measures” below).

The increase in net revenues for the three months ended December 31, 2013 was primarily due to higher regulated distribution revenue at LDC (\$47.9 million) and higher other income (\$4.2 million). The increase in distribution revenue was primarily due to revenue recognition related to the disposition of the 2008-2010 smart meter deferral account balances (\$57.5 million) (see “Smart Meters” above), revenue recognition related to the IRM adjustment and the eligible in-service capital expenditures under ICM (\$5.1 million), and higher consumption in the fourth quarter of 2013 (\$3.7 million). These variances were partially offset by a reduction in distribution revenue related to

the revision of prior year tax positions based on reassessments received and in process, not reflected in applications for electricity distribution rates resulting in an over-recovery of PILs from customers (\$19.4 million). The increase in other income for the three months ended December 31, 2013 was primarily due to higher revenue in connection with disposal of scrap material, solar panel installation, and duct rental fees.

The increase in net revenues for the year ended December 31, 2013 was primarily due to higher regulated distribution revenue at LDC (\$53.7 million) and higher other income (\$4.3 million). The increase in distribution revenue was primarily due to revenue recognition related to the disposition of the 2008-2010 smart meter deferral account balances (\$57.5 million) (see "Smart Meters" above), revenue recognition related to the IRM adjustment and the eligible in-service capital expenditures under ICM (\$8.2 million), and an unfavourable revenue adjustment recorded in 2012 for PILs variances accumulated in regulatory variance accounts (\$4.8 million). These variances were partially offset by a reduction in distribution revenue related to the revision of prior year tax positions based on reassessments received and in process, not reflected in applications for electricity distribution rates resulting in an over-recovery of PILs from customers (\$19.4 million). The increase in other income for the year ended December 31, 2013 was primarily due to higher revenue in connection with disposal of scrap material, solar panel installation, and duct rental fees.

Expenses

Operating expenses for the three months and year ended December 31, 2013 were \$79.3 million and \$272.0 million compared to \$65.1 million and \$245.2 million for the comparable periods in 2012.

The increase in operating expenses for the three months ended December 31, 2013 was primarily due to the cost of power restoration incurred in 2013 as a result of the Ice Storm that adversely affected the City (\$10.2 million) and the recognition of operating expenses related to the disposition of the 2008-2010 smart meter deferral account balances (\$7.1 million) (see "Smart Meters" above). These variances were partially offset by lower costs associated with street lighting maintenance and customer demand billable work (\$2.7 million).

The increase in operating expenses for the year ended December 31, 2013 was primarily due to the cost of power restoration incurred in 2013 as a result of the Ice Storm that adversely affected the City (\$10.2 million), a favourable reassessment for payments in lieu of property taxes to the Ministry of Finance of Ontario recorded in the second quarter of 2012 (\$8.7 million), and the recognition of operating expenses related to the disposition of the 2008-2010 smart meter deferral account balances (\$7.1 million) (see "Smart Meters" above).

Depreciation and amortization expense for the three months and year ended December 31, 2013 was \$66.6 million and \$172.8 million compared to \$35.9 million and \$141.6 million for the comparable periods in 2012.

The increase in depreciation and amortization expense for the three months and year ended December 31, 2013 was primarily due to the recognition of depreciation and amortization expenses related to the disposition of the 2008-2010 smart meter deferral account balances (\$28.7 million) (see "Smart Meters" above).

Net Financing Charges

Net financing charges for the three months and year ended December 31, 2013 were \$15.1 million and \$66.3 million compared to \$18.6 million and \$74.0 million for the comparable periods in 2012.

The decrease in net financing charges for the three months and year ended December 31, 2013 was primarily due to the refinancing of maturing debentures at a lower interest rate in the second quarter of 2013.

Gain on Disposals of PP&E

Gain on disposals of PP&E for the three months and year ended December 31, 2013 were \$0.2 million and \$1.3 million compared to \$1.8 million and \$1.8 million for the comparable periods in 2012.

The decrease in gain on disposals of PP&E for the three months and year ended December 31, 2013 was primarily due to a lower gain realized in connection with the disposals of surplus properties at LDC in 2013.

Restructuring Costs

In the first quarter of 2012, the Corporation's Board of Directors approved a workforce restructuring program aimed at reducing operating expenditures for LDC. The program was approved following the decision by the OEB to deny

the request of LDC to set its electricity distribution rates for 2012, 2013 and 2014 under the cost of service framework. In preparing its revised application using the IRM framework, LDC concluded that significant cost reductions were necessary to manage its business within the confines of the expected allowed electricity distribution rates provided by the IRM framework. The main component of these operating cost reduction initiatives was a workforce restructuring program, which included the severance of management employees and a voluntary exit incentive program for targeted unionized positions.

Restructuring costs for the year ended December 31, 2013 were \$nil compared to \$27.8 million for the comparable period in 2012.

Income Tax Expense (Recovery)

Income tax expense for the three months and year ended December 31, 2013 was \$2.6 million and \$4.3 million compared to an income tax recovery of \$0.1 million and an income tax expense of \$4.6 million for the comparable periods in 2012.

The increase in income tax expense for the three months ended December 31, 2013 was due to higher income before taxes.

The decrease in income tax expense for the year ended December 31, 2013 was due to higher deductions for permanent and temporary differences between accounting and tax treatments (\$4.6 million) and favourable resolution of issues identified in prior periods and related reassessments by the Ministry of Finance of Ontario (\$4.9 million). These variances were partially offset by higher income before taxes (\$9.3 million).

Results of Operations – 2012 compared to 2011

Net income was \$86.0 million in 2012 compared to \$95.9 million in 2011. The decrease in net income was primarily due to restructuring costs recognized in the first quarter of 2012 (\$27.8 million) related to the cost reduction initiatives at LDC, lower net revenues (\$9.7 million), and lower gains on disposals of surplus properties (\$2.1 million). These unfavourable variances were partially offset by lower operating expenses (\$17.1 million), lower depreciation expense (\$9.5 million), lower income tax expense (\$1.7 million), and lower net financing charges (\$1.3 million). For further details, see “Selected Consolidated Financial Data” above and the Corporation’s 2012 annual MD&A as filed on the System for Electronic Document Analysis and Retrieval website at www.sedar.com.

Quarterly Results of Operations

The table below presents unaudited quarterly consolidated financial information of the Corporation for 2013 and 2012, which has been prepared in accordance with US GAAP.

Quarterly Results of Operations (in thousands of Canadian dollars, unaudited)				
	December 31 2013 \$	September 30 2013 \$	June 30 2013 \$	March 31 2013 \$
Revenues	819,669	833,339	792,905	756,880
Costs	772,965	778,240	743,934	717,087
Net income	29,220	35,885	37,555	18,581
	December 31 2012 \$	September 30 2012 \$	June 30 2012 \$	March 31 2012 \$
Revenues	691,847	751,270	709,700	699,660
Costs	652,274	693,809	649,831	666,040
Net income (loss)	22,842	34,436	41,538	(12,826)

The Corporation's quarterly results are impacted by changes in revenues resulting from variations in seasonal weather conditions, the fluctuations in electricity prices, and the timing and recognition of regulatory decisions. Consequently, the Corporation's revenues, all other things being equal, would tend to be higher in the first quarter as a result of higher energy consumption for winter heating, and in the third quarter due to air conditioning/cooling. A variation in the above trend was noted in 2013 and 2012, evidenced by higher revenue and cost of purchased power in the second quarters of both years, compared to the first quarters of both years. This variation was primarily due to an increase in commodity costs (see "Electricity Distribution – Industry Overview" above).

Financial Position

The following table outlines the significant changes in the consolidated balance sheets as at December 31, 2013 as compared to the consolidated balance sheets as at December 31, 2012.

Consolidated Balance Sheet Data (in thousands of Canadian dollars)		
Balance Sheet Account	Increase (Decrease) \$	Explanation of Significant Change
Assets		
Cash and cash equivalents	(76,592)	See "Liquidity and Capital Resources" below.
Accounts receivable, net of allowance for doubtful accounts	27,555	The increase was primarily due to the timing of billing and collection activities from electricity customers.
Unbilled revenue	48,786	The increase was primarily due to higher pass-through electricity commodity costs and higher consumption in December 2013 compared to December 2012.
Income tax receivable	(7,315)	The decrease was due to a favourable change in prior year reassessments received and in process.
PP&E and intangible assets, net	175,107	The increase was primarily due to the 2013 capital program expenditures and the disposition of the 2008-2010 smart meter deferral account balances (see "Smart Meters" above in the section entitled "Results of Operations – 2013 compared to 2012"), partially offset by depreciation during the period and net eligible in-service capital expenditures under ICM reclassified to regulatory assets per the direction from the OEB.
Regulatory assets	120,270	The increase was primarily due to the reclassification of ICM-related net eligible in-service capital expenditures, partially offset by the net impact of the disposition of the 2008-2010 smart meter deferral account balances (see "Smart Meters" above in the section entitled "Results of Operations – 2013 compared to 2012").

Consolidated Balance Sheet Data
(in thousands of Canadian dollars)

Balance Sheet Account	Increase (Decrease) \$	Explanation of Significant Change
Deferred income tax assets	(36,713)	The decrease was due to lower net deductible temporary differences between tax and accounting values of PP&E.
Liabilities and Shareholder's Equity		
Working capital facility	19,084	The increase was due to funds drawn under the Corporation's working capital facility (see "Liquidity and Capital Resources" below).
Commercial paper	150,000	The increase was due to funds drawn under the Corporation's commercial paper program (see "Liquidity and Capital Resources" below).
Accounts payable and accrued liabilities	73,379	The increase was primarily due to higher electricity commodity costs payable to the IESO, higher capital programs, and the costs related to the Ice Storm (see "Ice Storm" above in the section entitled "Results of Operations – 2013 compared to 2012").
Restructuring accrual	(11,954)	The decrease was due to payments made against the restructuring accrual related to the workforce restructuring program initiated by the Corporation in the first quarter of 2012.
Debentures	(20,258)	The decrease was due to the repayment of \$470.1 million senior unsecured debentures, offset by the issuance of \$450.0 million senior unsecured debentures during the second quarter of 2013 (see "Liquidity and Capital Resources" below).
Post-retirement benefits	(15,098)	The decrease was primarily due to the actuarial gain recorded in 2013.
Regulatory liabilities	(13,676)	The decrease was primarily due to lower income tax payable to customers in the future.
Retained earnings	78,246	The increase in retained earnings was due to net income for the year (\$121.2 million), partially offset by dividends paid (\$43.0 million).

Liquidity and Capital Resources

Sources of Liquidity and Capital Resources

The Corporation's current assets and current liabilities amounted to \$555.3 million and \$696.4 million, respectively, as at December 31, 2013, resulting in a working capital deficit of \$141.1 million. The deficit is due to the

Corporation's decision to utilize its commercial paper program and revolving credit facility in lieu of issuing additional debentures to fulfill the Corporation's liquidity requirements, including funding significant capital spending in the current year.

The Corporation's primary sources of liquidity and capital resources are cash provided by operating activities, issuances of commercial paper, amounts available to be drawn against its credit facilities, and borrowings from debt capital markets. The Corporation's liquidity and capital resource requirements are mainly for capital expenditures to maintain and improve the electricity distribution system of LDC, to purchase power, to meet financing obligations and for prudential requirements.

The Corporation does not believe that equity contributions from the City, its sole shareholder, will constitute a source of capital.

The City has authorized the Corporation to provide financial assistance to its subsidiaries, and LDC to provide financial assistance to other subsidiaries of the Corporation, in the form of guarantees, letters of credit, direct loans or otherwise, for the purpose of enabling them to carry on their businesses, with financial assistance provided to subsidiaries other than LDC not to exceed an aggregate amount of \$500.0 million.

On December 17, 2013, the Corporation launched a commercial paper program allowing up to \$400.0 million of unsecured short-term promissory notes to be issued in various maturities of no more than one year. The commercial paper program is supported by liquidity facilities available under the Corporation's revolving credit facility; hence, available borrowing under its revolving credit facility is reduced by the amount of commercial paper outstanding at any point in time. Proceeds from the commercial paper program are being used for general corporate purposes. For the three months ended December 31, 2013, the average outstanding borrowing under the commercial paper program was \$33.5 million with a weighted average interest rate of 1.21%. Borrowings under the commercial paper program bear interest based on the prevailing market conditions at the time of issuance.

On September 6, 2013, the Corporation extended the maturity date of its \$600.0 million revolving credit facility from October 10, 2017 to October 10, 2018. Borrowings under the revolving credit facility bear interest at short-term floating rates with reference to the Corporation's credit rating.

As at December 31, 2013, no amounts had been drawn under the revolving credit facility and \$19.1 million had been drawn under the \$20.0 million working capital facility. As at December 31, 2013, \$50.1 million of letters of credit had been issued against the \$75.0 million prudential facility. For the three months and the year ended December 31, 2013, the average outstanding borrowings on the Corporation's credit facilities, excluding the prudential facility and commercial paper, were \$69.2 million and \$59.2 million with weighted average interest rates of 1.81% and 2.09 %, respectively. The revolving credit facility, the working capital facility, and the prudential credit facility are summarized in note 11 to the Consolidated Financial Statements.

The Corporation filed a base shelf prospectus dated December 10, 2012 with the securities commissions or similar regulatory authorities in each of the provinces of Canada. These filings allow the Corporation to make offerings of unsecured debt securities of up to \$1,500.0 million during the 25-month period following the date of the prospectus.

On April 9, 2013, the Corporation issued Series 8 (\$250.0 million) and Series 9 (\$200.0 million) debentures, which bear interest payable semi-annually in arrears and contain covenants which, subject to certain exceptions, restrict the ability of the Corporation and LDC to create security interests, incur additional indebtedness or dispose of all or substantially all of their assets. The Corporation may redeem all or part of the Series 8 and Series 9 debentures at any time prior to maturity at a price equal to the greater of the Canada Yield Price (determined in accordance with the terms of the debentures) and par, plus accrued and unpaid interest up to and excluding the date fixed for redemption. The net proceeds of the debentures, together with borrowings under the Corporation's revolving credit facility, were used to repay the Corporation's Series 1 and Series 5 debentures which matured on May 7, 2013 and May 6, 2013, respectively. Debt issuance costs of \$2.7 million relating to the Series 8 and Series 9 debentures were deferred as other assets in the second quarter of 2013.

As at December 31, 2013, the Corporation had long-term debentures outstanding in the principal amount of \$1,450.0 million. These debentures mature between 2017 and 2063. The Corporation may issue up to \$1,050.0 million of additional debentures under the existing base shelf prospectus.

Credit Ratings
As at December 31, 2013

	Debentures	Commercial Paper
DBRS	A (high)	R-1 (low)
Standard & Poor's	A	-

The Corporation believes that it has sufficient available sources of liquidity and capital to satisfy working capital requirements for the next 12 months.

Consolidated Statements of Cash Flows
(in thousands of Canadian dollars)

	Three months		Year	
	Ended December 31		Ended December 31	
	2013	2012	2013	2012
	\$	\$	\$	\$
Cash and cash equivalents, beginning of period	-	137,323	76,592	154,256
Net cash provided by operating activities	79,602	54,925	236,123	246,729
Net cash used in investing activities	(126,857)	(104,949)	(411,652)	(265,432)
Net cash provided by (used in) financing activities	47,255	(10,707)	98,937	(58,961)
Cash and cash equivalents, end of period	-	76,592	-	76,592

Net Cash Provided by Operating Activities

Net cash provided by operating activities for the three months and year ended December 31, 2013 was \$79.6 and \$236.1 million compared to \$54.9 million and \$246.7 million for the comparable periods in 2012.

The increase in net cash provided by operating activities for the three months ended December 31, 2013 was primarily due to lower working capital and an increase in net income.

The decrease in net cash provided by operating activities for the year ended December 31, 2013 was primarily due to higher working capital, partially offset by an increase in net income.

Net Cash Used in Investing Activities

Net cash used in investing activities for the three months and year ended December 31, 2013 was \$126.9 million and \$411.7 million compared to \$104.9 million and \$265.4 million for the comparable periods in 2012.

The increase in net cash used in investing activities for the three months ended December 31, 2013 was primarily due to higher capital expenditures in 2013.

The increase in net cash used in investing activities for the year ended December 31, 2013 was primarily due to higher capital expenditures in 2013 and the sale and maturity of investments in 2012.

Electricity distribution is a capital-intensive business. As the largest municipal electricity distribution company in Canada, LDC continues to invest in rebuilding existing aging infrastructure to address safety, reliability and customer service requirements.

LDC estimates that approximately one-third of its electricity distribution assets are past their expected useful lives. As a strategic response to meet the objective of maximizing customer and stakeholder satisfaction through providing safe and reliable service, LDC is committed to maintenance and capital expenditure requirements for distribution plant refurbishment and replacement.

The following table summarizes the Corporation's capital expenditures for the periods indicated.

Capital Expenditures (in thousands of Canadian dollars)				
	Three months		Year	
	Ended December 31		Ended December 31	
	2013	2012	2013	2012
	\$	\$	\$	\$
Regulated LDC				
Distribution system				
Planned	114,060	84,545	340,347	226,609
Reactive	14,132	11,529	35,002	28,775
Copeland Station	9,515	1,834	45,320	4,065
Technology assets	7,074	7,472	17,118	23,204
Other ¹	5,676	1,788	7,874	5,922
	150,457	107,168	445,661	288,575
Other ²	1,176	1,362	4,653	3,800
Total Capital Expenditures	151,633	108,530	450,314	292,375

¹ Includes fleet capital and buildings.

² Includes unregulated capital expenditures primarily related to TH Energy equipment.

The total regulated capital expenditures were \$150.5 million and \$445.7 million for the three months and year ended December 31, 2013 compared to \$107.2 million and \$288.6 million for the comparable periods in 2012. For the year ended December 31, 2013, the increase in regulated capital expenditures was primarily related 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).

The largest capital initiatives in 2013 include the replacement of overhead infrastructure, the replacement of underground infrastructure, the delivery of customer connections, and the construction of Copeland Station in response to the developing need for distribution solutions in the downtown core of the City.

The replacement of overhead infrastructure includes replacing poles, overhead transformers, overhead switches and other aging overhead infrastructure and equipment. The replacement of underground infrastructure includes replacing direct buried cables, transformers, handwells, and other aging underground infrastructure. Both initiatives will allow LDC to continue to provide ongoing safe and reliable service to its customers. As at December 31, 2013, the year-to-date capital expenditures for the overhead and the underground infrastructure initiatives were \$78.2 million and \$65.9 million, respectively.

The delivery of customer connections includes spending related to new services and upgrades to existing services for specific commercial customers. For 2013, capital expenditures for the delivery of customer connections were \$52.0 million, net of related capital contributions received of \$23.6 million.

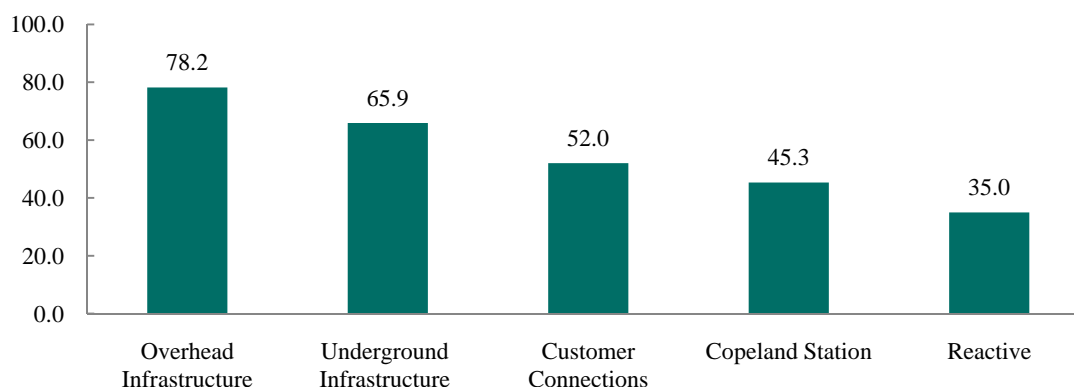
Copeland Station will be the first transformer station built in downtown Toronto since the 1960's and will be the second underground transformer station in Canada. When in service, the new station will provide electricity to buildings and neighbourhoods in the central-southwest region of Toronto. Between 2006 and 2011, the population in the City's downtown increased by over 50%, and Toronto is now the fourth largest metropolitan area⁴, by population, in North America. Copeland Station will provide much needed additional capacity to serve current and future load requirements in this high-density, high-growth area of Toronto.

On May 22, 2013, the Corporation celebrated the official groundbreaking at the station. On February 1, 2014, the tunnel boring machine arrived on-site and was being prepared to begin tunnelling north to connect the new infrastructure to the grid. As at December 31, 2013, the capital expenditures on the Copeland Station project

⁴ <http://www.toronto.ca/legdocs/mmis/2013/ed/bgrd/backgroundfile-56336.pdf>

amounted to \$60.5 million of which \$45.3 million was recorded in 2013. The total capital expenditures required to complete Copeland Station are expected to be approximately \$194.9 million. All capital expenditures related to Copeland Station are recorded to PP&E.

Most Significant Regulated Capital Expenditures
(\$ Millions)
Year ended December 31, 2013



Net Cash Provided by (Used in) Financing Activities

Net cash provided by financing activities for the three months and year ended December 31, 2013 was \$47.3 million and \$98.9 million compared to net cash used in financing activities of \$10.7 million and \$59.0 million for the comparable periods in 2012.

The increase in net cash provided by financing activities for the three months ended December 31, 2013 was primarily due to an increase in funds drawn under the Corporation's commercial paper program and working capital facility related to higher capital expenditures in 2013, partially offset by a decrease in funds drawn under the Corporation's revolving credit facility.

The increase in net cash provided by financing activities for the year ended December 31, 2013 was primarily due to funds drawn under the Corporation's commercial paper program and working capital facility related to higher capital expenditures, a decrease in customer deposits in 2012 in compliance with OEB rules and regulations, and lower dividends paid in 2013 compared to 2012. These variances were partially offset by the net effect of the payment in connection with the retirement of \$470.1 million of senior unsecured debentures and the issuance of \$450.0 million of senior unsecured debentures in the second quarter of 2013.

The shareholder direction adopted by the City with respect to the Corporation provides that the Board of Directors of the Corporation will use its best efforts to ensure that the Corporation meets certain financial performance standards, including those relating to the credit rating and dividends. Subject to applicable law, the shareholder direction provides that the Corporation will pay dividends to the City each year amounting to the greater of \$25.0 million or 50% of the Corporation's consolidated net income for the prior fiscal year. The dividends are not cumulative and are payable as follows:

- \$6.25 million on the last day of each fiscal quarter of the year; and
- the amount, if any, by which 50% of the Corporation's annual consolidated net income for the year exceeds \$25.0 million, within ten days after the approval of the Corporation's audited consolidated financial statements for the year by the Board of Directors of the Corporation.

For the year ended December 31, 2013, the Board of Directors of the Corporation declared and paid dividends totalling \$43.0 million to the City.

On March 19, 2014, the Board of Directors of the Corporation declared dividends in the amount of \$41.87 million. The dividends are comprised of \$35.62 million with respect to net income for the year ended December 31, 2013,

payable to the City on March 28, 2014, and \$6.25 million with respect to the first quarter of 2014, payable to the City on March 31, 2014.

Summary of Contractual Obligations and Other Commitments

The following table presents a summary of the Corporation's debentures, major contractual obligations and other commitments.

Summary of Contractual Obligations and Other Commitments As at December 31, 2013 (in thousands of Canadian dollars)

	Total	2014	2015/2016	2017/2018	After 2018
	\$	\$	\$	\$	\$
Working capital facility	19,084	19,084	-	-	-
Commercial paper	150,000	150,000	-	-	-
Debentures – principal repayment	1,450,000	-	-	250,000	1,200,000
Debentures – interest payments	958,583	60,995	121,990	109,115	666,483
Operating lease obligations	20,268	6,175	11,970	2,123	-
Capital project and other commitments ^{1,2}	82,569	79,797	2,772	-	-
Capital lease obligations	11,418	2,537	5,074	3,807	-
AROs	7,147	2,417	377	376	3,977
Total contractual obligations and other commitments	2,699,069	321,005	142,183	365,421	1,870,460

¹ Reflect capital project commitments for construction services and estimated capital contributions, with the majority related to Copeland Station.

² Subsequent to December 31, 2013, the Corporation entered into capital commitments of approximately \$21.0 million for capital contributions payable to Hydro One Networks Inc. over the next year in respect of Copeland Station.

Corporate Developments

Distribution Rates for LDC

Regulatory developments in Ontario's electricity industry, including current and possible future consultations between the OEB and interested stakeholders, may affect LDC's electricity distribution rates and other permitted recoveries in the future.

On May 10, 2012, LDC filed an application for electricity distribution rates for 2012, 2013, and 2014 using the IRM framework, including the filing of an ICM application (the "IRM/ICM Application").

On October 31, 2012, LDC submitted an update to its IRM/ICM Application modifying the requested capital expenditures for 2012 and 2013 to \$283.0 million and \$579.1 million, respectively, and requesting that consideration for 2014 be deferred to a second phase of the proceeding, once LDC had received a decision from the OEB in respect of phase one. On November 3, 2012, the OEB accepted LDC's request for a two-phase proceeding: phase one comprising LDC's 2012 and 2013 work program proposals and phase two comprising LDC's 2014 work program proposal.

On April 2, 2013, the OEB issued a partial decision and order for phase one of the proceeding comprising LDC's 2012 and 2013 work program proposals. The OEB's decision determined that eligible capital funding under the ICM framework was to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to \$203.3 million for 2012 and \$484.2 million for 2013. New rates became effective June 1, 2013. In 2015, LDC will be allowed to seek recovery for capital spent in 2012 and 2013 that has not yet been approved by the OEB in the current ICM decision due to the standard operation of the regulatory model.

On August 1, 2013, LDC filed an application with the OEB requesting approval for the disposition of balances in its smart meter deferral account related to smart meter installations in 2008, 2009 and 2010. In the application, LDC requested two new rate riders effective May 1, 2014. The first rate rider relates to the recovery of \$23.9 million, which represents the cumulative revenue requirement net of recoveries from an existing smart meter rate rider. This

existing smart meter rate rider would be discontinued when the new rate riders become effective. The second rate rider relates to the recovery of \$9.6 million, which represents the forecasted 2014 incremental revenue requirement until LDC may be permitted to transfer the smart meter assets into rate base.

On August 19, 2013, LDC submitted an update to its IRM/ICM Application regarding its 2014 work program proposal. The filed update incorporates the OEB's guidance on the ICM methodology provided in the April 2, 2013 partial decision and order with respect to phase one of this proceeding. In phase two, LDC sought approval for total capital expenditures amounting to \$398.8 million for 2014.

On December 18, 2013, LDC filed a settlement agreement with the OEB, which allowed for the entirety of LDC's requested 2014 capital program. On December 19, 2013, the OEB approved this settlement agreement. Consistent with the April 2, 2013 partial decision and order with respect to phase one, eligible capital funding under the ICM framework is to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to \$398.8 million for 2014.

On January 16, 2014, the OEB approved LDC's requested disposition of the smart meter deferral account balances, permitting the recovery of \$23.9 million and \$9.6 million through two separate rate riders effective May 1, 2014.

CDM Activities

On March 31, 2010, the Minister of Energy and Infrastructure of Ontario, under the guidance of sections 27.1 and 27.2 of the OEB Act, directed the OEB to establish CDM targets to be met by electricity distributors. Accordingly, on November 12, 2010, the OEB amended LDC's distribution licence to require LDC, as a condition of its licence, to achieve 1,304 GWh of energy savings and 286 MW of summer peak demand savings, over the period beginning January 1, 2011 through December 31, 2014.

Effective January 1, 2011, LDC entered into an agreement with the OPA in the amount of approximately \$50.0 million to deliver CDM programs extending from January 1, 2011 to December 31, 2014. As at December 31, 2013, LDC received approximately \$45.9 million from the OPA for the delivery of CDM programs. All programs to be delivered are fully funded and paid in advance by the OPA. Amounts received but not yet spent are presented under current liabilities as deferred conservation credit. Upon the expiration of the agreement, LDC is required to repay to the OPA any excess funding received for program administration less any cost efficiency incentives. These programs are expected to support the achievement of the mandatory CDM targets described above.

On December 21, 2012, the Minister of Energy of Ontario issued a direction to the OPA under subsection 25.32(4.1) of the Electricity Act to extend the funding time period for OPA-contracted province-wide CDM initiatives under the Green Energy Act framework to December 31, 2015.

OEB PILs Proceeding

The OEB conducted a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for certain MEUs. On June 24, 2011, the OEB issued its decision for these MEUs and provided guidelines for the calculation and further disposition of the balances accumulated in the PILs regulatory variance accounts.

LDC reviewed the balance of its PILs regulatory variance accounts and applied the guidelines provided by the OEB. LDC applied for disposition of the balance as part of its IRM/ICM Application filed on May 10, 2012. The OEB issued its decision and order on April 2, 2013 approving the disposition of the balance. The impact was recorded previously in the Corporation's consolidated financial statements.

Changes to the Corporation's Board of Directors

On April 3, 2013, the City, as the sole shareholder of the Corporation, appointed David Williams, Colum Bastable, Vincent Brescia, Glenna Carr, Derek Cowbourne, Sara Gelgor, Paulette Kennedy and Isabel Meharry to the Board of Directors as independent directors of the Corporation. Their appointments were effective April 15, 2013 for a term ending April 14, 2015 or until their successors are appointed. On April 3, 2013, the City also nominated David Williams as Chairman of the Corporation. Mr. Williams was appointed Chairman by the Corporation's Board of Directors effective April 15, 2013 for a term ending April 14, 2015 or until his successor is appointed.

Effective January 1, 2013, the City, as the sole shareholder of the Corporation, appointed councillor Gloria Lindsay Luby to the Board of Directors of the Corporation to replace councillor Ron Moeser and also re-appointed each of councillor Josh Colle, as the Mayor's designate, and councillor Shelley Carroll to the Board of Directors of the Corporation. Their appointments are effective for a term ending November 30, 2014 or until their successors are appointed.

Labour Agreement

On February 13, 2014, CUPE One ratified collective agreements governing inside and outside employees 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 February 1, 2015, 1.75% effective February 1 2016, 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. The escalator clauses only become effective if certain prescribed thresholds are exceeded.

Legal Proceedings

In the ordinary course of business, the Corporation is subject to various legal actions and claims with customers, suppliers, former employees and other parties. On an ongoing basis, the Corporation assesses the likelihood of any adverse judgments or outcomes as well as potential ranges of probable costs and losses. A determination of the provision required, if any, for these contingencies is made after an analysis of each individual issue. The provision may change in the future due to new developments in each matter or changes in approach, such as a change in settlement strategy. If damages were awarded under these actions, the Corporation and its subsidiaries would make a claim under their liability insurance which the Corporation believes would cover any damages which may become payable by the Corporation and its subsidiaries in connection with these actions. See note 22 (a) to the Consolidated Financial Statements for a discussion of material legal proceedings.

Share Capital

The authorized share capital of the Corporation consists of an unlimited number of common shares without par value, of which 1,000 common shares are issued and outstanding as at the date hereof.

Transactions with Related Parties

As a wholly-owned subsidiary of the City, the Corporation and the City are considered related parties. All transactions with the City are conducted on terms similar to those offered to unrelated parties.

Summary of Transactions with Related Parties (in thousands of Canadian dollars)

	Year Ended December 31	
	2013 \$	2012 \$
Revenues	246,894	222,032
Operating expenses and capital expenditures	31,861	26,259
Dividends	42,995	47,966

Summary of Amounts Due to/from Related Parties
(in thousands of Canadian dollars)

As at December 31		
	2013	2012
	\$	\$
Accounts receivable	5,579	7,810
Unbilled revenue	19,425	17,018
Accounts payable and accrued liabilities	45,472	38,020
Advance deposits	8,816	8,926

Revenues represent amounts charged to the City primarily for electricity, street lighting and ancillary services. Operating expenses and capital expenditures represent amounts charged by the City for purchased road cut repairs, property taxes and other services. Dividends are paid to the City.

Accounts receivable represent receivables from the City primarily for electricity, street lighting and ancillary services. Unbilled revenue represents receivables from the City related to electricity and other services provided and not yet billed. Accounts payable and accrued liabilities represent amounts payable to the City related to road cut repairs and other services, as well as amounts received from the City for the construction of electricity distribution assets. Advance deposits represent amounts received from the City for future expansion projects.

Controls and Procedures

For purposes of certain Canadian securities regulations, the Corporation is a “Venture Issuer”. As such, it is exempt from certain of the requirements of National Instrument 52-109 Certification of Disclosure in Issuers’ Annual and Interim Filings. Accordingly, the Chief Executive Officer and Chief Financial Officer have reviewed the Consolidated Financial Statements and the MD&A for the three months and year ended December 31, 2013. Based on their knowledge and exercise of reasonable diligence, they have concluded that these documents fairly present in all material respects the financial condition, results of operations and cash flows of the Corporation for the periods presented.

Risk Management and Risk Factors

The Corporation faces various risks that could impact the achievement of its strategic objectives. It adopts an enterprise wide approach to risk management, achieved through a process of consolidating and aligning the various views of risk across the enterprise via a risk governance structure. The Corporation executes its ERM activities via an ERM framework that is aligned to industry best practices and international guidelines. The Corporation views ERM as a management activity undertaken to add value and improve overall operations. It helps the Corporation by enabling the attainment of its strategic goals and objectives through a systematic, disciplined approach towards identifying, evaluating, treating, monitoring and reporting of risks. Accordingly, ERM is an integral part of the strategic management of the Corporation and is routinely considered in forecasting, planning and executing all aspects of the business.

The ERM framework is operationalized by a consistent, disciplined methodology that clearly defines the risk management process which incorporates subjective elements, risk quantification and risk interdependencies.

While the Corporation’s philosophy is that ERM is the responsibility of all business units, at all levels, in matters strategic and operational, the ERM governance structure is comprised of three key levels.

At the top level is the Board of Directors, who works to maintain a general understanding of the risk categories, the types of risks to which the Corporation may be exposed and the practices used to identify, assess, measure and manage those risks. Quarterly, the Board of Directors reviews the Corporation’s risk profile, a list of key risks together with treatment activities that represents the greatest threats to meeting the Corporation’s strategic objectives.

The second level is the ROC, a lead body to ensure systems are in place to identify, manage, and monitor risks. Through its review of reports from the business and other areas, the ROC assesses the appropriateness and consistent application of systems to manage risks within the Corporation. The ROC also ensures that key risks are brought forward to the attention of the Board and for action by executive management.

Finally, the third level is the Risk Forum. The Risk Forum supports the ROC and is a collection of subject matter experts from across the Corporation who actively engage in the day to day management of risks. Working with the ROC, the Risk Forum oversees the Corporation's risk profile, its performance against the defined risk appetite and determines appropriate risk responses. They also work to ensure effective, efficient, complete and transparent risk reporting to the ROC.

The Corporation is subject to a variety of risks including those described below:

Regulatory Developments

Ontario's electricity industry regulatory developments and policy changes may affect the electricity distribution rates charged by LDC and the costs LDC is permitted to recover. This may in turn have a material adverse effect on the financial performance of the Corporation and/or its ability to provide reliable service to its customers. In particular, there can be no assurance that:

- the OEB will approve LDC's electricity distribution rates under the RRFE, at levels that will permit LDC to carry out its planned capital work programs required to maintain safe and reliable service to its customers and earn the allowed rate of return on the investment in the business;
- the regulatory instruments that arise from the RRFE will be sufficient to address LDC's operations, needs and circumstances in respect of future applications for electricity distribution rates;
- the OEB will not set a lower recovery for LDC's cost of capital;
- the full cost of providing service to distribution customers will be permitted to be recovered through LDC's electricity distribution rates;
- the OEB will not permit competitors to provide distribution services in LDC's licensed area, or permit loads within LDC's service area to become electrically served by a means other than through LDC's electricity distribution system;
- the OEB will allow recovery for revenue lost as a consequence of unanticipated effects of CDM;
- parts of LDC's services will not be separated from LDC and opened to competition; or
- regulatory or other changes will not be made to the PILs regime.

Changes to any of the laws, rules, regulations and policies applicable to the businesses carried on by the Corporation could also have a significant impact on the Corporation. There can be no assurance that the Corporation will be able to comply with applicable future laws, rules, regulations and policies. Failure by the Corporation to comply with applicable laws, rules, regulations and policies may subject the Corporation to civil or regulatory proceedings that may have a material adverse effect on the Corporation.

Any future regulatory decision to disallow or limit the recovery of costs could lead to potential asset impairment and charges to results from operations, which could have a material adverse effect.

Condition of Distribution Assets

LDC estimates that approximately one-third of its electricity distribution assets are past their expected useful lives. LDC's ability to continue to provide a safe work environment for its employees and a reliable and safe distribution service to its customers and the general public will depend on, among other things, the OEB allowing recovery of costs in respect of LDC's maintenance program and capital expenditure requirements for distribution plant refurbishment and replacement.

LDC is focused on overcoming the above challenges and executing its maintenance program. However, if LDC is unable to carry out these plans in a timely and optimal manner, equipment performance will degrade which may compromise the reliability of distribution assets, the ability to deliver sufficient electricity and/or customer supply security and increase the costs of operating and maintaining these assets.

Information Technology Infrastructure

LDC's ability to operate effectively is in part dependent on the development, maintenance and management of complex information technology systems. Computer systems are employed to operate LDC's electricity distribution system and financial, billing and business systems to capture data and to produce timely and accurate information. Failures of any one of the financial, business and operating systems could have a material adverse effect on the Corporation's business, operating results, financial condition and prospects. The Corporation mitigates this risk through various methods including the use of security event management tools on its distribution and business systems, by separating the electricity distribution system from the business systems and by providing company-wide awareness training to personnel.

LDC's electricity distribution infrastructure and technology systems are also potentially vulnerable to damage or interruption from cyber attacks, which could have an adverse impact on its operations, financial conditions, brand and reputation. While LDC has implemented preventative measures to monitor and protect against cyber attacks and mitigate their effects, there can be no assurance that such measures will be completely effective in protecting LDC's electricity distribution infrastructure or assets from a cyber attack or the effects thereof.

Natural and Other Unexpected Occurrences

LDC's operations are exposed to the effects of natural and other unexpected occurrences, such as severe or unexpected weather conditions, terrorism and pandemics. In the current year, the City experienced two severe weather events, one of which (see "Ice Storm" above in the section entitled "Results of Operations – 2013 compared to 2012") had a significant financial impact. Although LDC's facilities and operations are constructed, operated and maintained to withstand such occurrences, there can be no assurance that they will successfully do so in all circumstances. Any major damage to LDC's facilities or interruption of LDC's operations arising from these occurrences could result in lost revenues and repair costs that can be substantial. Although the Corporation has insurance, if it sustained a large uninsured loss caused by natural or other unexpected occurrences, LDC would apply to the OEB for the recovery of the loss related to the electricity distribution system. There can be no assurance that the OEB would approve, in whole or in part, such an application.

Electricity Consumption

LDC's electricity distribution rates are comprised of a fixed charge and a usage-based (consumption) charge. The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control (e.g., principally sustained periods of hot or cold weather could increase the consumption of electricity, sustained periods of mild weather could decrease the consumption of electricity and general economic conditions could affect overall electricity consumption). Accordingly, there can be no assurance that LDC will earn the revenue requirement approved by the OEB.

Economic conditions could also lead to lower overall electricity consumption, particularly in the commercial customer segment, which is estimated to be the most sensitive to economic changes. Lower electricity consumption from customers could negatively impact LDC's revenue. On an annual basis, the Corporation estimates that a decrease of 1% in electricity consumption would reduce net revenue by approximately \$3.5 million.

Market and Credit Risk

LDC is subject to credit risk with respect to customer non-payment of electricity bills. LDC is permitted to mitigate the risk of customer non-payment using any means permitted by law, including security deposits (including letters of credit, surety bonds, cash deposits or lock-box arrangements, under terms prescribed by the OEB), late payment penalties, pre-payment, pre-authorized payment, load limiters or disconnection. In the event of an actual payment default and a corresponding bad debt expense incurred by LDC, approximately 80% of the expense would be related to commodity and transmission costs and the remainder to LDC's distribution revenue. While LDC would be liable for the full amount of the default, there can be no assurance that the OEB would allow recovery of the bad debt expense from remaining customers. Established practice in such cases is that the OEB would examine any electricity distributor's application for recovery of extraordinary bad debt expenses on a case-by-case basis.

The Corporation is exposed to fluctuations in interest rates for the valuation of its post-retirement benefit obligations. The Corporation estimates that a 1% (100 basis point) increase in the discount rate used to value these obligations would decrease the accrued benefit obligation, as at December 31, 2013, by approximately \$37.0 million, and a 1% (100 basis point) decrease in the discount rate would increase the accrued benefit obligation, as at December 31, 2013, by approximately \$45.5 million.

As at December 31, 2013, aside from the valuation of its post-retirement benefit obligations, the Corporation was exposed to interest rate risk predominately from short-term borrowings under its commercial paper program, while most of its remaining obligations were either non-interest bearing or bear fixed interest rates, and its financial assets were predominately short-term in nature and mostly non-interest bearing. The Corporation estimates that a 100 basis point increase (decrease) in short-term interest rates, with all other variables held constant, would result in an increase (decrease) of approximately \$2.1 million to annual net financing charges.

Additional Debt Financing and Credit Rating

Cash generated from operations, after the payment of expected dividends, is not expected to be sufficient to repay existing indebtedness, fund capital expenditures and meet other obligations. The Corporation relies on debt financing through its medium-term note program, commercial paper program or existing credit facilities to repay existing indebtedness, finance the Corporation's daily operations, and fund capital expenditures. The Corporation's ability to arrange sufficient and cost-effective debt financing could be adversely affected by a number of factors, including financial market conditions, the regulatory environment in Ontario, the Corporation's results of operations and financial condition, the ratings assigned to the debentures issued under the Corporation's medium-term note program by credit rating agencies, the current timing to maturity of the Corporation's debentures, the availability of the commercial paper market, and general economic conditions. See notes 11 and 13 to the Consolidated Financial Statements.

Should the Corporation's credit rating from both credit rating agencies fall below "A (minus)" with stable outlook (S&P) and "A (low)" with stable trend (DBRS), the Corporation and its subsidiaries may be required to post additional collateral with the IESO.

Work Force Renewal

Over the next decade, a significant portion of LDC's employees will become eligible for retirement, including potential retirements occurring in supervisory, trades and technical positions. Accordingly, LDC will be required to attract, train and retain skilled employees. There can be no assurance that LDC will be able to attract and retain the required workforce.

Labour Relations

The Corporation's ability to operate successfully in the electricity industry in Ontario will continue to depend in part on its ability to make changes to existing work processes and conditions to adapt to changing circumstances. The Corporation's ability to make such changes, in turn, will continue to depend in part on its relationship with its labour unions and its ability to develop plans and approaches that are acceptable to its labour unions. There can be no assurance that the Corporation will be able to secure the support of its labour unions.

Insurance

Although the Corporation maintains insurance, there can be no assurance that the Corporation will be able to obtain or maintain adequate insurance in the future at rates it considers reasonable or that insurance will continue to be available. In addition, there can be no assurance that available insurance will cover all losses or liabilities that might arise in the conduct of the Corporation's business. The Corporation self-insures against risks (e.g., business interruption and physical damage to certain automobiles). The occurrence of a significant uninsured claim or a claim in excess of the insurance coverage limits maintained by the Corporation could have a material adverse effect on the Corporation's results of operations and financial position.

Conflicts of Interest

The City owns all of the outstanding shares of the Corporation and has the power to determine the composition of the Board of Directors of the Corporation and influence the Corporation's major business and corporate decisions, including its financing programs and dividend payments. A conflict may arise between the City's role as the sole

shareholder of the Corporation and its role as the administrator of the City's budget and other matters for the residents of the City.

Change of Ownership

The City may decide to sell all or part of the Corporation. In the case of such event, depending on the nature of the transaction, the Corporation's credit ratings could be negatively affected.

Real Property Rights

Certain terminal stations and municipal sub-stations of LDC are located on lands owned by the Province, the City and others. In some cases, LDC does not have and may not be able to obtain formal access agreements with respect to such facilities. Failure to obtain or maintain access agreements could adversely affect LDC's operations.

LDC Competition

In the past, there had been one electricity distributor in each region of Ontario. Under the current regulatory regime, a person must obtain a licence from the OEB in order to own and operate an electricity distribution system. LDC has the right to distribute electricity in the City. Although the distribution licence specifies the area in which the distributor is authorized to distribute electricity, unless otherwise provided, the licence does not provide exclusive distribution rights for such area.

The Corporation believes that the complexities and potential inefficiencies that would be created by having multiple electricity distributors authorized to serve a single area are likely to result in the continuation of the practice of having a single electricity distributor authorized to serve a single area. In addition, the Corporation believes that there are significant barriers to entry with respect to the business of electricity distribution in Ontario, including the cost of maintaining an electricity distribution system, OEB regulation of electricity distribution rates and the level of regulatory compliance required to operate an electricity distribution system. However, the Corporation recognizes that more than one distribution licence could be issued for the same area and there is a possibility that in the future some business functions or activities could be separated from LDC and made open to competition from non-regulated business entities, or that defined geographical areas within LDC's service area may be electrically supplied by a means other than through LDC's electricity distribution system.

Non-GAAP Financial Measures

The Corporation's MD&A includes references to "net revenues", which is a non-GAAP financial measure. The definition of net revenues is revenue minus the cost of purchased power. This measure does not have any standard meaning prescribed by US GAAP and is not necessarily comparable to similarly titled measures of other companies. The Corporation uses this measure to assess its performance and to further make operating decisions. Users of the MD&A utilize this measure to assess the Corporation's financial performance from ongoing operations.

Critical Accounting Estimates

The preparation of the Corporation's Consolidated Financial Statements in accordance with US GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses for the year. The estimates are based on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Actual results may differ from these estimates and judgments under different assumptions or conditions.

The following critical accounting estimates involve significant estimates and judgments used in the preparation of the Consolidated Financial Statements:

Revenue Recognition

Revenue from the sale of electricity is recorded on the basis of cyclical billings and includes an estimated amount for electricity delivered and not yet billed, the amount of which is impacted by energy demand, customer class usage patterns and composition, and weather conditions. Revenue related to eligible capital expenditures under the ICM

framework is recognized on the basis of in-service assets. Other revenues, which include revenues from electricity distribution related services, revenues from the delivery of street lighting services and revenues from demand billable activities, are recognized as the services are rendered.

Regulatory Assets and Liabilities

As at December 31, 2013, regulatory assets amounted to \$241.5 million and were primarily related to the reclassification of ICM-related net eligible in-service capital expenditures and timing differences in the recognition of actuarial losses and prior service costs of post-retirement benefits. As at December 31, 2013, regulatory liabilities amounted to \$183.1 million and were primarily related to deferred income tax assets payable to customers. These assets and liabilities can be recognized for rate-setting and financial reporting purposes only if the OEB directs the relevant regulatory treatment or if future OEB direction is judged to be probable. In the event that the disposition of these balances was assessed to no longer be probable, the balances would be recorded in the Corporation's consolidated statements of net income and comprehensive income in the period that the assessment is made. The measurement of regulatory assets and liabilities is subject to certain estimates and assumptions, including assumptions made in the interpretation of the OEB's regulations and decisions.

Employee Future Benefits

Employee future benefits other than pension provided by the Corporation include medical, dental and life insurance benefits, and accumulated sick leave credits. These plans provide benefits to employees when they are no longer providing active service. The accrued benefit obligation and net periodic benefit cost are calculated by independent actuaries using the projected unit credit method and based on assumptions that reflect management's best estimate. The assumptions were determined by management recognizing the recommendations of the Corporation's actuaries. There could be no assurance that actual employee future benefits cost will not differ significantly from the estimates calculated using management's assumptions.

Asset Retirement Obligations

The Corporation recognizes a liability for the future removal and handling costs for contamination in distribution equipment and for the future environmental remediation of certain properties. The liability is recognized when an ARO is incurred and when the fair value can be reasonably estimated. AROs amounted to \$6.3 million as at December 31, 2013 compared to \$5.1 million as at December 31, 2012. See notes 4 (n) and 15 to the Consolidated Financial Statements.

Significant Accounting Policies

The Consolidated Financial Statements of the Corporation have been prepared in accordance with US GAAP and are presented in Canadian dollars. In preparing the Consolidated Financial Statements, management makes estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Ministry of Energy of Ontario, or the Ministry of Finance of Ontario. The significant accounting policies of the Corporation are summarized in notes 2 and 4 to the Consolidated Financial Statements.

Adoption of New Accounting Pronouncements

In December 2011, the FASB issued ASU No. 2011-11, "Balance Sheet (Topic 210): *Disclosures about Offsetting Assets and Liabilities*". The amendments require an entity to disclose both gross and net information about financial instruments and transactions eligible for offset in the consolidated balance sheets. ASU No. 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Retrospective application is required. The ASU No. 2013-01, "Balance Sheet (Topic 210): *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*", was issued in January 2013 to amend the scope of ASU No. 2011-11 to clarify that the disclosure requirements are limited to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions that are either offset in the consolidated balance sheets or subject to enforceable master netting arrangements or similar agreements. The adoption of these amendments did not have an impact on the Corporation's consolidated balance sheets and related disclosures.

Future Accounting Pronouncements

On July 21, 2011, the OSC granted an exemption to allow the Corporation to prepare its consolidated financial statements in accordance with US GAAP for its fiscal years beginning on or after January 1, 2012 but before January 1, 2015. In the absence of the exemption, the Corporation would have previously been required to adopt IFRS on January 1, 2012. On March 19, 2014, the Board of Directors of the Corporation approved the adoption of IFRS for the year beginning on January 1, 2015 due to the pending expiration of the exemption. Accordingly, the Corporation's consolidated financial statements for 2015 are expected to be prepared in accordance with IFRS and applied retrospectively to the Corporation's opening IFRS consolidated statement of financial position as at January 1, 2014.

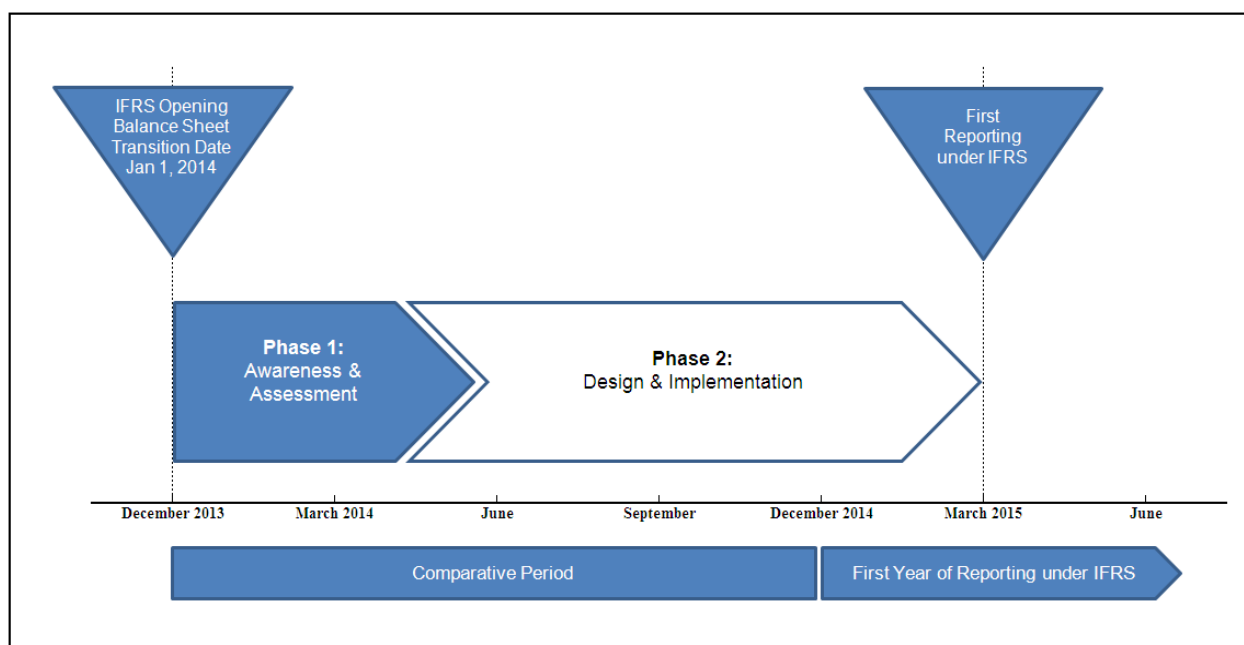
The Corporation has an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its consolidated financial statements. The Corporation believes that the impact on its financial statements could be material.

IFRS Conversion Project

As a result of above decision, the Corporation has re-initiated its IFRS conversion project, which was previously suspended as a result of the Corporation's decision to adopt US GAAP. The Corporation established a formal project governance structure. This structure includes a steering committee consisting of senior levels of management from finance, information technology and operations, among others. Regular progress reports are provided to senior executive management.

The Corporation's project consists of two phases:

- 1) the awareness and assessment phase; and
- 2) the design and implementation phase.



The Corporation updated its awareness and initial assessment during the fourth quarter of 2013. During the initial assessment it was determined that the areas of accounting differences with the highest potential impact to the Corporation are accounting for PP&E, PILs, employee future benefits, regulatory deferral accounts, as well as initial adoption of IFRS under the provisions of IFRS 1, First-time Adoption of IFRS ("IFRS 1"). The Corporation next updated the detailed assessment of accounting and disclosure differences which is expected to be completed in the first quarter of 2014. In parallel, a detailed assessment of the impact of the IFRS conversion on the Corporation's systems, processes and controls as well as other business, regulatory and tax impacts is also in process. During the awareness and assessment phase, the Corporation established a communication plan and a staff-training plan.

The Corporation has not yet started the design and implementation phase of the project. The design phase will involve establishing issue-specific working groups in each of the identified risk areas. The working groups will establish key milestones which include developing recommendations, analyzing financial system and internal control impacts, developing significant accounting policies, and carrying out ongoing discussions with external auditors, in each area. Based on the outcomes of each working group, the Corporation is currently determining the projected impacts of adopting IFRS on its financial statements after considering the options available under IFRS 1.

The roll-out of the changes developed in the design phase will take place during the implementation phase and involve the development of new accounting policies and accounting manuals and the associated training for the finance and operational teams, testing the effectiveness of the changes made to systems, a simulation of the financial reporting process, preparation of opening balance sheet on transition date and related reconciliations, assessing the ongoing impacts on the IFRS financial statements and related disclosures.

The Corporation has revised its project plan to reflect the necessary work involved in determining the impacts of adopting IFRS at the new adoption date of January 1, 2015. The following table provides certain key activities of the changeover plan and an assessment of the Corporation's progress at this time. This information reflects the Corporation's most recent assumptions and expectations. Circumstances may arise such as changes in IFRS, regulations, or economic conditions, which would affect these assumptions or expectations.

Key Activities	Status
Accounting policies & procedures:	
<ul style="list-style-type: none">• High level review of major differences between US GAAP and IFRS• Establish issue-specific working groups in the identified risk areas• Detailed assessment of accounting and disclosure differences, accounting policy choices and IFRS 1 elections available• Develop recommendations and accounting policies through ongoing discussions with external auditors• Finalize new accounting policies and accounting manuals	<ul style="list-style-type: none">• All accounting policy positions are in process• Final approval of the policies will be finalized in 2014• Continue to monitor ongoing IASB projects and assess potential impacts• Accounting policies and procedure manuals continue to be updated based on the IASB project developments
Financial statements preparation:	
<ul style="list-style-type: none">• Identify US GAAP to IFRS financial statements presentation differences and design interim and annual financial statements formats and related notes disclosures• Simulate the financial reporting process under IFRS• Prepare the opening balance sheet on the date of transition and IFRS 1 related reconciliations and disclosures• Assess ongoing impacts on the IFRS financial statements and related disclosures	<ul style="list-style-type: none">• Developed drafted financial statements formats• Started testing of system related modifications to IFRS generated financial statements• Preparation of the opening balance sheet on transition date is in progress
Training & communication:	
<ul style="list-style-type: none">• Provide training to affected finance and operational teams, management and the Board of Directors, and relevant committees thereof, including the audit committee• Develop and execute staff training plan, and roll out communication initiatives• Continue to update audit committee and senior management on a quarterly basis for key developments in IFRS and the potential impacts to the Corporation's financial statements	<ul style="list-style-type: none">• Completed detailed training for resources directly engaged in the changeover and general awareness training to broader group of finance employees• Started topic-specific and relevant training to finance and operational teams on all finalized positions. Key areas include PP&E, PILs, employee benefits, provisions, capital contributions, borrowing costs and financial statement presentation• Continue ongoing, periodic internal and external communications on the Corporation's progress on the IFRS project and direction• Develop staff training plans with respect to regulatory deferral accounts

Key Activities	Status
Business impacts:	
<ul style="list-style-type: none"> Evaluate impacts and implement necessary changes to debt covenants, internal performance measures, contracts and processes 	<ul style="list-style-type: none"> Impacts to debt covenants, regulatory and other business processes are being assessed
Information technology systems:	
<ul style="list-style-type: none"> Analysis of financial system to identify required modifications Test the effectiveness of the changes made to systems Ensure solution captures financial information under US GAAP and IFRS during the year of transition for comparative reporting purposes 	<ul style="list-style-type: none"> Completed system changes for reporting purposes including subledger configurations for derecognition and depreciation on a component level. Further changes to information systems are to be made based upon the changes required to meet the regulatory deferral account standard Complete the modifications to the system to accommodate the new transition date of January 1, 2014 and begin to accumulate IFRS data for reporting comparative information Continue to implement remaining required modifications to financial systems
Control environment:	
<ul style="list-style-type: none"> Detailed assessment of the impact of IFRS conversion on people, systems, processes and internal controls Analyze and update internal control processes and documentation Implement related controls and procedures to ensure the integrity and effectiveness of internal controls over financial reporting ("ICFR") and disclosure controls and procedures ("DC&P") 	<ul style="list-style-type: none"> Based on the accounting policies and procedures developed, the Corporation continues to evaluate and document the impacts on new and existing controls to ensure the integrity and effectiveness of ICFR and DC&P Additional controls may be required to address first-time IFRS adoption and new processes implemented to support ongoing IFRS reporting requirements. These controls will be implemented and tested on a timely basis for reporting under IFRS in 2015.

In general, a first-time adopter is required to apply the IFRS standards retrospectively and recognize any consequential adjustments in retained earnings. IFRS 1 contains all of the transitional requirements applicable for the first-time adoption of IFRS. Several mandatory and optional exemptions to the retrospective application are available. The Corporation has considered the impacts of IFRS 1 and an initial assessment has been made as to which exemptions would be elected upon transition. At this time, the impact on the Corporation's future financial position and results of operations is not reasonably determinable. In addition, during the year of 2014 until the transition, changes to IFRS may impact exemptions available for first-time adopters, and in turn, may change the Corporation's original assessments and policy selections.

The Corporation has completed a detailed assessment of the accounting and disclosure differences between US GAAP and IFRS and identified the following areas as having the potential to materially impact the consolidated financial statements on the date of transition to IFRS and post-IFRS implementation.

Risk Areas	Key Differences IFRS vs. US GAAP	Potential Key Impacts
IAS 12 - Income Taxes	IAS 12 requires that a deferred tax asset is recognized to the extent it is probable that it will be realized - i.e. a net approach, whereas US GAAP allows all deferred tax assets being recognized and a valuation allowance being recognized to the extent that it is more likely than not that the deferred tax assets will not be realized - i.e. a gross approach.	Currently a valuation allowance has been established for certain capital loss carry forwards and allowed tax depreciation under US GAAP. All other deferred tax assets are considered more likely than not to be realized. The impact of adopting IAS 12 is one of disclosure only as the net deferred tax assets recorded would be similar under both standards.
IAS 16 - PP&E	<p>IAS 16 requires that the estimates of useful life and residual value, and the method of depreciation, are reviewed at a minimum at each annual reporting period. Any changes are accounted for prospectively as a change in estimate.</p> <p>The carrying amount of an item of PP&E shall be derecognized upon disposal or when no future economic benefits are expected. The gain or loss arising from the derecognition of an item of PP&E shall be included in profit or loss (unless IAS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.</p>	<p>As a result of adoption of IAS 16, useful lives and residual value will need to be reviewed annually.</p> <p>The Corporation will be derecognizing all items of PP&E as soon as they are taken out of service. PP&E will decrease with a corresponding increase to depreciation expense.</p>

Risk Areas	Key Differences IFRS vs. US GAAP	Potential Key Impacts
IAS 19 - Employee Benefits	<p>IAS 19 does not specify whether an entity should distinguish current and non-current portions related to post-employment benefits. Under US GAAP, the amount of the actuarial present value of benefits included in the benefit obligation which is expected to be paid in the next 12 months is classified as current.</p> <p>Actuarial gains or losses of defined benefit plans are recognized immediately in OCI and cannot be recycled into profit or loss. The corridor method, which is permitted under US GAAP has been eliminated under IFRS.</p> <p>For other long-term benefits other than post-employment benefits, IAS 19 requires benefits that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service to be classified as current.</p> <p>Under IFRS, short-term benefits that accumulate are recognized even when the benefit is non-vested, as opposed to US GAAP, in which recognition of such benefits is permitted but not mandatory.</p>	<p>Based on preliminary assessments, the Corporation will elect to account for all post-employment benefits as non-current under IFRS.</p> <p>All actuarial gains and losses related to post-employment benefits will be recognized immediately into OCI under IFRS and will not be allowed to be recycled to profit or loss.</p> <p>The Corporation's long-term benefits are not expected to be wholly settled within 12 months and therefore will remain as non-current under IFRS.</p> <p>As a result of adoption of IAS 19, the Corporation will need to accrue for the required employee benefits liability.</p>
IAS 23- Borrowing Costs	<p>The core principle of IAS 23 is that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense in the period in which they are incurred.</p> <p>Borrowing costs under IFRS are calculated using the weighted average interest rate of the Corporation's general borrowings, including borrowing costs previously capitalized, as opposed to the OEB prescribed rate on a simple interest basis permitted under US GAAP. Borrowing costs should also be capitalized as soon as the asset meets the conditions of commencement date as opposed to the current practice, in which costs can be capitalized after the 6 month mark.</p>	<p>Based on preliminary assessments, it is expected that additional borrowing costs would be capitalized as a result of the adoption of IAS 23.</p>
IAS 37 - Provisions, Contingent Assets and Liabilities	<p>IAS 37 requires a discount rate that reflects current market assessments of the time value of money and risks specific to the liability, whereas US GAAP requires the use of a credit-adjusted risk-free rate.</p>	<p>Based on preliminary assessments, the impact on the date of transition when using the IFRS 1 optional exemption is an increase to decommissioning provisions, a decrease to PP&E, and a decrease to opening retained earnings.</p>
IFRIC 18 - Transfer Assets from Customers (Capital Contributions)	<p>IFRIC 18 does not allow for the netting of capital contributions received against items of PP&E.</p>	<p>Based on preliminary assessments, there will be a reclassification between PP&E, and unearned revenue liability. The capital contribution will be amortized, and recognized into revenue opposed to against depreciation under US GAAP. Presentation differences will have no impact on the net income reported.</p>
IFRS 14 – Regulatory Deferral Accounts	<p>The Corporation is in the process of determining key differences.</p>	<p>The Corporation is in the process of determining key differences.</p>

Forward-Looking Information

The Corporation includes forward-looking information in its MD&A within the meaning of applicable securities laws in Canada. The purpose of the forward-looking information is to provide management's expectations regarding the Corporation's future results of operations, performance, business prospects and opportunities and may not be appropriate for other purposes. All forward-looking information is given pursuant to the "safe harbour" provisions of applicable Canadian securities legislation. The words "aims", "anticipates", "believes", "budgets", "committed", "could", "estimates", "expects", "focus", "forecasts", "intends", "may", "might", "plans", "projects", "schedule", "should", "strives", "will", "would" and similar expressions are often intended to identify forward-looking information, although not all forward-looking information contains these identifying words. The forward-looking information reflects management's current beliefs and is based on information currently available to the Corporation's management.

The forward-looking information in the MD&A includes, but is not limited to, statements regarding the Corporation's achievement of its strategic pillars as described in the section entitled "Corporate Strategy", the Corporation's plans to borrow funds to repay maturing debentures and to finance the investment in LDC's infrastructure and the Corporation's available sources of liquidity and capital resources and the sufficiency thereof to satisfy working capital requirements for the next 12 months as described in the sections entitled "Liquidity and Capital Resources" and "Additional Debt Financing and Credit Rating", the anticipated capacity to be provided by Copeland Station and the expected capital expenditures required to complete Copeland Station as described in the section entitled "Liquidity and Capital Resources", the ability to pay any damages in connection with legal actions and claims as described in the section entitled "Legal Proceedings", the impact of market volatility on the Corporation's consolidated results of operations, performance, business prospects and opportunities as described in the section entitled "Quarterly Results of Operations", the effect of changes in energy consumption on future revenue as described in the section entitled "Electricity Consumption", the effect of changes in interest rates and discount rates on future revenue requirements and future post-retirement benefit obligations, respectively, as described in the section entitled "Market and Credit Risk", the changes in accounting estimates as described in the section entitled "Significant Accounting Policies", and the plans in connection with the IFRS conversion project and progress of the regulatory deferral account project as described in the section entitled "Future Accounting Pronouncements". The statements that make up the forward-looking information are based on assumptions that include, but are not limited to, the future course of the economy and financial markets, the receipt of applicable regulatory approvals and requested rate orders, the receipt of favourable judgments, the level of interest rates and the Corporation's ability to borrow, and the effectiveness of a potential future transition to IFRS by the Corporation.

The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from historical results or results anticipated by the forward-looking information. The factors which could cause results or events to differ from current expectations include, but are not limited to, market liquidity and the quality of the underlying assets and financial instruments, the timing and extent of changes in prevailing interest rates, inflation levels, legislative, judicial and regulatory developments that could affect revenues and the results of borrowing efforts.

All forward-looking information in the MD&A is qualified in its entirety by the above cautionary statements and, except as required by law, the Corporation undertakes no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise after the date hereof.

Selected Annual Information

The following table sets forth selected annual financial information of the Corporation for the three years ended December 31, 2013, 2012 and 2011. This information has been derived from the Consolidated Financial Statements.

Selected Annual Consolidated Financial Information (in thousands of Canadian dollars)

	2013 \$	2012 \$	2011 ¹ \$
Year Ended December 31,			
Net revenues ²	635,281	577,268	586,929
Operating expenses ²	271,958	245,173	262,241
Net income ²	121,241	85,990	95,932
Capital expenditures ³	450,314	292,375	437,067
As at December 31,			
Total assets ⁴	3,797,531	3,539,354	3,527,507
Total debentures ^{4,5}	1,449,332	1,469,590	1,469,527
Other non-current financial liabilities ⁶	15,531	16,175	27,101
Shareholder's equity ⁴	1,218,518	1,140,272	1,102,248
Dividends ³	42,995	47,966	33,063
Total debt to capitalization ratio ⁷	57.0%	56.3%	57.1%
Return on equity ⁸	10.3%	7.7%	9.0%

¹ The Corporation's consolidated financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. Selected financial information from comparative consolidated financial statements for 2011 have been adjusted retroactively from the consolidated financial statements previously filed to conform to the presentation of the Corporation's 2012 and 2013 consolidated financial statements prepared in accordance with US GAAP.

² See "Results of Operations" for further details on net revenues, operating expenses and net income.

³ See "Liquidity and Capital Resources" for further details on capital expenditures and dividends.

⁴ See "Financial Position" for further details of significant changes in assets, debentures and shareholder's equity.

⁵ Total debentures include current and long-term debentures.

⁶ Other non-current financial liabilities include non-current obligations under capital lease and non-current customers' advance deposits. Under US GAAP, deposits that are due or will be due on demand within one year from the end of the reporting period have been reclassified to other current financial liabilities.

⁷ Total debt to capitalization ratio = (total debt) / (total debt + total shareholder's equity), where total debt = (working capital facility + commercial paper + revolving credit facility + current portion of debentures + long-term portion of debentures).

⁸ Return on equity = net income / average total shareholder's equity. Return on equity is measured over a 12-month period.

Additional Information

Additional information with respect to the Corporation (including its annual information form) is available on the System for Electronic Document Analysis and Retrieval website at www.sedar.com.

Toronto, Canada

March 19, 2014



ANNUAL INFORMATION FORM
FOR THE YEAR ENDED DECEMBER 31, 2013

March 31, 2014

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PART 1 - FORWARD-LOOKING INFORMATION

The Corporation includes forward-looking information in this AIF within the meaning of applicable securities laws in Canada. The purpose of the forward-looking information is to provide management's expectations regarding the Corporation's future results of operations, performance, business prospects and opportunities and may not be appropriate for other purposes. All forward-looking information is given pursuant to the "safe harbour" provisions of applicable Canadian securities legislation. The words "aims", "anticipates", "believes", "budgets", "committed", "could", "estimates", "expects", "focus", "forecasts", "intends", "may", "might", "plans", "projects", "schedule", "should", "strives", "will", "would" and similar expressions are often intended to identify forward-looking information, although not all forward-looking information contains these identifying words. The forward-looking information reflects management's current beliefs and is based on information currently available to the Corporation's management.

The forward-looking information in this AIF includes, but is not limited to, statements regarding the Corporation's achievement of its strategic pillars as described in the section entitled "Toronto Hydro Corporation", anticipated capacity to be provided by Copeland Station and the expected capital expenditures required to complete Copeland Station as described in the section entitled "LDC's Electricity Distribution System", the future financial and operational effects of LDC's environmental protection requirements as described in the section entitled "Environmental Matters", market volatility on the Corporation's consolidated results of operations, performance, business prospects and opportunities as described in the section "General Development of the Business", the plans in connection with the IFRS conversion project and progress of the Rate-Regulated Accounting project as described in the section entitled "Accounting Policies", the effect of changes in energy consumption on future revenue as described in the section entitled "Electricity Consumption", the effect of changes in interest rates and discount rates on future revenue requirements and future post-retirement benefit obligations, respectively, as described in the section entitled "Market and Credit Risk", the Corporation's plans to borrow funds to repay maturing Debentures and to finance LDC's daily operations and the investment in LDC's infrastructure as described in the section entitled "Additional Debt Financing and Credit Rating", and the ability to pay any damages in connection with legal actions and claims as described in the section entitled "Legal Proceedings". The statements that make up the forward-looking information are based on assumptions that include, but are not limited to, the future course of the economy and financial markets, the receipt of applicable regulatory approvals and requested rate orders, the receipt of favourable judgments, the level of interest rates and the Corporation's ability to borrow.

The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from historical results or results anticipated by the forward-looking information. The factors which could cause results or events to differ from current expectations include, but are not limited to, market liquidity and the quality of the underlying assets and financial instruments, the timing and extent of changes in prevailing interest rates, inflation levels, legislative, judicial and regulatory developments that could affect revenues and the results of borrowing efforts.

Additional factors which could cause actual results or outcomes to differ materially from the results expressed or implied by forward-looking information include, among other things, the risk factors listed under Part 8 "Risk Factors" in this AIF. Please review this Part 8 – "Risk Factors" in detail. The Corporation cautions that the above list of risk factors is not exhaustive.

All forward-looking information in this AIF is qualified in its entirety by the above cautionary statements and, except as required by law, the Corporation undertakes no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise after the date hereof.

PART 2 - GLOSSARY OF DEFINED TERMS

"Affiliate Relationships Code" refers to the Affiliate Relationships Code for Electricity Distributors and Transmitters that was published by the OEB and became effective on April 1, 1999, as amended.

"AIF" refers to the Corporation's Annual Information Form.

"Amended and Restated City Note" refers to the Amended and Restated City Note dated May 1, 2006, in the principal amount of \$980,230,955, issued by the Corporation to the City. The Amended and Restated City Note has been cancelled. See section 6.2 under the heading "Indebtedness to the City".

"Board" refers to the board of directors of the Corporation.

"CAIDI" refers to the Customer Average Interruption Duration Index and is a measure (in hours) of the average duration of interruptions experienced by customers, not including MED. CAIDI represents the quotient obtained by dividing SAIDI by SAIFI.

"Canadian Environmental Protection Act" refers to the *Canadian Environmental Protection Act, 1999* (Canada), as amended.

"Capital Assets" refers to the sum of property, plant and equipment and intangible assets, net of accumulated depreciation and amortization. See note 4(f), note 4(g), note 7, and note 8 to the Consolidated Financial Statements.

"Capital Expenditures" refers to expenditures relating to property, plant and equipment and intangible assets.

"CDM" refers to conservation and demand management.

"CEA" refers to the Canadian Electricity Association.

"CEO" refers to the President and Chief Executive Officer of the Corporation.

"CFO" refers to the Chief Financial Officer of the Corporation.

"City" refers to the city incorporated under the *City of Toronto Act, 1997* (Ontario), as amended, and comprised of the former municipalities of Metropolitan Toronto, Toronto, East York, Etobicoke, North York, Scarborough and York.

"City Council" refers to Toronto City Council.

"City Councillor" refers to a councillor of City Council.

"Class Proceedings Act" refers to the *Class Proceedings Act, 1992* (Ontario), as amended.

"Conservation and Demand Management Code" refers to the Conservation and Demand Management Code for Electricity Distributors that was published and became effective on September 16, 2010.

"Consolidated Financial Statements" refers to the comparative audited consolidated financial statements of the Corporation together with the auditors' report thereon and the notes thereto as at and for the years ended December 31, 2013 and December 31, 2012, a copy of which is available on the SEDAR website at www.sedar.com.

"Consumer Price Index" refers to the index measuring price movements published by Statistics Canada.

"Consumer Protection Act" refers to the *Consumer Protection Act, 2002* (Ontario), as amended.

"Corporation" refers to Toronto Hydro Corporation.

"CP Program" refers to the commercial paper program established by the Corporation under which the Corporation issues commercial paper. See section 9.3 under the heading "Credit Facility".

"Criminal Code" refers to the *Criminal Code* (Canada), as amended.

"Dangerous Goods Transportation Act" refers to the *Dangerous Goods Transportation Act* (Ontario), as amended.

"DBRS" refers to DBRS Limited.

"Debentures" refers to the 6.11% Series 1 senior unsecured debentures issued by the Corporation on May 7, 2003, the 5.15% Series 2 senior unsecured debentures issued by the Corporation on November 14, 2007, the 4.49% Series 3 senior unsecured debentures issued by the Corporation on November 12, 2009, the 6.11% Series 4 senior unsecured debentures issued by the Corporation on April 1, 2010, the 6.11% Series 5 senior unsecured debentures issued by the Corporation on April 1, 2010, the 5.54% Series 6 senior unsecured debentures issued by the Corporation on May 20, 2010, the 3.54% Series 7 senior unsecured debentures issued by the Corporation on November 18, 2011, the 2.91% Series 8 senior unsecured debentures issued by the Corporation on April 9, 2013 and the 3.96% Series 9 senior unsecured debentures issued by the Corporation on April 9, 2013. See note 13 to the Consolidated Financial Statements.

"Distribution System Code" refers to the Distribution System Code that was published by the OEB on July 14, 2000, as amended.

"EHSMS" refers to the Environment, Health and Safety Management System.

"Electricity Act" refers to the *Electricity Act, 1998* (Ontario), as amended.

"Electricity Property" refers to a municipal corporation's or an MEU's interest in real or personal property used in connection with generating, transmitting, distributing or retailing electricity.

"Electricity Restructuring Act" refers to the *Electricity Restructuring Act, 2004* (Ontario), as amended.

"Energy Competition Act" refers to the *Energy Competition Act, 1998* (Ontario), as amended.

"Energy Consumer Protection Act" refers to the *Energy Consumer Protection Act, 2010* (Ontario), as amended.

"Environmental Protection Act" refers to the *Environmental Protection Act, 1990* (Ontario), as amended.

"ERM" refers to Enterprise Risk Management.

"Fire Protection and Prevention Act" refers to the *Fire Protection and Prevention Act, 1997* (Ontario), as amended.

"GAAP" refers to Generally Acceptable Accounting Principles.

"Green Energy Act" refers to the *Green Energy Act, 2009* (Ontario), as amended.

"GWh" refers to a gigawatt-hour, a standard unit for measuring electrical energy produced or consumed over time. One GWh is the amount of electricity consumed by one million kWh.

"Hydro One" refers to Hydro One Inc.

"IASB" refers to the International Accounting Standards Board.

"ICM" refers to Incremental Capital Module. See section 4.3(f)(i) under the heading "Rate Setting Mechanism" for more information.

"IEEE" refers to the Institute of Electrical and Electronic Engineers Inc.

"IESO" refers to the Independent Electricity System Operator.

"IFRS" refers to the International Financial Reporting Standards.

"Interest Act" refers to the *Interest Act* (Canada), as amended.

"IRM" refers to Incentive Regulation Mechanism. See section 4.3(f)(i) under the heading "Rate Setting Mechanism" for more information.

"ISO" refers to the International Organization for Standardization.

"ITA" refers to the *Income Tax Act* (Canada), as amended.

"kW" refers to a kilowatt, a common measure of electrical power equal to 1,000 Watts.

"kWh" refers to a kilowatt-hour, a standard unit for measuring electrical energy produced or consumed over time. One kWh is the amount of electricity consumed by ten 100 Watt light bulbs burning for one hour.

"LDC" refers to the Corporation's wholly-owned subsidiary, Toronto Hydro-Electric System Limited.

"**Management's Discussion and Analysis**" or "**MD&A**" refers to Management's Discussion and Analysis of Financial Condition and Results of Operations of the Corporation for the year ended December 31, 2013, a copy of which is available on the SEDAR website at www.sedar.com.

"**Market Participants**" refers to persons authorized to participate in the wholesale market for electricity administered by the IESO, including generators, transmitters, electricity distributors, retailers and consumers.

"MED" refers to major event days as defined by IEEE specification 1366.

"Mercer" refers to Mercer (Canada) Limited.

"MEU" refers to a municipal electricity utility in the Province of Ontario.

"Ministry of Finance" refers to the Ministry of Finance of Ontario.

"Moody's" refers to Moody's Investors Service, Inc.

"MTN Program" refers to the medium term note program established by the Corporation under which the Corporation issues Debentures. See section 9.2 under the heading "Debentures".

"MW" refers to megawatt, a common measure of electrical power equal to one million watts.

"**Named Executive Officer**" or "**NEO**" means, collectively, the Corporation's CEO, the CFO, and the three most highly compensated executive officers of Toronto Hydro who were serving as executive officers as at December 31, 2013, and each individual who would be amongst the three most highly compensated executive officers for the Corporation, but for the fact that such individuals were not executive officers on December 31, 2013, if any.

"OBCA" refers to the *Business Corporations Act* (Ontario), as amended.

"OEB" refers to the Ontario Energy Board.

"OEB Act" refers to the *Ontario Energy Board Act, 1998* (Ontario), as amended.

"OEFC" refers to the Ontario Electricity Financial Corporation.

"OHSAS" refers to the Occupational Health and Safety Assessment Series.

"OMERS" refers to the Ontario Municipal Employees Retirement System, a multi-employer, contributory, defined benefit pension plan established in 1962 by the Province for employees of municipalities, local boards and school boards in Ontario.

"OPA" refers to the Ontario Power Authority.

"Open Access" refers to the opening of the Province's wholesale and retail electricity markets to competition pursuant to the requirement under the Electricity Act that transmitters and distributors of electricity in the Province provide generators, retailers and consumers with non-discriminatory access to their transmission and electricity distribution systems. Open Access commenced on May 1, 2002.

"OPG" refers to Ontario Power Generation Inc.

"OSC" refers to the Ontario Securities Commission.

"PCBs" refers to polychlorinated biphenyls, a synthetic chemical compound consisting of chlorine, carbon and hydrogen. PCBs are used primarily as insulating and cooling elements in electrical equipment. Secondary uses include hydraulic and heat transfer fluids, flame proofing adhesives, paints, sealants and cable insulating paper.

"PILs" refers to the Payments In Lieu of Corporate Taxes regime contained in the Electricity Act pursuant to which MEUs that are exempt from tax under the ITA and the TA are required to make, for each taxation year, payments in lieu of corporate taxes to the OEFC. See note 4(p) and note 18 to the Consolidated Financial Statements.

"Province" refers to the Province of Ontario.

"Residential Tenancies Act" refers to the *Residential Tenancies Act, 2006* (Ontario), as amended.

"Retail Settlement Code" refers to the Retail Settlement Code that was published by the OEB on December 13, 2000 and became effective on the commencement of Open Access (except with respect to "Service Agreements", as that term is defined in the Retail Settlement Code, which came into effect on March 1, 2001), as amended.

"ROC" refers to the Risk Oversight Committee.

"RRFE" refers to the Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach.

"S&P" refers to Standard & Poor's Financial Services LLC, a subsidiary of the McGraw-Hill Companies Inc.

"SAIDI" means System Average Interruption Duration Index and is a measure (in hours) of the annual system average interruption duration for customers served, not including MED. SAIDI represents the quotient obtained by dividing the total customer hours of interruptions longer than one minute by the number of customers served.

"SAIFI" means System Average Interruption Frequency Index and is a measure of the frequency of service interruptions for customers served, not including MED. SAIFI represents the quotient obtained by dividing the total number of customer interruptions longer than one minute by the number of customers served.

"SEDAR" refers to the Canadian Securities Administrators' System for Electronic Document Analysis and Retrieval. SEDAR's website is www.sedar.com.

"Shareholder Direction" refers to the Shareholder Direction adopted by the Council of the City with respect to the Corporation, as amended and restated from time to time, pursuant to which the City has set out certain corporate governance principles with respect to the Corporation.

"Smart Meter" refers to a metering device capable of recording and transmitting hourly consumption information of a residential or general service customer.

"Standard Supply Customers" refers to persons connected to an electricity distributor's distribution system who are not served by retailers or whose retailer is unable to sell them electricity or who request the distributor to sell electricity to them.

"Standard Supply Service" refers to an electricity distributor's obligation to sell electricity to Standard Supply Customers, or to give effect to such rates as determined by the OEB under section 79.16 of the OEB Act.

"Standard Supply Service Code" refers to the Standard Supply Service Code for Electricity Distributors that was published by the OEB on December 8, 1999 and became effective on the commencement of Open Access, as amended.

"TA" refers to the *Taxation Act, 2007* (Ontario), as amended.

"Technical Standards and Safety Act" refers to the *Technical Standards and Safety Act, 2000* (Ontario), as amended.

"TH Energy" refers to the Corporation's wholly-owned subsidiary, Toronto Hydro Energy Services Inc.

"Toronto Hydro" refers to the Corporation and its subsidiaries.

"Total Recordable Injury Frequency" refers to the number of recordable injuries multiplied by 200,000 divided by exposure hours, as per CEA standards.

"Transfer By-law" refers to By-law No. 374-1999 of the City made under section 145 of the Electricity Act pursuant to which the Toronto Hydro-Electric Commission and the City transferred their assets and liabilities and employees in respect of the electricity distribution system to LDC and in respect of electricity generation, co-generation and energy services to TH Energy. The Transfer By-law permits the Treasurer of the City to adjust the fair market value of the assets and the consideration paid in respect of the electricity distribution assets transferred to LDC as a consequence of OEB rate orders and permitted rates of return for 2000 or any subsequent year.

"Transportation of Dangerous Goods Act" refers to the *Transportation of Dangerous Goods Act, 1992* (Canada), as amended.

"Unit Smart Meter" refers to a unit Smart Meter installed by LDC in a unit of a multi-unit complex where the multi-unit complex is not connected solely to a bulk meter, and includes such other meters as may be prescribed by the Energy Consumer Protection Act.

"US GAAP" refers to United States Generally Accepted Accounting Principles.

"Watt" or **"W"** refers to a common measure of electrical power. One Watt equals the power used when one ampere of current flows through an electrical circuit with a potential of one volt.

Unless otherwise specified, all references to statutes are to statutes of the Province and all references to dollars are to Canadian dollars.

PART 3 - CORPORATE STRUCTURE

3.1 Name, Address, Incorporation

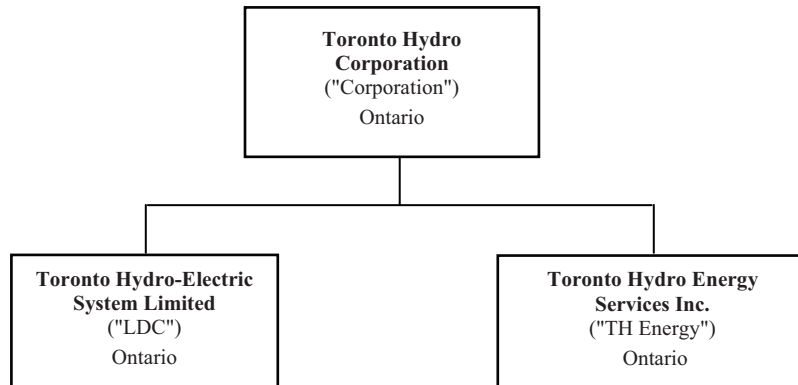
On January 1, 1998, the former municipalities of Metropolitan Toronto, Toronto, East York, Etobicoke, North York, Scarborough and York amalgamated to form the City. At the same time, the electric commissions of Toronto, East York, Etobicoke, North York, Scarborough and York were combined to form the Toronto Hydro-Electric Commission. Toronto Hydro is the successor to the Toronto Hydro-Electric Commission.

The Corporation, LDC and TH Energy were incorporated under the OBCA on June 23, 1999. Pursuant to the Transfer By-law, the Toronto Hydro-Electric Commission and the City transferred their assets and liabilities in respect of the electricity distribution system to LDC and electricity generation, co-generation and energy services to TH Energy. See note 1 to the Consolidated Financial Statements.

The registered and head office of the Corporation is located at 14 Carlton Street, Toronto, Ontario, M5B 1K5.

3.2 Inter-corporate Relationships

The sole shareholder of the Corporation is the City. The Corporation, in turn, owns 100% of the shares of the principal subsidiaries listed below:



PART 4- BUSINESS OF TORONTO HYDRO

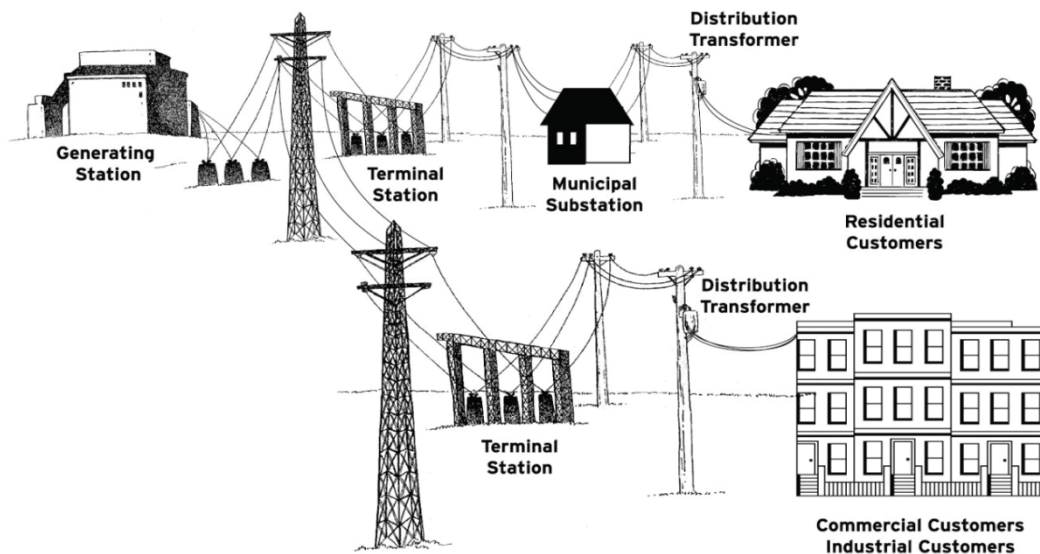
4.1 Industry Structure

The electricity industry in the Province is divided into four principal segments:

- Generation - the production of electricity at generating stations using nuclear, fossil, hydro, solar, wind or other sources of energy;
- Transmission - the transfer of electricity from generating stations to local areas using large, high-voltage power lines;
- Distribution - the delivery of electricity to homes and businesses within local areas using relatively low-voltage power lines; and
- Retailing - the purchase of electricity from generators and its sale to consumers together with a range of related services.

Electricity produced at generating stations is boosted to high voltages by nearby transformers so that the electricity can be transmitted long distances over transmission lines with limited power loss. The voltage is then reduced (stepped down) at terminal stations for supply to electricity distributors or large customers. Electricity distributors carry the electricity to distribution transformers that further reduce the voltage for supply to local customers. Electricity is distributed in the Province through a network of local electricity distributors that includes approximately eighty municipal electricity distributors, a few privately owned electricity distributors, and Hydro One.

The following diagram illustrates the basic structure of an electricity infrastructure system:



4.2 Toronto Hydro Corporation

The Corporation is a holding company which wholly-owns two subsidiaries:

- LDC – which distributes electricity and engages in CDM activities; and
- TH Energy – which provides street lighting services.

The Corporation supervises the operations of, and provides corporate and management services and strategic direction to, its subsidiaries.

The Corporation's vision is to "continuously maximize customer and stakeholders' satisfaction by being safe, reliable and environmentally responsible at optimal costs". The Corporation has an ERM framework that helps determine whether the Corporation is well positioned to achieve its strategic objectives. The ERM framework provides a consistent, disciplined methodology for controlling risk by identifying, assessing, managing, monitoring and reporting risks for the Corporation.

The Corporation is focused on the following four strategic pillars:

People – the Corporation aims to maintain an engaged, healthy, productive, and safe workforce to meet changing business requirements, as it strives to:

- Provide a healthy and safe workplace
- Develop a skilled and knowledgeable workforce
- Keep its workforce engaged

The Corporation will continue to strengthen its already strong safety culture through various internal initiatives in order to achieve world-class results. The Corporation is committed to employee safety and will remain persistent in its efforts to mitigate the risk of injury to its workforce. This will be accomplished through ongoing safety inspections, audits, annual policy review and the continuation of the safety programs and standards. The Corporation will continue to use the internal responsibility system to reinforce the importance of safety in the workplace.

Financial – the Corporation aims to meet the financial objectives of its shareholder, as it strives to:

- Provide a fair return to the shareholder
- Continue to increase shareholder value

The Corporation has provided its shareholder with an annual increase in economic value over the last decade. To meet financial objectives of the shareholder, the Corporation seeks to increase shareholder value and is committed to provide a fair return to its shareholder in the future. Along with excellence in corporate financing and financial management, the Corporation will strive to maintain an investment grade credit rating.

Operations – the Corporation aims to improve reliability through sustainable system management, as it strives to:

- Keep the lights on
- Keep the system safe
- Build a grid that supports a modern Toronto

The Corporation is engaging in resource and capital-intensive programs to improve capacity, reliability and quality. The capital program will replace aging assets and accommodate next generation technology to suit the regulatory trends that incent the increased use of distributed generation.

Customer – the Corporation aims to provide value to customers, as it strives to:

- Make it easy to work with
- Help conserve energy
- Provide innovative tools and technology

The Corporation is looking at ways to improve the level of satisfaction that customers experience, whether it is through education and awareness programs, interaction with call centre representatives, their account managers or over the internet. The Corporation continues to undertake initiatives and invest in technology and processes to improve the customer experience. In turn, this focus on customer service will provide long-term value for money.

4.3 Toronto Hydro-Electric System Limited

The principal business of Toronto Hydro is the distribution of electricity by LDC. LDC owns and operates \$2.8 billion of Capital Assets comprised primarily of an electricity distribution system that delivers electricity to approximately 730,000 customers located in the City. LDC is the largest municipal electricity distribution company in Canada and distributes approximately 18.4% of the electricity consumed in the Province.

(a) LDC's Electricity Distribution System

Electricity produced at generating stations is transmitted along transmission lines owned by Hydro One to terminal stations at which point the voltage is then reduced (or stepped down) to distribution-level voltages. Distribution-level voltages are then distributed across LDC's electricity distribution system to distribution class transformers at which point the voltage is further reduced (or stepped down) for supply to end use customers. Electricity typically passes through a meter before reaching a distribution board or service panel that directs the electricity to end use circuits.

LDC's electricity distribution system is serviced from a control centre, 34 terminal stations and a transmission system terminal station, and is comprised of approximately 16,000 primary switches, approximately 60,560 distribution transformers, 167 in-service municipal substations, approximately 15,000 kilometres of overhead wires supported by approximately 175,400 poles and approximately 11,200 kilometres of underground wires.

(i) Control Centre

LDC has one control centre. The control centre co-ordinates and monitors the distribution of electricity throughout LDC's electricity distribution assets, and provides isolation and work protection for LDC's construction and maintenance crews and external customers. LDC's control centre utilizes supervisory control and data acquisition (SCADA) systems to monitor, operate, sectionalize and restore the electricity distribution system.

(ii) Terminal Stations

LDC receives electricity at 34 terminal stations at which the voltage is stepped down to distribution-level voltages. These terminal stations contain power transformers and high-voltage switching equipment that are owned by Hydro One. These terminal stations also contain low-voltage equipment such as circuit breakers, switches and station busses that are typically owned by LDC.

(iii) Transmission System Terminal Stations

LDC receives electricity at Cavanagh transmission system terminal station at which the voltage is stepped down to distribution-level voltages. The transmission system terminal station contains power transformers, high-voltage switching equipment, and low-voltage equipment such as circuit breakers, switches and station busses that are owned by LDC.

One of LDC's largest capital initiatives currently in progress is the construction of Copeland Station in response to the developing need for distribution solutions in the downtown core of the City. Copeland Station will be considered a transmission system terminal station for which all the equipment and real property are owned by LDC.

Copeland Station will be the first transformer station built in downtown Toronto since the 1960's and will be the second underground transformer station in Canada. When in service, the new station will provide electricity to buildings and neighbourhoods in the central-southwest region of Toronto. Between 2006 and 2011, the population

in the City's downtown increased by over 50%, and Toronto is now the fourth largest metropolitan area¹, by population, in North America. Copeland Station will provide much needed additional capacity to serve current and future load requirements in this high-density, high-growth area of Toronto.

On May 22, 2013, the Corporation celebrated the official groundbreaking at the station. On February 1, 2014, the tunnel boring machine arrived on-site and was being prepared to begin tunnelling north to connect the new infrastructure to the grid. As at December 31, 2013, the capital expenditures on the Copeland Station project amounted to \$60.5 million of which \$45.3 million was recorded in 2013. The total capital expenditures required to complete Copeland Station are expected to be approximately \$194.9 million.

(iv) *Distribution Transformers and Municipal Substations*

Distribution voltage electricity is distributed from the terminal stations to distribution transformers that are typically located in buildings or vaults or mounted on poles or surface pads and that are used to reduce or step down voltages to utilization levels for supply to customers. The electricity distribution system includes approximately 60,560 distribution transformers. The electricity distribution system also includes 167 in-service municipal substations that are located in various parts of the City and are used to reduce or step down electricity voltage prior to delivery to distribution transformers. LDC also delivers electricity at distribution voltages directly to certain commercial and industrial customers that own their own substations.

(v) *Wires*

LDC distributes electricity through a network comprised of an overhead circuit of approximately 15,000 kilometres supported by approximately 175,400 poles and an underground circuit of approximately 11,200 kilometres.

(vi) *Metering*

LDC provides its customers with meters through which electricity passes before reaching a distribution board or service panel that directs the electricity to end use circuits on the customer's premises. The meters are used to measure electricity consumption. LDC owns the meters and is responsible for their maintenance and accuracy.

In accordance with the decision by the Province's Ministry of Energy to install Smart Meters throughout the Province, LDC launched its Smart Meter project in 2006. The Smart Meter project's objective was to install Smart Meters and supporting infrastructure for all residential and small (less than 50 kW) commercial customers. LDC substantially completed its Smart Meter project in 2010.

As part of its metering services, LDC also installs Unit Smart Meters in multi-unit complexes. As at December 31, 2013, LDC had installed approximately 40,000 Unit Smart Meters in multi-unit complexes.

(vii) *Reliability of Distribution System*

The table below sets forth certain industry recognized measurements of system reliability with respect to LDC's electricity distribution system and the composite measures reported by LDC and the CEA for the twelve month periods ending December 31 in the years indicated below.

	LDC 2013	LDC 2012	CEA 2012⁽¹⁾
SAIDI	1.14	1.03	4.43
SAIFI	1.44	1.40	2.48
CAIDI	0.79	0.74	1.78

Note:

- (1) CEA 2012 Service Continuity Report on Distribution System Performance in Canadian Electrical Utilities, excluding significant events. At the date of this AIF, the CEA 2013 Service Continuity Report has not been published.

¹ <http://www.toronto.ca/legdocs/mmis/2013/ed/bgrd/backgroundfile-56336.pdf>

(b) LDC's Service Area and Customers

LDC is the sole provider of electricity distribution services in the City, and serves approximately 730,000 customers. The City is the largest city in Canada with a population of approximately 2.8 million. The City is a financial centre with large and diversified service and industrial sectors.

The table below sets out LDC's customer classes and certain operating data with respect to each class for each of the years in the two-year period ended December 31, 2013:

	Year ended December 31	
	2013	2012
Residential Service ⁽¹⁾		
Number of customers (as at December 31).....	648,380	637,910
kWh	5,072,507,820	5,173,953,186
Revenue	\$814,286,790	\$709,457,130
% of total service revenue	25.9%	25.3%
General Service ⁽²⁾		
Number of customers (as at December 31)	81,137	80,699
kWh	17,027,338,964	17,205,736,682
Revenue	\$2,066,620,770	\$1,867,588,336
% of total service revenue	65.7%	66.7%
Large Users ⁽³⁾		
Number of customers (as at December 31)	51	52
kWh	2,325,901,972	2,182,029,776
Revenue	\$264,547,925	\$222,358,154
% of total service revenue	8.4%	7.9%
Total		
Number of customers (as at December 31)	729,568	718,661
kWh	24,425,748,756	24,561,719,644
Revenue	\$3,145,455,485	\$2,799,403,620

Notes:

- (1) "Residential Service" means a service that is for domestic or household purposes, including single family or individually metered multi-family units and seasonal occupancy.
- (2) "General Service" means a service supplied to premises other than those receiving "Residential Service" and "Large Users" and typically includes small businesses and bulk-metered multi-unit residential establishments. This service is provided to customers with a monthly peak demand of 5,000 kW or less averaged over a twelve-month period.
- (3) "Large Users" means a service provided to a customer with a monthly peak demand of 5,000 kW or more averaged over a twelve-month period.

(c) LDC's Customer Care and Billing System

On July 6, 2011, LDC implemented a new customer care and billing system for its regulated electricity distribution business. This system provides a modern and integrated billing platform that leverages the technology of Smart Meters and enables LDC to respond to evolving business and regulatory requirements.

(d) LDC's Real Property

The following table sets forth summary information with respect to the principal real property owned, leased or otherwise used by LDC:

<u>Property</u>	<u>Total</u>	<u>Owned</u>	<u>Leased</u>	<u>Other⁽¹⁾</u>
Terminal stations	34 sites	7	-	27
Transmission system terminal stations	1 site	1	-	-
Municipal substations	167 sites	155	4	8
Decommissioned municipal substations	28 sites	28	-	-

<u>Property</u>	<u>Total</u>	<u>Owned</u>	<u>Leased</u>	<u>Other⁽¹⁾</u>
Control centre ⁽²⁾	1 site	1	-	-
Operations centres ⁽³⁾	7 sites	3	4	-
Other ⁽⁴⁾	2 sites	2	-	-

Notes:

- (1) Certain terminal stations and municipal substations are located on lands owned by the Province, the City and others. Where electricity distribution lines cross over and run parallel with lands owned by railway companies, appropriate access rights, generally referred to as crossing agreements, have been obtained from the railway companies.
- (2) LDC's control centre is located within one of its operations centres.
- (3) LDC's operation centres accommodate office, staff, crews, vehicles, equipment and material necessary to operate and monitor the electricity distribution system.
- (4) Parcels of land for future use.

Under the OEB Act, electricity distributors are entitled to apply to the OEB for authority to expropriate land required in connection with new or expanded electricity distribution lines or interconnections. If, after a hearing, the OEB is of the opinion that the expropriation of land is in the public interest, the OEB may make an order authorizing expropriation upon payment of specified compensation. The Electricity Act grandfathered thousands of existing unregistered easements, principally for distribution over third-party lands. The Electricity Act also authorizes electricity distributors to locate assets on, over or under public streets and highways.

(e) Regulation of LDC

(i) Legislative Framework

The Electricity Act and the OEB Act provide the broad legislative framework for the Province's electricity market.

The Electricity Act restructured the Province's electricity industry. Under the Electricity Act, the former Ontario Hydro was reorganized into five separate corporations (listed below under their current names):

- OPG, the entity responsible for the former Ontario Hydro's generation business;
- Hydro One, the entity responsible for the former Ontario Hydro's electricity transmission, distribution and energy services businesses;
- OEFC, the entity responsible for managing and retiring the former Ontario Hydro's outstanding indebtedness and remaining liabilities;
- IESO, a non-profit corporation responsible for central market operations; and
- Electrical Safety Authority, a non-profit corporation responsible for the electric installation inspection function.

Additionally, the Electricity Act requires electricity distributors in the Province to keep their distribution businesses separate from their other businesses.

The business of LDC and other electricity distributors is regulated by the OEB, which has broad powers relating to licensing, standards of conduct and service, the regulation of electricity distribution rates charged by LDC and other electricity distributors and transmission rates charged by Hydro One and other transmitters. The OEB Act states that, subject to certain exceptions, LDC and other electricity distributors shall not carry on any business activity other than the distribution of electricity, except through affiliated companies. As an exception to the general restriction on its business activities, the OEB Act permits LDC to provide additional services related to the promotion of CDM activities and alternative, cleaner and renewable sources of energy.

In 2004, the Electricity Restructuring Act established the OPA as a non-profit, self-financed organization with the mandate to ensure long-term electricity supply adequacy in the Province. The OPA is authorized and has the responsibility to implement an integrated power system supply plan and deliver CDM programs in the Province.

The Energy Consumer Protection Act came into force on January 1, 2011. The Energy Consumer Protection Act amends several statutes, including the OEB Act, the Electricity Act, the Consumer Protection Act and the Residential Tenancies Act. The Energy Consumer Protection Act also enables and sets out the requirements relating to LDC's installation of Unit Smart Meters in multi-unit complexes and provides new rules regarding the manner in which energy consumers are to be billed for their electricity consumption.

(ii) *Licences*

Distribution Licence

The OEB has granted LDC a distribution licence. The term of the current licence is until October 16, 2023. The licence allows LDC to own and operate an electricity distribution system in the City. Among other things, the licence provides that LDC must keep financial records associated with distributing electricity separate from its financial records associated with other activities, may not impose charges for the distribution of electricity except in accordance with distribution rate orders approved by the OEB and must comply with industry codes established by the OEB.

Electricity Retailer Licence

On March 7, 2000, the OEB issued an electricity retailer licence to TH Energy. This licence was most recently renewed on May 5, 2010 and terminates on May 4, 2015, although the term may be unilaterally extended by the OEB. The licence allows TH Energy to retail electricity subject to the terms and conditions contained in the licence. TH Energy does not currently engage in electricity retailing.

Electricity Generation Licence

On December 18, 2002, the OEB issued an electricity generation licence to TH Energy and TREC Windpower Co-operative (No.1) Incorporated (the co-venturers), in connection with a wind turbine located at Exhibition Place in the City. The licence allows the co-venturers to generate electricity or provide ancillary services for sale through the IESO-administered markets, or directly to another person, subject to certain terms and conditions. This licence terminates on December 17, 2022, although the term may be extended by the OEB.

(iii) *Industry Codes*

The OEB has established the Affiliate Relationships Code, the Distribution System Code, the Retail Settlement Code, the Standard Supply Service Code, and the Conservation and Demand Management Code. These codes prescribe minimum standards of conduct, as well as standards of service, for electricity distributors in the non-competitive electricity market, and have been assigned the following ranking in the event there is a conflict between them:

- (1) Affiliate Relationships Code
- (2) Distribution System Code

- (3) Retail Settlement Code
- (4) Standard Supply Service Code
- (5) Conservation and Demand Management Code

These codes are summarized below.

Affiliate Relationships Code

The Affiliate Relationships Code establishes standards and conditions for the interaction between electricity distributors and their affiliated companies. It is intended to minimize the potential for an electricity distributor to cross-subsidize competitive or non-monopoly activities, protect the confidentiality of consumer information collected by an electricity distributor and ensure that there is no preferential access to regulated services. The Affiliate Relationships Code prescribes standards of conduct for an electricity distributor with respect to the following: the degree of separation from affiliates; sharing of services and resources; transfer pricing; financial transactions with affiliates; equal access to services; and confidentiality of customer information.

Distribution System Code

The Distribution System Code establishes the minimum conditions that an electricity distributor must meet in carrying out its obligations to distribute electricity under its licence and under the Energy Competition Act, and has been amended as the regulatory environment has evolved. Generally, the Distribution System Code prescribes the rights and responsibilities of electricity distributors and electricity distribution customers with respect to the following: connections; connection agreements and conditions of service; expansion projects; alternative bids (available to customers for work otherwise done by an electricity distributor); metering; operations; disconnection and security deposits; and other matters.

Retail Settlement Code

The Retail Settlement Code outlines the obligations of an electricity distributor with respect to its relationship with retail market participants and its role as a retail market settlements administrator. Under the terms of the Retail Settlement Code, an electricity distributor is required to do the following: unbundle the costs of competitive electricity services and non-competitive electricity services; record, in variance accounts, the difference between amounts billed by the IESO to the electricity distributor for competitive and non-competitive electricity services, and the aggregate amounts billed by the electricity distributor to consumers, retailers and others for the same services; and provide electricity billing and settlement services to retailers and customers.

Standard Supply Service Code

The Standard Supply Service Code requires an electricity distributor to act as a default supplier and provide Standard Supply Service to persons connected to the electricity distributor's distribution system. The Standard Supply Service Code also specifies the conditions and manner by which OEB approved Standard Supply Service rates are to be charged to customers. Under the Standard Supply Service Code, an electricity distributor's rates for Standard Supply Service must be approved by the OEB and must consist of the price of electricity and an administrative charge that will allow the electricity distributor to cover its costs of providing the service.

Conservation and Demand Management Code

The Conservation and Demand Management Code sets out the obligations and requirements that licensed electricity distributors must comply with in relation to CDM targets as set out in their licences, as well as the operational framework for electricity distributor-operated CDM activities. The Conservation and Demand Management Code also sets out the conditions and rules that licensed electricity distributors are required to follow if they choose to use OEB approved CDM programs to meet their CDM targets.

(f) Distribution Rates

(i) Rate Setting Mechanism

Pursuant to Section 78 of the OEB Act, the OEB is mandated to regulate the electricity distribution rates charged by electricity distributors. Generally, an electricity distributor's rates are set by way of either a Cost of Service or IRM framework.

A Cost of Service application requires a detailed examination of evidence and an assessment of the costs incurred by an electricity distributor to provide service, including: capital costs and cost rates for equity and debt; PILs payments; amortization costs; operations, maintenance, and administrative costs; and cost of service offsets in the form of revenues from sources other than electricity distribution rates. The electricity distributor's rates are calculated to recover the total amount of all costs less revenue from other sources, as determined by the OEB, required to provide service to its customers.

The IRM framework provides for an annual adjustment to an electricity distributor's rates based on a formulaic calculation with no direct examination of evidence regarding the electricity distributor's actual costs and infrastructure needs. The IRM rate setting plan runs on a five year cycle, with a Cost of Service rate application known as a "rebasement application" serving as the starting point for four subsequent annual rate changes determined through the IRM adjustment process.

On October 18, 2012, the OEB released its RRFE report, which guides the OEB in setting rates for electricity distributors in 2015 and onwards.

The RRFE identifies three rate-setting methods to provide choices for distributors with varying capital requirements. Each distributor may apply to the OEB under the rate-setting method that best meets its needs and circumstances. The three rate-setting methods are:

- (1) the Fourth Generation version of IRM (described below);
- (2) a Custom Incentive Rate-setting method, under which rates are set based on a five year forecast of a distributor's revenue requirement and sales volumes; and
- (3) an Annual Incentive Rate-setting Index method, which involves adjustment of rates by a simple price cap index formula.

As part of the RRFE, the OEB's Fourth Generation version of IRM allows electricity distributors to adjust their rates by the difference between the inflation factor (as determined by Statistics Canada) and the sum of:

- (1) an OEB-determined productivity factor (currently set at 0.00%, representing expected annual, industry-wide electricity distributor productivity gain); and
- (2) an OEB-determined stretch factor (set between 0.00% and 0.60%, representing an additional productivity target determined by benchmarked electricity distributor performance).

In certain circumstances, a distributor may also request, under the IRM, relief by way of the ICM, which is intended to address specific capital expenditure needs that occur during the IRM term, and are not otherwise funded by the formulaic calculation. In order to determine whether a distributor is eligible for the ICM, the OEB conducts a review of the application by way of a detailed examination of a distributor's evidence and consideration of a number of criteria, such as materiality, need and prudence.

The RRFE also requires distributors to file five-year capital plans to support their rate applications, and to report annually on identified performance outcomes.

The Corporation is currently in the process of preparing an application for 2015-2019 electricity distribution rates under the Custom Incentive Rate-setting method.

See section 5.2 under the heading "Rate Applications" for more information on LDC's rate applications.

(ii) *Other Regulated Charges*

The OEB's 2006 Rate Handbook provides standard rates and guidelines to electricity distributors with respect to other regulated charges that are non-competitive in nature, required under OEB codes and guidelines, governed by the market rules or are under the direction of the Province, including transmission charges and retail service charges relating to services provided by electricity distributors to electricity retailers in accordance with the Retail Settlement Code.

4.4 Toronto Hydro Energy Services Inc.

TH Energy is a professional energy services company with \$24.3 million of Capital Assets. Until January 1, 2012, TH Energy owned and operated all of the street lighting assets located in the City and had the sole right to provide maintenance and capital improvements to the street lighting systems throughout the City until 2035, and such services were sub-contracted to LDC. Effective January 1, 2012, TH Energy transferred a portion of its street lighting assets to LDC. TH Energy continues to provide street lighting system maintenance and capital improvement services to the City, and such services continue to be sub-contracted to LDC. See section 5.3 under the heading "Street Lighting Activities" for more information on the transfer of street lighting assets from TH Energy to LDC.

Until June 30, 2013, TH Energy provided consolidated billing services to the City, and such services were sub-contracted to LDC. TH Energy also operates a wind turbine located at the Better Living Centre (Exhibition Place) in a joint venture with TREC Windpower Cooperative (No.1) Incorporated.

4.5 Environmental Matters

(a) Environmental Protection Requirements

Toronto Hydro is subject to extensive federal, provincial and local regulation relating to the protection of the environment. The principal federal legislation is the Canadian Environmental Protection Act which regulates the use, import, export and storage of toxic substances, including PCBs and ozone-depleting substances. Toronto Hydro is also subject to the federal Transportation of Dangerous Goods Act which prescribes safety standards and requirements for the handling and transportation of hazardous goods including PCBs and sets reporting, training and inspection requirements relating thereto.

The principal provincial legislation is the Environmental Protection Act which regulates releases and spills of contaminants, including PCBs, ozone-depleting substances and other halocarbons, contaminated sites, waste management, and the monitoring and reporting of airborne contaminant discharge. The provincial Technical Standards and Safety Act also applies to Toronto Hydro's operations with respect to the handling of and training related to compressed gas, propane and liquid fuels. The provincial Fire Protection and Prevention Act requires Toronto Hydro to incorporate procedures and training for dealing with any spills of flammable or combustible liquids. The provincial Dangerous Goods Transportation Act prescribes safety standards and requirements for the transportation of dangerous goods on provincial highways and sets out inspection requirements related thereto.

Municipal by-laws regulate discharges of industrial sewage and storm water run-off to the municipal sewer system and the reporting of the release of certain toxic substances into the atmosphere.

(b) Financial and Operational Effects of Environmental Protection Requirements

In 2013, LDC spent approximately \$0.44 million to meet environmental protection requirements. These costs are not anticipated to significantly increase for future years, and do not currently have a material impact on the Corporation's financial and operational results.

The Corporation recognizes a liability for the future environmental remediation of certain properties and for future removal and handling costs for contamination in electricity distribution equipment in service and in storage. The liability is recognized when the asset retirement obligation is incurred and when the fair value is determined. As at December 31, 2013, the Corporation's asset retirement obligations amounted to \$6.3 million. See notes 4(n) and 15 to the Consolidated Financial Statements.

(c) Environmental Policy and Oversight

Toronto Hydro has a strong commitment to the environment through the enforcement of a well defined Environmental Policy. Conformance with the Environmental Policy is managed by Toronto Hydro's Environmental, Health and Safety department led by the Chief Human Resources & Safety Officer. The content of, and conformance with, the Environmental Policy is reviewed annually by the Board.

Toronto Hydro's Environmental Policy identifies several core environmental principles, which include:

- Compliance with all applicable laws, codes and standards;
- Continual improvement of environmental performance through the establishment of annual objectives, targets and programs;
- Employee engagement through education, training and providing general awareness of the Environmental Policy requirements and the environmental management system;
- Community engagement including consultation and engagement of environmental issues within the community and various stakeholders such as suppliers, customers, regulators, industry and the public;
- Pollution prevention through the implementation of policies, programs and procedures; and
- Integration of environmental considerations into our business processes.

LDC manages its environmental aspects in conformance with ISO 14001 and was certified on February 5, 2013 as meeting the requirements of the ISO 14001 standard by a third party auditor.

Legislative environmental reporting for federal, provincial and municipal governments is compiled and submitted annually. Third party environmental compliance audits are also conducted bi-annually in conformance with LDC's environment, health and safety audit plan.

Toronto Hydro's environmental policies, programs and procedures are reviewed and approved by management. Quarterly updates are presented to the Board covering current environmental risks, environmental compliance audit findings, mitigation strategies and other material environmental matters.

4.6 Additional Information Regarding Toronto Hydro

(a) Employees

At December 31, 2013, Toronto Hydro had approximately 1,530 employees. Included in Toronto Hydro's employees are 961 members of bargaining units represented by the Canadian Union of Public Employees, Local One ("CUPE One"), and 54 engineers represented by the Society of Energy Professionals.

On February 13, 2014, CUPE One ratified collective agreements governing inside and outside employees 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. The escalator clauses only become effective if certain prescribed thresholds are exceeded.

On April 12, 2012, the Society of Energy Professionals ratified a new collective agreement for a four-year period expiring December 31, 2015. The collective agreement implemented wage increases of 1.5% retroactive to January 1, 2012, 1.75% effective January 1, 2013 and 2.0% effective on each of January 1, 2014 and January 1, 2015, respectively.

Full time employees of Toronto Hydro participate in the OMERS pension plan. Plan benefits are determined on a formula based on the highest 5-year average contributory earnings and years of service with an offset for Canada Pension Plan benefits and are indexed to increases in the Consumer Price Index, subject to an annual maximum of 6%. Any increase in the Consumer Price Index above 6% per year is carried forward for later years. Both participating employers and participating employees are required to make plan contributions based on participating

employees' contributory earnings. All obligations to make payments to retirees under the OMERS pension plan are the responsibility of OMERS.

In addition to OMERS, Toronto Hydro provides other retirement and post-retirement benefits to employees, including medical, dental and life insurance benefits. See note 4(m) and note 14 to the Consolidated Financial Statements.

(b) Specialized Skills and Knowledge

Trades and technical jobs play a critical role in the safe and reliable design, construction and maintenance of LDC's electricity distribution system. These jobs include overhead, underground, and stations trades as well as controllers, designers and engineers. LDC hires experienced workers when available, along with apprentices to trades and technical positions. Trade apprentices require between 54 and 78 months to become fully competent and capable of performing all aspects of their job. LDC provides trades, legislative and compliance training through its apprenticeship program.

(c) Health and Safety

Toronto Hydro is committed to a safe and injury free work environment for all employees, contractors, visitors and the public. Through LDC's EHSMS, based on British Standards Institution OHSAS 18001:2007 Standard *"Occupational Health and Safety Management System - Requirements"*, LDC maintains and reviews procedures, programs and the Occupational Health and Safety Policy which outlines several core principles including:

- Compliance
- Continual Improvement
- Engagement and Consultation
- Communication
- Accountability
- Risk Management
- Contractor Management
- Incident Investigation
- Performance Monitoring

The content of, and compliance with, the Occupational Health and Safety Policy is reviewed annually by the Board.

Toronto Hydro's health and safety performance is reviewed periodically by the Human Resources Committee of the Board. In 2013, the Total Recordable Injury Frequency was 2.26 recordable injuries per 200,000 hours worked compared to 2.15 in 2012.

LDC's legislated occupational health and safety requirements come under provincial jurisdiction exclusively and all legislated occupational health and safety reporting requirements are complied with. Management assurance that these requirements are met is accomplished by commissioning third party health and safety compliance audits conducted in conformance with LDC's environmental, health and safety audit plan.

Toronto Hydro's occupational health and safety policies, programs and procedures are reviewed and approved by management. Quarterly updates are presented to the Board covering current occupational health and safety risks, performance, compliance audit findings, mitigation strategies and other occupational health and safety matters.

(d) Code of Business Conduct

All employees, officers and directors of Toronto Hydro are required to comply with the principles set out in the Code of Business Conduct, which was implemented by Toronto Hydro in 2004, and is reviewed and approved by the Board from time to time. The Code provides for the appointment of an Ethics Officer and establishes a direct hotline to the Ethics Officer by which perceived violations of the principles set out in the Code may be reported, anonymously or otherwise. The Ethics Officer reports quarterly to the Audit Committee of the Board on the nature

of complaints received including those related to audit and accounting matters. Where the complaint involves the conduct of a director or officer of the Corporation, the Ethics Officer is required to report it to the Chair of the Audit Committee, who oversees the investigation of that complaint. A copy of Toronto Hydro's Code of Business Conduct is available on the SEDAR website at www.sedar.com.

(e) Insurance

Toronto Hydro's current insurance policies provide coverage for a variety of losses and expenses which might arise from time to time, including comprehensive general liability, all risk property and boiler and machinery insurance, covering loss or damage on certain physical assets, liabilities of directors and officers and automobile liability. Toronto Hydro believes that the coverage, amounts and terms of its insurance arrangements are consistent with prudent Canadian industry practice.

(f) Investments

Toronto Hydro's investment activities are governed by the terms of the Shareholder Direction and by the terms of the Corporation's Treasury Policy. The Corporation's Treasury Policy was adopted by the Board, is administered by LDC's Treasury Department and overseen by the Corporation's CFO. The primary objective of the Treasury Policy is the implementation of appropriate and effective short-term cash management, investment and borrowing strategies required to manage all corporate funds and related financial risks. The Treasury Policy includes specific operational rules, procedures and benchmarks relating to cash management, liquidity, investments, foreign exchange hedging, borrowing of funds, interest rate risk management, investor relations and corporate debt financing.

(g) Intangible Property

The Corporation owns various intangible assets, such as computer software systems used in the course of business, and intellectual property, including the "Toronto Hydro" brand name and the trademark Toronto Hydro star logo. The Corporation also owns the trademarks peakSAVER[®], POWERSHIFT[®] and PEAKSAVER PLUS[®]. The trademarks peakSAVER[®] and PEAKSAVER PLUS[®] have been licensed by the Corporation to the OPA and sub-licensed to various electricity distributors in the Province for the promotion of a province-wide demand response CDM program.

(h) Seasonal Effects

The Corporation's quarterly results are impacted by changes in revenues resulting from variations in seasonal weather conditions, the fluctuations in electricity prices, and the timing and recognition of regulatory decisions. Consequently, the Corporation's revenues, all other things being equal, would tend to be higher in the first quarter as a result of higher energy consumption for winter heating, and in the third quarter due to air conditioning/cooling. A variation in the above trend was noted in 2013 and 2012, evidenced by higher revenue and cost of purchased power in the second quarters of both years, compared to the first quarters of both years. This variation was primarily due to an increase in commodity costs.

PART 5 - GENERAL DEVELOPMENT OF THE BUSINESS

5.1 Business Operations

(a) Three Year History

The following table sets forth selected annual financial information of the Corporation for the three years ended December 31, 2013, 2012 and 2011. This information has been derived from the Consolidated Financial Statements and is presented in millions of dollars.

	Year ended December 31		
	2013	2012 ¹	2011 ¹
Net Income	\$121.2	\$86.0	\$95.9
Capital Expenditures	\$450.3	\$292.4 ²	\$437.1
Total assets	\$3,797.5	\$3,539.4	\$3,527.5
Shareholder's equity	\$1,218.5	\$1,140.3	\$1,102.2

Notes:

- (1) The Corporation's consolidated financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. Selected financial information from comparative consolidated financial statements for 2011 have been adjusted retroactively from the consolidated financial statements previously filed to conform to the presentation of the Corporation's consolidated financial statements for the years end December 31, 2013 and 2012, which were prepared in accordance with US GAAP.
- (2) Capital expenditures disclosed in the 2012 AIF have been restated to conform to the presentation in the Consolidated Financial Statements. See note 24 to the Consolidated Financial Statements and the section "Liquidity and Capital Resources" in the Corporation's MD&A for the year ended December 31, 2013 for more information.

(b) Business Operations

Over the past three years, the Corporation continued to streamline its business operations to focus on LDC's core businesses of distributing electricity and engaging in CDM activities.

On January 1, 2011, the Corporation amalgamated with one of its wholly-owned subsidiaries, 1455948 Ontario Inc. ("14 Co."). At the time of the amalgamation, 14 Co. did not have any business operations. 14 Co. had been incorporated by the Corporation to operate an equal partnership with a wholly-owned subsidiary of OPG, OPG EBT Holdco Inc. (the "EBT Express Partnership"). The EBT Express Partnership owned an interest in The SPi Group Inc., an electronic clearing house for wholesale and retail electricity transactions. On April 30, 2009, the EBT Express Partnership sold its interest in The SPi Group Inc. to EARTH Corporation for cash consideration of approximately \$5.2 million. The Corporation's share of the sale proceeds from this transaction as it relates to 14 Co. was approximately \$2.6 million.

On January 1, 2012, the Corporation completed the transfer of a portion of the street lighting assets from TH Energy to the new wholly-owned legal entity (1798594 Ontario Inc.), and the amalgamation of LDC with the new wholly-owned entity. See section 5.3 under the heading "Street Lighting Activities" for more information.

5.2 Rate Applications

LDC's electricity distribution rates are typically effective from May 1 to April 30 of the following year. Accordingly, LDC's distribution revenue for the first four months of 2012 was based on the electricity distribution rates approved for the May 1, 2011 to April 30, 2012 rate year (the "2011 Rate Year"). LDC's distribution revenue for the first four months of 2013 was based on the electricity distribution rates approved for the May 1, 2012 to April 30, 2013 rate year (the "2012 Rate Year"). Similarly, distribution revenue for the last eight months of 2013 was based on the electricity distribution rates approved for May 1, 2013 to April 30, 2014 (the "2013 Rate Year") (see 5.2(b)).

The following is an overview of LDC's rate applications from 2011 to date.

(a) 2011 Rate Year

LDC's electricity distribution rates for the 2011 Rate Year were determined through an application filed under the Cost of Service framework. On July 7, 2011, the OEB issued its decision regarding LDC's electricity distribution rates for the 2011 Rate Year. The decision provided for a distribution revenue requirement and rate base of \$522.0 million and \$2,298.2 million, respectively. In addition, the decision provided for capital program spending levels and operating, maintenance and administration spending levels of \$378.8 million and \$238.0 million, respectively.

(b) 2012-2014 Rate Application

On May 10, 2012, LDC filed an application for electricity distribution rates for 2012, 2013, and 2014 using the IRM framework, including the filing of an ICM application (the “IRM/ICM Application”).

On October 31, 2012, LDC submitted an update to its IRM/ICM Application modifying the requested capital expenditures for 2012 and 2013 to \$283.0 million and \$579.1 million, respectively, and requesting that consideration for 2014 be deferred to a second phase of the proceeding, once LDC had received a decision from the OEB in respect of phase one. On November 3, 2012, the OEB accepted LDC’s request for a two-phase proceeding: phase one comprising LDC’s 2012 and 2013 work program proposals and phase two comprising LDC’s 2014 work program proposal.

On April 2, 2013, the OEB issued a partial decision and order for phase one of the proceeding comprising LDC’s 2012 and 2013 work program proposals. The OEB’s decision determined that eligible capital funding under the ICM framework was to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to \$203.3 million for 2012 and \$484.2 million for 2013. New rates became effective June 1, 2013. In 2015, LDC will be allowed to seek recovery for capital spent in 2012 and 2013 that has not yet been approved by the OEB in the current ICM decision due to the standard operation of the regulatory model.

On August 1, 2013, LDC filed an application with the OEB requesting approval for the disposition of balances in its smart meter deferral account related to smart meter installations in 2008, 2009 and 2010. In the application, LDC requested two new rate riders effective May 1, 2014. The first rate rider relates to the recovery of \$23.9 million, which represents the cumulative revenue requirement net of recoveries from an existing smart meter rate rider. This existing smart meter rate rider would be discontinued when the new rate riders become effective. The second rate rider relates to the recovery of \$9.6 million, which represents the forecasted 2014 incremental revenue requirement until LDC may be permitted to transfer the smart meter assets into rate base.

On August 19, 2013, LDC submitted an update to its IRM/ICM Application regarding its 2014 work program proposal. The filed update incorporates the OEB’s guidance on the ICM methodology provided in the April 2, 2013 partial decision and order with respect to phase one of this proceeding. In phase two, LDC sought approval for total capital expenditures amounting to \$398.8 million for 2014.

On December 18, 2013, LDC filed a settlement agreement with the OEB, which allowed for the entirety of LDC’s requested 2014 capital program. On December 19, 2013, the OEB approved this settlement agreement. Consistent with the April 2, 2013 partial decision and order with respect to phase one, eligible capital funding under the ICM framework is to be calculated on an in-service basis. This correlates to the approval of capital expenditures amounting to \$398.8 million for 2014.

On January 16, 2014, the OEB approved LDC’s requested disposition of the smart meter deferral account balances, permitting the recovery of \$23.9 million and \$9.6 million through two separate rate riders effective May 1, 2014.

5.3 Street Lighting Activities

On June 15, 2009, the Corporation filed an application with the OEB seeking an electricity distribution licence for a new wholly-owned legal entity to which the Corporation intended to transfer the street lighting assets of TH Energy. Concurrently, the Corporation filed another application with the OEB seeking approval for the merger of LDC and the new legal entity. The main objective of these applications was to transfer the street lighting assets to the regulated electricity distribution activities of LDC to increase the overall safety of the related infrastructure.

On February 11, 2010, the OEB issued its decision in regard to these applications. In its decision, the OEB agreed that, under certain conditions, the treatment of certain types of street lighting assets as regulated assets is justified. The OEB ordered the Corporation to provide a detailed valuation of the street lighting assets and to perform an operational review to determine which street lighting assets could become regulated assets.

The Corporation performed a detailed asset operational review and financial valuation of the street lighting assets, which was submitted to the OEB on January 31, 2011.

On August 3, 2011, the OEB issued its final decision allowing the transfer of a portion of the street lighting assets to the new wholly-owned legal entity (1798594 Ontario Inc.), and for LDC to amalgamate with the new legal entity. On January 1, 2012, the Corporation completed the asset transfer and amalgamation. The purchase price for such assets, including a post-closing adjustment, was \$42.5 million, subject to transaction costs.

5.4 Conservation and Demand Management

On March 31, 2010, the Minister of Energy and Infrastructure of Ontario, under the guidance of sections 27.1 and 27.2 of the OEB Act, directed the OEB to establish CDM targets to be met by electricity distributors. Accordingly, on November 12, 2010, the OEB amended LDC's distribution licence to require LDC, as a condition of its licence, to achieve 1,304 GWh of energy savings and 286 MW of summer peak demand savings, over the period beginning January 1, 2011 through December 31, 2014.

Effective January 1, 2011, LDC entered into an agreement with the OPA in the amount of approximately \$50.0 million to deliver CDM programs extending from January 1, 2011 to December 31, 2014. As at December 31, 2013, LDC received approximately \$45.9 million from the OPA for the delivery of CDM programs. All programs to be delivered are fully funded and paid in advance by the OPA. Amounts received but not yet spent are presented under current liabilities as deferred conservation credit. Upon the expiration of the agreement, LDC is required to repay to the OPA any excess funding received for program administration less any cost efficiency incentives. These programs are expected to support the achievement of the mandatory CDM targets described above.

On December 21, 2012, the Minister of Energy of Ontario issued a direction to the OPA under subsection 25.32(4.1) of the Electricity Act to extend the funding time period for OPA-contracted province-wide CDM initiatives under the Green Energy Act framework to December 31, 2015.

5.5 Contact Voltage

On June 30, 2009, LDC filed an application with the OEB seeking recovery of costs incurred in 2009 for the remediation of safety issues related to contact voltage. LDC sought recovery of \$14.4 million by way of fixed term rate riders of 3 years for the street lighting and unmetered scattered load rate classes, and one year for all other classes.

On December 10, 2009, the OEB issued an initial decision in this proceeding which provided for the recovery of allowable actual expenditures incurred above the amount deemed as controllable expenses in LDC's 2009 approved electricity distribution rates. At the time of the decision, the Corporation estimated the allowable recovery of costs at \$9.1 million.

On October 29, 2010, the OEB issued a second decision in the matter, following further review of costs incurred by LDC. In this decision, the OEB deemed the balance allowable for recovery at \$5.3 million. The variance from the Corporation's original estimate was mainly due to the OEB's interpretation of the definition of controllable expenses used to determine the final allowable recovery. In connection with this decision from the OEB, the Corporation revised its recovery estimate for contact voltage costs, resulting in an increase in operating expenses of \$3.8 million in 2010. On November 18, 2010, LDC filed a motion to review the decision with the OEB seeking an amendment to allow for recovery in accordance with the initial decision rendered on December 10, 2009. On March 25, 2011, the OEB issued its decision on the LDC motion, denying the requested additional recovery.

5.6 OEB PILs Proceeding

The OEB conducted a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for certain MEUs. On June 24, 2011, the OEB issued its decision for these MEUs and provided guidelines for the calculation and further disposition of the balances accumulated in the PILs regulatory variance accounts.

LDC reviewed the balance of its PILs regulatory variance accounts and applied the guidelines provided by the OEB. LDC applied for disposition of the balance as part of its IRM/ICM Application filed on May 10, 2012. The OEB issued its decision and order on April 2, 2013 approving the disposition of the balance. The impact was recorded previously in the Corporation's consolidated financial statements.

5.7 Accounting Policies

The Consolidated Financial Statements of the Corporation have been prepared in accordance with US GAAP and are presented in Canadian dollars. In preparing the Consolidated Financial Statements, management makes estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and the reported amounts of revenues and expenses for the year. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Ministry of Energy of Ontario, or the Ministry of Finance of Ontario. The significant accounting policies of the Corporation are summarized in notes 2 and 4 to the Consolidated Financial Statements.

On July 21, 2011, the OSC granted an exemption to allow the Corporation to prepare its consolidated financial statements in accordance with US GAAP for its fiscal years beginning on or after January 1, 2012 but before January 1, 2015. In the absence of the exemption, the Corporation would have previously been required to adopt IFRS on January 1, 2012. On March 19, 2014, the Board of Directors of the Corporation approved the adoption of IFRS for the year beginning on January 1, 2015 due to the pending expiration of the exemption. Accordingly, the Corporation's consolidated financial statements for 2015 are expected to be prepared in accordance with IFRS and applied retrospectively to the Corporation's opening IFRS consolidated statement of financial position as at January 1, 2014.

The Corporation has an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its consolidated financial statements. The Corporation believes that the impact on its financial statements could be material.

On January 31, 2014 the IASB published the interim standard of rate regulated accounting. See section "IFRS Conversion Project" in the Corporation's MD&A for the year ended December 31, 2013 for more information on the Corporation's conversion to IFRS.

PART 6 - RELATIONSHIP WITH THE CITY

6.1 Shareholder Direction

As sole shareholder of the Corporation, the City has adopted the Shareholder Direction that sets out the following corporate governance principles with respect to Toronto Hydro:

- the objectives and principles that govern the operations of Toronto Hydro;
- the matters in addition to those set out in the OBCA that require the approval of the City as the sole shareholder of the Corporation; and
- certain financial and administrative arrangements between the Corporation and the City.

(a) Shareholder Objectives and Principles

The Shareholder Direction requires Toronto Hydro to conduct its affairs and govern its operations in accordance with such rules, policies, directives or objectives as directed by City Council from time to time.

The Shareholder Direction provides that the following objectives and principles shall govern the operations of Toronto Hydro:

- to operate Toronto Hydro on an efficient and commercially prudent basis;
- to optimize the City's return on equity as the sole shareholder of the Corporation and operate Toronto Hydro with a view to meeting the financial performance objectives of the City as set out in the Shareholder Direction;

- to provide a reliable, effective and efficient electricity distribution system that supports the electricity demands of residents and businesses in the City;
- to operate Toronto Hydro in an environmentally responsible manner consistent with the City's energy, climate change and urban forestry objectives and, as appropriate, utilizing emerging green technologies;
- to ensure that the business is managed in material compliance with all law; and
- to engage in recruitment and procurement practices designed to attract employees and suppliers from the City's diverse community.

The Shareholder Direction provides that the Board is responsible for determining and implementing the appropriate balance among these objectives and principles and for causing Toronto Hydro to conduct its affairs in accordance with the same.

(b) Shareholder Approval

In addition to those matters set out in the OBCA, the following matters, among others, require the approval of the City as the sole shareholder of the Corporation:

- subject to certain exceptions in the case of LDC, creating any security over the assets of the Corporation or LDC;
- in the case of LDC, providing any financial assistance to any person other than in accordance with the Shareholder Direction;
- in the case of the Corporation and LDC, making any investment in or providing any financial assistance to any subsidiary of the Corporation (other than LDC), other than trade payables incurred in the ordinary course of business on customary terms and an investment in or financial assistance to a subsidiary that originally was an investment in or financial assistance to LDC, in excess of 12% of the shareholder's equity of LDC as shown in its most recent financial statements; and
- acquiring any interest in the electricity distribution system, undertaking or securities of a distributor operating outside the City unless, among other things, the acquisition does not adversely affect the dividend payable to the City and there is no dilution of the City's shareholding in the Corporation.

The City has authorized the Corporation to provide financial assistance to its subsidiaries for the purpose of enabling them to carry on their respective businesses, including, in the case of LDC, for the purpose of satisfying the prudential requirements of the IESO. See note 17 to the Consolidated Financial Statements. The Shareholder Direction limits the financial assistance that may be provided by the Corporation to its subsidiaries to an aggregate amount of \$500.0 million, except in the case of LDC, which financial assistance is unlimited.

(c) Financial Performance

The Shareholder Direction provides that the Board will use its best efforts to ensure that Toronto Hydro meets certain financial performance standards, including those relating to the credit rating and dividends.

(d) Credit Rating

The Shareholder Direction provides that the Corporation will obtain and maintain a rating of A minus or higher (or its equivalent rating, depending on the credit rating agency) on its senior debt securities, as rated by two accredited credit rating agencies in Ontario (which include S&P, DBRS and Moody's).

(e) Dividends

Subject to applicable law, the Shareholder Direction provides that the Corporation will pay dividends to the City each year amounting to the greater of \$25.0 million or 50% of the Corporation's consolidated net income for the prior fiscal year. The dividends are not cumulative and are payable as follows:

- \$6.25 million on the last day of each fiscal quarter of the year; and
- the amount, if any, by which 50% of the Corporation's annual consolidated net income for the year exceeds \$25.0 million, within ten days after the approval of the Corporation's audited consolidated financial statements for the year by the Board.

The Corporation declared and paid dividends to the City totalling \$33.1 million in 2011, \$48.0 million in 2012 and \$43.0 million in 2013.

On March 19, 2014, the Board declared dividends in the amount of \$41.87 million. The dividends are comprised of \$35.62 million with respect to net income for the year ended December 31, 2013, payable to the City on March 28, 2014, and \$6.25 million with respect to the first quarter of 2014, payable to the City on March 31, 2014.

LDC declared and paid \$nil dividends to the Corporation in 2011 and 2012, and \$40.0 million in 2013.

TH Energy declared and paid dividends to the Corporation amounting to \$nil in 2011, \$28.5 million in 2012 and \$nil in 2013.

On August 15, 2013, the Corporation passed a resolution to reduce the share capital of TH Energy to \$20 million and to distribute \$20 million to the Corporation, which was paid on August 16, 2013.

6.2 Indebtedness to the City

On April 1, 2010, the City monetized its interest in the Amended and Restated City Note under which the Corporation had \$490.1 million of indebtedness outstanding to the City. The Amended and Restated City Note represented the Corporation's remaining indebtedness to the City in consideration for the transfer of \$980.2 million of electricity distribution system assets by the Toronto Hydro-Electric Commission and the City to LDC upon initial formation of Toronto Hydro on July 1, 1999.

The Amended and Restated City Note was converted, in accordance with its terms, into two series of debentures of the Corporation ("Series 4" and "Series 5") on April 1, 2010 and sold to the public by a syndicate of investment dealers. The Corporation did not receive any proceeds from the offering of the Series 4 and Series 5 debentures. Following the completion of the offering of the Series 4 and Series 5 debentures, the Amended and Restated City Note was cancelled. The Corporation repaid the Series 4 and Series 5 debentures which matured on December 30, 2011 and May 6, 2013, respectively.

As at the date of this AIF, the Corporation has no further indebtedness outstanding to the City.

6.3 Services Provided to the City

Toronto Hydro provides certain services to the City at commercial and regulated rates, including street lighting maintenance services, and, prior to June 30, 2013 only, consolidated electricity billing services. These services are provided by TH Energy and sub-contracted to LDC. See section 4.4 under the heading "Toronto Hydro Energy Services Inc." for more information. See note 20 to the Consolidated Financial Statements.

PART 7 – TAXATION

7.1 Tax Regime

The Corporation is exempt from tax under the ITA, if not less than 90% of the capital of the Corporation is owned by the City and not more than 10% of the income of the Corporation is derived from activities carried on outside the municipal geographical boundaries of the City. In addition, the Corporation's subsidiaries are also exempt from tax under the ITA provided that all of their capital is owned by the Corporation and not more than 10% of their respective income is from activities carried on outside the municipal geographical boundaries of the City. A corporation exempt from tax under the ITA is also exempt from tax under the TA.

The Corporation and each of its subsidiaries are MEUs for purposes of the PILs regime contained in the Electricity Act. The Electricity Act provides that a MEU that is exempt from tax under the ITA and the TA is required to make, for each taxation year, a PILs payment to the OEFC in an amount equal to the tax that it would be liable to pay under the ITA and the TA if it were not exempt from tax. The PILs regime came into effect on October 1, 2001, at which time the Corporation and each of its subsidiaries were deemed to have commenced a new taxation year for purposes of determining their respective liabilities for PILs payments.

If the Corporation or a subsidiary ceases to be exempt from tax under the ITA and the TA, it will become subject to tax under those statutes, will no longer be required to make PILs payments to the OEFC, and will be deemed to have disposed of its assets for proceeds of disposition equal to their fair market value at that time and to have reacquired its assets at the same amount with the result that:

- such corporation would become liable to make a PILs payment in respect of any income or gains arising as a result of these deemed dispositions; and
- the amount of annual taxes payable by the corporation under the ITA, and the TA may be different from the PILs payment that would be payable without a loss of tax-exempt status to reflect, among other things, the consequences of these deemed dispositions and acquisitions.

The Electricity Act also provides that a municipal corporation or an MEU is required to pay a transfer tax when it transfers Electricity Property. An interest in Electricity Property includes any interest in a corporation, partnership or other entity that derives its value in whole or in part from Electricity Property. The transfer tax is the prescribed percentage (currently 33%) of the fair market value of the interest transferred. The amount of transfer tax payable where the interest that is transferred is an interest in a corporation, partnership or other entity, is calculated in accordance with a special rule. The amount of transfer tax payable by an MEU on a transfer of Electricity Property may be reduced by:

- any PILs payment made by the MEU in respect of the part of the taxation year up to and including the date that the transfer takes place or a previous taxation year;
- any amount that the MEU has paid as tax under Part III of the TA in respect of the part of the taxation year up to and including the date of the transfer or a previous taxation year; and
- any amount that the MEU would be liable to pay under Part I of the ITA in respect of the taxation year if that tax were calculated on the basis that the MEU had no income during the taxation year other than the capital gain, or income under paragraph 14(1)(b) of the ITA in respect of the disposition of eligible capital property, arising on the transfer of the property subject to the transfer tax.

Transfers of Electricity Property made to a municipal corporation, a MEU, Hydro One or OPG will be an excluded transfer and thereby exempt from the transfer tax.

In addition, a refund of transfer tax will be made where such tax had been paid on the sale or transfer of Electricity Property and where the proceeds of that transfer were reinvested in certain other capital or depreciable assets used in connection with generating, transmitting, distributing or retailing electricity in Ontario and, subject to certain deeming rules, before the end of the second taxation year following the taxation year in which the liability to pay the transfer tax arose.

PILs payments are deductible in computing the transfer tax only to the extent that they have not been previously applied to reduce transfer tax payable by a municipal corporation or a MEU.

7.2 PILs Recoveries through Rates

The OEB Filing Requirements For Electricity Distribution Rate Applications provides for electricity distribution rate adjustments to permit recoveries relating to PILs payments. These recoveries are recalculated and submitted for recovery by LDC in each Cost of Service or rebasing distribution rate application. LDC is also generally at risk for variances between forecasted and actual PILs paid, excluding variances arising from changes in tax rates not assumed in the setting of rates for the period in question, which variances are disposed of through deferral accounts under both a Cost of Service or IRM. See notes 9(g), 9(h) and 22(b) to the Consolidated Financial Statements.

7.3 Tax Contingencies

The Ministry of Finance had issued assessments in respect of payments in lieu of additional municipal and school taxes under section 92 of the Electricity Act that were in excess of the amounts LDC believes were payable. The dispute arose as a result of inaccurate information incorporated into Ontario Regulation 224/00. The Corporation has worked with the Ministry of Finance to resolve this issue, and as a result the Ministry of Finance issued Ontario Regulation 423/11 on August 31, 2011. The new regulation revoked Ontario Regulation 224/00 and corrected inaccurate information retroactively to 1999.

In May 2012, the Ministry of Finance completed its reassessment as a consequence of the change in regulation. The impact of the reassessment issued was favourable to the Corporation.

PART 8 - RISK FACTORS

8.1 Risk Oversight

Toronto Hydro faces various risks that could impact the achievement of its strategic objectives. It adopts an enterprise wide approach to risk management, achieved through a process of consolidating and aligning the various views of risk across the enterprise via a risk governance structure. Toronto Hydro executes its ERM activities via an ERM framework that is aligned to industry best practices and international guidelines. Toronto Hydro views ERM as a management activity undertaken to add value and improve overall operations. It helps Toronto Hydro by enabling the attainment of its strategic goals and objectives through a systematic, disciplined approach towards identifying, evaluating, treating, monitoring and reporting of risks. Accordingly, ERM is an integral part of the strategic management of Toronto Hydro and is routinely considered in forecasting, planning and executing all aspects of the business.

The ERM framework is operationalized by a consistent, disciplined methodology that clearly defines the risk management process which incorporates subjective elements, risk quantification and risk interdependencies.

While Toronto Hydro's philosophy is that ERM is the responsibility of all business units, at all levels, in matters strategic and operational, the ERM governance structure is comprised of three key levels.

At the top level is the Board who work to maintain a general understanding of the risk categories, the types of risks to which Toronto Hydro may be exposed and the practices used to identify, assess, measure and manage those risks. Quarterly, the Board reviews Toronto Hydro's risk profile, a list of key risks together with treatment activities that represents the greatest threats to meeting Toronto Hydro's strategic objectives.

The second level is the ROC, a lead body to ensure systems are in place to identify, manage, and monitor risks. Through its review of reports from the business and other areas, the ROC assesses the appropriateness and consistent application of systems to manage risks within Toronto Hydro. The ROC also ensures that key risks are brought forward to the attention of the Board and for action by executive management.

Finally, the third level is the Risk Forum. The Risk Forum supports the ROC and is a collection of subject matter experts from across Toronto Hydro who actively engage in the day to day management of risks. Working with the

ROC, the Risk Forum oversees Toronto Hydro's risk profile, its performance against the defined risk appetite and determines appropriate risk responses. They also work to ensure effective, efficient, complete and transparent risk reporting to the ROC.

Toronto Hydro's business is subject to a variety of risks including those described in the following sections.

8.2 Regulatory Developments

Ontario's electricity industry regulatory developments and policy changes may affect the electricity distribution rates charged by LDC and the costs LDC is permitted to recover. This may in turn have a material adverse effect on the financial performance of the Corporation and/or LDC's ability to provide reliable service to its customers. In particular, there can be no assurance that:

- the OEB will approve LDC's electricity distribution rates under the RRFE, at levels that will permit LDC to carry out its planned capital work programs required to maintain safe and reliable service to its customers and earn the allowed rate of return on the investment in the business;
- the regulatory instruments that arise from the RRFE will be sufficient to address LDC's operations, needs and circumstances in respect of future applications for electricity distribution rates;
- the OEB will not set a lower recovery for LDC's cost of capital;
- the full cost of providing service to distribution customers will be permitted to be recovered through LDC's electricity distribution rates;
- the OEB will not permit competitors to provide distribution services in LDC's licensed area, or permit loads within LDC's service area to become electrically served by a means other than through LDC's electricity distribution system;
- the OEB will allow recovery for revenue lost as a consequence of unanticipated effects of CDM;
- parts of LDC's services will not be separated from LDC and opened to competition; or
- regulatory or other changes will not be made to the PILs regime.

Changes to any of the laws, rules, regulations and policies applicable to the businesses carried on by Toronto Hydro could also have a significant impact on Toronto Hydro. There can be no assurance that Toronto Hydro will be able to comply with applicable future laws, rules, regulations and policies. Failure by Toronto Hydro to comply with applicable laws, rules, regulations and policies may subject Toronto Hydro to civil or regulatory proceedings that may have a material adverse effect on the Corporation.

Any future regulatory decision to disallow or limit the recovery of costs could lead to potential asset impairment and charges to results from operations, which could have a material adverse effect on Toronto Hydro.

8.3 Condition of Distribution Assets

LDC estimates that approximately one-third of its electricity distribution assets are past their expected useful lives. LDC's ability to continue to provide a safe work environment for its employees and a reliable and safe distribution service to its customers and the general public will depend on, among other things, the OEB allowing recovery of costs in respect of LDC's maintenance program and capital expenditure requirements for distribution plant refurbishment and replacement.

LDC is focused on overcoming the above challenges and executing its maintenance program. However, if LDC is unable to carry out these plans in a timely and optimal manner, equipment performance will degrade which may compromise the reliability of distribution assets, the ability to deliver sufficient electricity and/or customer supply security and increase the costs of operating and maintaining these assets.

8.4 Information Technology Infrastructure

Toronto Hydro's ability to operate effectively is in part dependent on the development, maintenance and management of complex information technology systems. Computer systems are employed to operate LDC's electricity distribution system, and Toronto Hydro's financial, billing and business systems to capture data and to produce timely and accurate information. Failures of any one of the financial, business and operating systems could have a material adverse effect on the Corporation's business, operating results, financial condition and prospects. Toronto Hydro mitigates this risk through various methods including the use of security event management tools on its distribution and business systems, by separating the electricity distribution system from the business systems and by providing company-wide awareness training to personnel.

LDC's electricity distribution infrastructure and technology systems are also potentially vulnerable to damage or interruption from cyber attacks, which could have an adverse impact on its operations, financial conditions, brand and reputation. While LDC has implemented preventative measures to monitor and protect against cyber attacks and mitigate their effects, there can be no assurance that such measures will be completely effective in protecting LDC's electricity distribution infrastructure or assets from a cyber attack or the effects thereof.

8.5 Natural and Other Unexpected Occurrences

Toronto Hydro's operations are exposed to the effects of natural and other unexpected occurrences such as severe or unexpected weather conditions, terrorism and pandemics. In the current year, the City experienced two severe weather events, one of which (see section "Ice Storm" in the Corporation's MD&A for the year ended December 31, 2013 for more information) had a significant financial impact. Although Toronto Hydro's facilities and operations are constructed, operated and maintained to withstand such occurrences, there can be no assurance that they will successfully do so in all circumstances. Any major damage to Toronto Hydro's facilities or interruption of Toronto Hydro's operations arising from these occurrences could result in lost revenues and repair costs that can be substantial. Although Toronto Hydro has insurance, if it sustained a large uninsured loss caused by natural or other unexpected occurrences, LDC would apply to the OEB for the recovery of the loss related to the electricity distribution system. There can be no assurance that the OEB would approve, in whole or in part, such an application.

8.6 Electricity Consumption

LDC's electricity distribution rates are comprised of a fixed charge and a usage-based (consumption) charge. The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control (e.g., principally sustained periods of hot or cold weather could increase the consumption of electricity, sustained periods of mild weather could decrease the consumption of electricity and general economic conditions could affect overall electricity consumption). Accordingly, there can be no assurance that LDC will earn the revenue requirement approved by the OEB.

Economic conditions could also lead to lower overall electricity consumption, particularly in the commercial customer segment, which is estimated to be the most sensitive to economic changes. Lower electricity consumption from customers could negatively impact LDC's revenue. On an annual basis, the Corporation estimates that a decrease of 1% in electricity consumption would reduce net revenue by approximately \$3.5 million.

8.7 Market and Credit Risk

LDC is subject to credit risk with respect to customer non-payment of electricity bills. LDC is permitted to mitigate the risk of customer non-payment using any means permitted by law, including security deposits (including letters of credit, surety bonds, cash deposits or lock-box arrangements, under terms prescribed by the OEB), late payment penalties, pre-payment, pre-authorized payment, load limiters or disconnection. In the event of an actual payment default and a corresponding bad debt expense incurred by LDC, approximately 80% of the expense would be related to commodity and transmission costs and the remainder to LDC's distribution revenue. While LDC would be liable for the full amount of the default, there can be no assurance that the OEB would allow recovery of the bad debt expense from remaining customers. Established practice in such cases is that the OEB would examine any electricity distributor's application for recovery of extraordinary bad debt expenses on a case-by-case basis.

Toronto Hydro is exposed to fluctuations in interest rates for the valuation of its post-retirement benefit obligations. Toronto Hydro estimates that a 1% (100 basis point) increase in the discount rate used to value these obligations would decrease the accrued benefit obligation of the Corporation, as at December 31, 2013, by approximately \$37.0 million, and a 1% (100 basis point) decrease in the discount rate would increase the accrued benefit obligation, as at December 31, 2013, by approximately \$45.5 million.

As at December 31, 2013, aside from the valuation of its post-retirement benefit obligations, Toronto Hydro was exposed to interest rate risk predominately from short-term borrowings under its commercial paper program, while most of its remaining obligations were either non-interest bearing or bear fixed interest rates, and its financial assets were predominately short-term in nature and mostly non-interest bearing. The Corporation estimates that a 100 basis point increase (decrease) in short-term interest rates, with all other variables held constant, would result in an increase (decrease) of approximately \$2.1 million to annual net financing charges.

8.8 Additional Debt Financing and Credit Rating

Cash generated from operations, after the payment of expected dividends, is not expected to be sufficient to repay existing indebtedness, fund Capital Expenditures and meet other obligations. The Corporation relies on debt financing through its MTN Program, CP Program or existing credit facilities to repay existing indebtedness, finance the Corporation's daily operations, and fund Capital Expenditures. The Corporation's ability to arrange sufficient and cost-effective debt financing could be adversely affected by a number of factors, including financial market conditions, the regulatory environment in Ontario, the Corporation's results of operations and financial condition, the ratings assigned to the Corporation or the debentures issued under the Corporation's MTN Program by credit rating agencies, the current timing to maturity of the Corporation's Debentures, the availability of the commercial paper market and general economic conditions. See notes 11 and 13 to the Consolidated Financial Statements.

Should the Corporation's credit rating from both credit rating agencies fall below "A (minus)" with stable outlook (S&P) and "A (low)" with stable trend (DBRS), the Corporation and its subsidiaries may be required to post additional collateral with the IESO.

8.9 Work Force Renewal

Over the next decade, a significant portion of Toronto Hydro's employees will become eligible for retirement, including potential retirements occurring in supervisory, trades and technical positions. Accordingly, Toronto Hydro will be required to attract, train and retain skilled employees. There can be no assurance that Toronto Hydro will be able to attract and retain the required workforce.

8.10 Labour Relations

Toronto Hydro's ability to operate successfully in the electricity industry in Ontario will continue to depend in part on its ability to make changes to existing work processes and conditions to adapt to changing circumstances. Toronto Hydro's ability to make such changes, in turn, will continue to depend in part on its relationship with its labour unions and its ability to develop plans and approaches that are acceptable to its labour unions. There can be no assurance that Toronto Hydro will be able to secure the support of its labour unions.

8.11 Insurance

Although Toronto Hydro maintains insurance as described under section 4.6(e) under the heading "Insurance" above, there can be no assurance that Toronto Hydro will be able to obtain or maintain adequate insurance in the future at rates it considers reasonable or that insurance will continue to be available. In addition, there can be no assurance that available insurance will cover all losses or liabilities that might arise in the conduct of the Toronto Hydro's business. Toronto Hydro self-insures against risks (e.g., business interruption and physical damage to certain automobiles). The occurrence of a significant uninsured claim or a claim in excess of the insurance coverage limits maintained by Toronto Hydro could have a material adverse effect on the Corporation's results of operations and financial position.

8.12 Conflicts of Interest

The City owns all of the outstanding shares of the Corporation and has the power to determine the composition of the Board and influence the Corporation's major business and corporate decisions, including its financing programs and dividend payments. A conflict may arise between the City's role as the sole shareholder of the Corporation and its role as the administrator of the City's budget and other matters for the residents of the City.

8.13 Change of Ownership

The City may decide to sell all or part of the Corporation. In the case of such event, depending on the nature of the transaction, the Corporation's credit ratings could be negatively affected.

8.14 Real Property Rights

Certain terminal stations and municipal substations of LDC are located on lands owned by the Province, the City and others. In some cases, LDC does not have and may not be able to obtain formal access agreements with respect to such facilities. Failure to obtain or maintain access agreements could adversely affect LDC's operations.

8.15 LDC Competition

In the past, there had been one electricity distributor in each region of Ontario. Under the current regulatory regime, a person must obtain a licence from the OEB in order to own and operate an electricity distribution system. LDC has the right to distribute electricity in the City. Although the distribution licence specifies the area in which the distributor is authorized to distribute electricity, unless otherwise provided, the licence does not provide exclusive distribution rights for such area.

The Corporation believes that the complexities and potential inefficiencies that would be created by having multiple electricity distributors authorized to serve a single area are likely to result in the continuation of the practice of having a single electricity distributor authorized to serve a single area. In addition, the Corporation believes that there are significant barriers to entry with respect to the business of electricity distribution in Ontario, including the cost of maintaining an electricity distribution system, OEB regulation of electricity distribution rates and the level of regulatory compliance required to operate an electricity distribution system. However, the Corporation recognizes that more than one distribution licence could be issued for the same area and there is a possibility that in the future some business functions or activities could be separated from LDC and made open to competition from non-regulated business entities, or that defined geographical areas within LDC's service area may be electrically supplied by a means other than through LDC's electricity distribution system.

PART 9 - CAPITAL STRUCTURE

9.1 Share Capital

The authorized capital of the Corporation consists of an unlimited number of common shares without par value, of which 1,000 common shares are issued and outstanding as at the date of this AIF. The City is the sole shareholder of the Corporation. See note 19 to the Consolidated Financial Statements.

9.2 Debentures

On May 7, 2003, the Corporation issued \$225.0 million 6.11% senior unsecured debentures due May 7, 2013 ("Series 1"). On November 14, 2007, the Corporation issued \$250.0 million 5.15% senior unsecured debentures due November 14, 2017 ("Series 2").

On November 12, 2009, the Corporation issued \$250.0 million 4.49% senior unsecured debentures, due November 12, 2019 ("Series 3").

The net proceeds from the sale of the Series 1, Series 2 and Series 3 debentures were used by the Corporation for general corporate purposes including the repayment of then-existing indebtedness to the City under the terms of the Amended and Restated City Note.

On April 1, 2010, the Amended and Restated City Note was converted, in accordance with its terms, into \$245.0 million 6.11% senior unsecured debentures due December 30, 2011 ("Series 4") and \$245.0 million 6.11% senior unsecured debentures due May 6, 2013 ("Series 5") and sold to the public by a syndicate of investment dealers. The Corporation did not receive any proceeds from the offering of the Series 4 and Series 5 debentures. See section 6.2 under the heading "Indebtedness to the City" for further information.

On May 20, 2010, the Corporation issued \$200.0 million 5.54% senior unsecured debentures due May 21, 2040 ("Series 6"). The net proceeds from the sale of the Series 6 debentures were used principally to finance regulated Capital Expenditures of LDC.

On November 18, 2011, the Corporation issued \$300.0 million 3.54% senior unsecured debentures, due November 18, 2021 ("Series 7"). The net proceeds from the sale of the Series 7 debentures were used to repay the Corporation's Series 4 debentures which matured on December 30, 2011 for general corporate purposes.

On December 10, 2012, the Corporation filed a base shelf prospectus with the securities commissions or similar regulatory authorities in each of the provinces of Canada. These filings allow the Corporation to make offerings of unsecured debt securities of up to \$1.5 billion during the 25-month period following the date of the prospectus. See note 11 to the Consolidated Financial Statements.

On April 9, 2013, the Corporation issued \$250.0 million of 2.91% senior unsecured debentures due April 10, 2023 ("Series 8") and \$200.0 million of 3.96% senior unsecured debentures due April 9, 2063 ("Series 9"). The net proceeds of the debentures, together with borrowings under the Corporation's revolving credit facility, were used to repay the Corporation's Series 1 and Series 5 debentures which matured on May 7, 2013 and May 6, 2013 respectively.

9.3 Credit Facility

The Corporation is a party to a credit agreement with a syndicate of Canadian chartered banks which establishes a revolving credit facility, pursuant to which it may borrow up to \$600.0 million, of which up to \$210.0 million is available in the form of letters of credit. On September 6, 2013, the Corporation extended the maturity date of its revolving credit facility from October 10, 2017 to October 10, 2018. Borrowings under the revolving credit facility bear interest at short-term floating rates with reference to the Corporation's credit rating.

The revolving credit facility contains certain covenants, the most significant of which is a requirement that the debt to capitalization ratio not exceed 75%. As at December 31, 2013, the Corporation was in compliance with all covenants included in its revolving credit facility.

On December 17, 2013, the Corporation launched a CP Program, allowing up to \$400.0 million of unsecured short-term promissory notes to be issued in various maturities of no more than one year. The CP Program is supported by liquidity facilities available under the Corporation's revolving credit facility; hence, available borrowing under its revolving credit facility is reduced by the amount of commercial paper outstanding at any point in time. Proceeds from the CP Program are being used for general corporate purposes. As at December 31, 2013, \$150.0 million was outstanding under the CP Program. Borrowings under the CP Program bear interest based on the prevailing market conditions at the time of issuance.

Additionally, the Corporation is a party to:

- a demand facility with a Canadian chartered bank for \$75.0 million for the purpose of issuing letters of credit mainly to support LDC's prudential requirements with the IESO ("Prudential Facility"); and
- a demand facility with a second Canadian chartered bank for \$20.0 million for the purpose of working capital management ("Working Capital Facility").

As at December 31, 2013, no amounts had been drawn under the revolving credit facility, and \$19.1 million had been drawn under the Working Capital Facility. As at December 31, 2013, \$50.1 million of letters of credit had been issued against the Prudential Facility. For the year ended December 31, 2013, the average outstanding borrowings on the Corporation's credit facilities, excluding the Prudential Facility, were \$67.7 million with weighted average interest rate of 1.98%.

9.4 Credit Ratings

As at December 31, 2013, the debentures issued under the Corporation's MTN Program and the commercial paper issued under the Corporation's CP Program were rated as follows:

	<u>Debentures</u>	<u>Commercial paper</u>
DBRS.....	A (high)	R-1 (low)
S&P	A	-

DBRS rates long-term debt instruments by rating categories ranging from a high of "AAA" to a low of "D". All rating categories other than AAA and D also contain the subcategories "(high)" and "(low)" to indicate relative standing within the major rating categories. The absence of either a "(high)" or "(low)" designation indicates the rating is in the middle of the category. An A rating is the third highest of the ten rating categories. Long-term debt instruments which are rated in the "A" category by DBRS are considered to be of good credit quality, with substantial capacity for the payment of financial obligations. Entities in the "A" category, however, may be vulnerable to future events, but qualifying negative factors are considered manageable.

DBRS rates short-term debt instruments by rating categories ranging from a high of "R-1 (high)" to a low of "D". An R-1 (low) rating is the third highest of the ten rating categories. Short-term debt instruments which are rated in the "R-1 (low)" category by DBRS are considered to be of good credit quality, with substantial capacity for the payment of financial obligations. Entities in the "R-1 (low)" category, however, may be vulnerable to future events, but qualifying negative factors are considered manageable.

S&P rates long-term debt instruments by rating categories ranging from a high of "AAA" to a low of "D". Ratings from "AA" to "CCC" may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories. An A rating is the third highest of the ten rating categories. Long-term debt instruments which are rated in the "A" category by S&P are considered somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories; however, the obligor's capacity to meet its financial commitment on the obligation is still strong.

Credit ratings are intended to provide investors with an independent measure of the credit quality of an issue of securities. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the rating agency.

The Debentures are not listed, posted for trading or quoted on any stock exchange or quotation system.

The Debentures have been issued under the CDSX book entry system administered by CDS Clearing and Depository Services Inc. ("CDS") with BNY Trust Company of Canada as trustee. Accordingly, a nominee of CDS is the registered holder of the Debentures and beneficial ownership of the Debentures is evidenced through book entry credits to securities accounts of CDS participants (e.g., banks, trust companies and securities dealers), who act as agents on behalf of beneficial owners who are their customers, rather than by physical certificates representing the Debentures.

For the years ended December 31, 2013 and 2012, payments were made to both DBRS and S&P for credit rating services only.

PART 10 - DIRECTORS AND OFFICERS

10.1 Nomination of Directors

The Board consists of eleven directors, all of whom are appointed by the sole shareholder of the Corporation, the City.

Pursuant to the Shareholder Direction, in electing directors to the Board, the City gives due regard to the qualifications of a candidate, including: experience or knowledge; commercial sensitivity and acumen; independence of judgment; and personal integrity. The City seeks candidates with experience and knowledge in: public utility commissions or boards of major corporations or other commercial enterprises; corporate finance; corporate governance; market development; large system operation and management; urban energy industries; and public policy issues and laws relating to Toronto Hydro, the electricity industry, environmental matters, labour relations and occupational health and safety issues.

10.2 Directors and Officers

The following table sets forth, for each of the directors and executive officers of the Corporation, the name, province and country of residence, office, principal occupation and, if a director, the date on which the person became a director and the expiry date of his or her current term. Each director is elected to serve for two years or until his or her successor is elected. Each City Councillor director is also elected to serve for two years or until his or her successor is elected.

<u>Name ⁽¹⁾ and Residence</u>	<u>Office</u>	<u>Principal Occupation</u>	<u>Director Since</u>	<u>Expiry of Current Term</u>
Clare R. Copeland Ontario, Canada	Director and Chair of the Board of Directors	Chief Executive Officer, Falls Management Company ⁽²⁾	June 23, 1999	April 14, 2013 ⁽³⁾
Patricia Callon Ontario, Canada	Director	Chief Legal Officer, Canadian Securities Transition Office ⁽⁴⁾	August 1, 2005	April 14, 2013 ⁽³⁾
Brian Chu Ontario, Canada	Director	Partner, Bogart Robertson & Chu ⁽⁵⁾	August 1, 2005	April 14, 2013 ⁽³⁾
Shoba Khetrpal Ontario, Canada	Director	Corporate Director	December 1, 2008	April 14, 2013 ⁽³⁾
David Williams Ontario, Canada	Director and Chair of the Board of Directors	Corporate Director	March 31, 2010 ^(6,7)	April 14, 2015
Derek Cowbourne Ontario, Canada	Director	Corporate Director	December 1, 2008 ⁽⁶⁾	April 14, 2015
Paulette Kennedy Ontario, Canada	Director	Corporate Director	December 1, 2008 ⁽⁶⁾	April 14, 2015
Vincent Brescia Ontario, Canada	Director	President, Wyse Meter Solutions Inc. ⁽⁸⁾	July 12, 2012 ⁽⁶⁾	April 14, 2015
Colum Bastable Ontario, Canada	Director	Chairman, Cushman & Wakefield Ltd. ⁽⁹⁾	April 15, 2013 ⁽⁶⁾	April 14, 2015

<u>Name ⁽¹⁾ and Residence</u>	<u>Office</u>	<u>Principal Occupation</u>	<u>Director Since</u>	<u>Expiry of Current Term</u>
Sara Gelgor Ontario, Canada	Director	Vice President, Enterprise Programs, Global Compliance, Scotiabank ⁽¹⁰⁾	April 15, 2013 ⁽⁶⁾	April 14, 2015
Isabel Meharry Ontario, Canada	Director	Chief Financial Officer, Green Shield Canada ⁽¹¹⁾	April 15, 2013 ⁽⁶⁾	April 14, 2015
Glenna Carr Ontario, Canada	Director	Corporate Director	April 15, 2013 ⁽⁶⁾	April 14, 2015
Shelley Carroll Ontario, Canada	Director	Councillor, City of Toronto	December 7, 2010 ⁽¹²⁾	November 30, 2014
Josh Colle Ontario, Canada	Director	Councillor, City of Toronto	December 7, 2010 ⁽¹³⁾	November 30, 2014
Gloria Lindsay Luby Ontario, Canada	Director	Councillor, City of Toronto	January 1, 2013 ⁽¹⁴⁾	November 30, 2014
Anthony Haines Ontario, Canada	President and Chief Executive Officer	President and Chief Executive Officer, Toronto Hydro Corporation	N/A	N/A
Jean-Sebastien Couillard Ontario, Canada	Chief Financial Officer	Chief Financial Officer, Toronto Hydro Corporation	N/A	N/A
Paul Sommerville Ontario, Canada	Vice President, Regulatory Affairs and General Counsel	Vice President, Regulatory Affairs and General Counsel, Toronto Hydro Corporation	N/A	N/A

Notes:

- (1) No director serves as a director or trustee of another reporting issuer except for: (a) Mr. Copeland, who serves as a trustee of RioCan Real Estate Investment Trust, and a director of Danier Leather Inc., Chesswood Group Limited (formerly called Chesswood Income Fund), Entertainment One Ltd., MDC Partners Inc., and Telesat Canada; and (b) Mr. Williams, who serves as a director of Shoppers Drug Mart Corporation, Mitel Networks Corporation, and the Lead Director of Mattamy Homes Corporation.
- (2) Falls Management Company is the developer and operator of Casino Niagara and Niagara Fallsview Casino Resort.
- (3) Effective April 14, 2013, Clare Copeland ceased to be a director and Chair of the Board and Patricia Callon, Brian Chu and Shoba Khetapal ceased to be directors of the Corporation.
- (4) The Canadian Securities Transition Office was established by the Government of Canada in 2009 to lead the transition to a single Canadian securities regulator.
- (5) Bogart, Robertson & Chu is a law firm.
- (6) Effective April 15, 2013, David Williams was re-appointed as a director and appointed as Chair of the Board, Paulette Kennedy, Vince Brescia and Derek Cowbourne were re-appointed as directors of the Corporation and Colum Bastable, Glenna Carr, Sara Gelgor and Isabel Meharry were appointed directors of the Corporation.
- (7) Mr. Williams also served as a director of the Corporation from June 23, 1999 to August 1, 2005.
- (8) Wyse Meter Solutions Inc. is an end to end sub-metering solutions provider for electrical, water and natural gas services.
- (9) Cushman & Wakefield Ltd. is a private corporation providing real estate brokerage and advisory services to the commercial real estate industry in Canada.
- (10) The Bank of Nova Scotia ("Scotiabank") is a chartered bank under the Bank Act (Canada).

- (11) Green Shield Canada provides health and dental plans for groups and individuals.
- (12) Councillor Carroll was reappointed as a City Council director to the Board effective as of January 1, 2013.
- (13) Councillor Colle was reappointed as the Mayor's designate to the Board effective as of January 1, 2013.
- (14) Councillor Lindsay Luby was appointed as a City councillor director to the Board of Director effective as of January 1, 2013.
- (15) As at March 31, 2014, female directors constituted 54.5% (6 of 11) of the members of the Corporation's Board.

10.3 Principal Occupations

All of the directors and executive officers of the Corporation have held the principal occupations identified in section 10.2 above with the same or associated companies or organizations for 5 years or more, except for:

- (a) Ms. Callon, who was a Consultant with the Ontario Securities Commission between September 2005 and August 2009;
- (b) Ms. Kennedy, who was a Commissioner of the Ontario Securities Commission from April 2008 to March 2013;
- (c) Councillor Colle, who was Associate Vice-President of Bridgepoint Group Ltd. from August 2008 to November 2010;
- (d) Mr. Haines who was the President of LDC from September 2006 until his appointment as CEO effective October 1, 2009;
- (e) Mr. Williams, who was interim President and CEO of Shoppers Drug Mart Corporation from February 2011 to October 2011;
- (f) Ms. Carr, who was Chair of the Board of Atomic Energy of Canada Ltd. from January 2008 to September 2011;
- (g) Mr. Brescia, who was President and Chief Executive Officer of Federation of Rental-Housing Providers of Ontario from January 2000 to October 2013;
- (h) Ms. Gelgor, who was Chief Compliance Officer at ScotiaLife Financial, Scotiabank from March 2008 to January 2014.

10.4 Cease Trade Orders, Bankruptcies, Penalties or Sanctions

Mr. Copeland was a director of White Rose Crafts and Nursery Sales Limited when it filed a voluntary assignment into bankruptcy in June 2002. Mr. Copeland resigned from this position in June 2002. Mr. Copeland also sat on the board of directors of Playdium Entertainment Corporation, which filed an application under the Companies' Creditors Arrangement Act (Canada) in February 2001. Mr. Copeland resigned from this position in May 2001. In each instance, Mr. Copeland had been asked to join the board when the company was already in difficulty due to his corporate restructuring experience.

Except as noted above, no director or executive officer of the Corporation is, as at the date of this AIF, or has within ten years prior to the date of this AIF:

- (a) been a director, chief executive officer or chief financial officer of any company (including the Corporation) that was the subject of a cease trade or similar order or an order that denied the company access to any exemption under securities legislation for a period of more than 30 consecutive days, where such order was issued while the director or executive officer was acting in the capacity as director, chief executive officer or chief financial officer;
- (b) been a director, chief executive officer or chief financial officer of any company (including the Corporation) that was the subject of a cease trade or similar order or an order that denied the company

access to any exemption under securities legislation for a period of more than 30 consecutive days, where such order was issued after the director or executive officer ceased to be a director, chief executive officer or chief financial officer and which resulted from an event that occurred while that person was acting in the capacity as director, chief executive officer or chief financial officer;

- (c) been a director, chief executive officer or chief financial officer of any company (including the Corporation) that, while that person was acting in that capacity or within a year of that person ceasing to act in that capacity, became bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold its assets; or
- (d) become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold the assets of such director or executive officer.

10.5 Independence

The Board consists of eleven directors, all of whom are appointed by the City in its capacity as sole shareholder of the Corporation. Three of the directors are Councillors of the City and are not considered independent because of their positions. None of the other directors have a direct or indirect material relationship with the Corporation and are independent within the meaning of applicable Canadian securities law.

No members of management sit on the Board. The Board meets regularly in the absence of management to discuss the management of the Corporation. Under its mandate, the Board is authorized to retain independent legal counsel and other advisors if it considers this appropriate. The mandate also provides that the Board shall have unrestricted access to the officers of the Corporation and is authorized to invite officers and employees of the Corporation and others to attend or participate in its meetings and proceedings if it considers this appropriate.

10.6 Committees of the Board of Directors

The Board had established four standing committees (Audit Committee, Corporate Governance Committee, Compensation Committee, Health and Safety Committee). On May 16, 2013, the Board amalgamated the Compensation and Health and Safety Committees to form the Human Resources Committee.

(a) Audit Committee

The Audit Committee is responsible for overseeing the adequacy and effectiveness of financial reporting, accounting systems, internal financial control structures and financial risk management systems. The Audit Committee reviews the Corporation's quarterly and annual financial statements as well as financial statements prepared in connection with securities offerings or required by applicable regulatory authorities, reviews the audit plans of the external auditors, oversees the internal audit of the Corporation, reviews reports related to reimbursement of business related expenses of officers and recommends the external auditor for appointment by the Corporation's sole shareholder. Members of the Audit Committee are Ms. Kennedy, Mr. Brescia and Ms. Meharry. Ms. Kennedy is the Chair of the Audit Committee. Prior to April 15, 2013, the Audit Committee was comprised of Mr. Chu (Chair), Ms. Kennedy and Ms. Khetrapal. See Part 11 under the heading "Audit Committee" below for further information on the Audit Committee.

(b) Corporate Governance Committee

The Corporate Governance Committee is responsible for considering and making recommendations to the Board with respect to matters relating to the corporate governance of Toronto Hydro, including board and committee composition and mandates, and guidelines for assessing the effectiveness of the Board and its committees and procedures to ensure that the Board functions independently from management. The Corporate Governance Committee also reviews and approves all orientation and education materials and programs for new and current directors undertaken by management. Members of the Corporate Governance Committee are Mr. Cowbourne, Ms. Carr and Ms. Gelgor. Mr. Cowbourne is the Chair of the Corporate Governance Committee. Prior to April 15, 2013, the Corporate Governance Committee was comprised of Mr. Cowbourne (Chair), Mr. Chu and Ms. Kennedy.

(c) Compensation Committee

Until May 16, 2013, the Compensation Committee was responsible for reviewing and assisting the Board in overseeing Toronto Hydro's compensation program.

(d) Health and Safety Committee

Until May 16, 2013, the Health and Safety Committee was responsible for considering and making recommendations to the Board with respect to matters of health and safety.

(e) Human Resources Committee

The Compensation and Health and Safety Committees were combined to form the new Human Resources Committee on May 16, 2013. The Human Resources Committee is responsible for reviewing and assisting the Board in overseeing the recruitment and assessment of the CEO and the compensation of the CEO, reviewing and approving the compensation of the executive officers, reviewing and approving executive compensation disclosure under applicable securities laws, and reviewing and making recommendations to the Board regarding the compensation structure and benefit plans and programs of Toronto Hydro. The Human Resources Committee is also responsible for reviewing and approving the parameters of collective bargaining negotiations, and reviewing and making recommendations to the Board with respect to environmental and health and safety matters. Members of the Human Resources Committee are Mr. Bastable, Councillor Colle and Mr. Williams. Mr. Bastable is the Chair of the Human Resources Committee. Prior to April 15, 2013, the Compensation Committee was comprised of Ms. Callon (Chair), Mr. Copeland, Mr. Bastable and Ms. Beed. Prior to April 15, 2013, the Health and Safety Committee was comprised of Mr. Williams (Chair), Ms. Callon and Ms. Khetrapal. See section 12.1(a) under the heading "Human Resources Committee" for further information on the Human Resources Committee.

10.7 Board Orientation and Continuing Education

Each new director, upon joining the Board, is given a comprehensive set of materials designed to provide him/her with a summary of the key organizational, financial, regulatory, and operational aspects of Toronto Hydro. These materials also contain information on the various Toronto Hydro boards and their committees.

On an on-going basis, as part of regular and special board meetings, directors receive presentations and reports on topics related to Toronto Hydro's businesses and the obligations and responsibilities of directors. Topics covered are either suggested by management or requested by the directors. As well, directors receive information from management in response to any actions arising at a board meeting or otherwise.

10.8 Board, Committee and Director Assessments

The Corporate Governance Committee oversees a process used to evaluate the effectiveness of the Board as a whole, its committees and the individual directors. The process is facilitated by an independent external consultant with expertise in board assessments as selected by the Board and consists of a written questionnaire evaluating the Board, its committees and the individual directors that is completed periodically by each director. The directors' responses to the questionnaire related to the operation of the Board and its committees are compiled into a summary report by the consultant that is reviewed by the Corporate Governance Committee. This report and recommended remedial actions are presented by the Chair of the Corporate Governance Committee to the Board for review, consideration and implementation.

10.9 Board Oversight and Management of Risks

In 2009, the Corporation adopted an ERM Program to add value and improve the Corporation's operations through enabling the attainment of its strategic goals and objectives. It helps the Corporation achieve this by bringing a systematic and disciplined approach towards identifying, evaluating, treating, monitoring and reporting of risks applicable to Toronto Hydro. Accordingly, ERM is an integral part of the strategic management of the Corporation's business and is routinely considered in forecasting, planning and executing all aspects of the

Corporation's operations. The ERM Program follows industry best practice and adopts a rigorous top-down / bottom-up approach towards the management of risks.

See Part 8 under the heading "Risk Factors" above for further information on ERM.

10.10 Indebtedness of Directors and Executive Officers

No director, executive officer, employee, former director, former executive officer or former employee or associate of any director or executive officer of the Corporation or any of its subsidiaries had any outstanding indebtedness to the Corporation or any of its subsidiaries except routine indebtedness or had any indebtedness that was the subject of a guarantee, support agreement, letter of credit or other similar arrangement or understanding provided by the Corporation or any of its subsidiaries.

10.11 Summary of Attendance of Directors

The following table summarizes the attendance of individual directors at meetings of the Board held for the 12-month period ending December 31, 2013.

Director	Board Meetings Attended
Clare R. Copeland ⁽¹⁾	2 of 2
Patricia Callon ⁽¹⁾	2 of 2
Brian Chu ⁽¹⁾	2 of 2
Shoba Khetrapal ⁽¹⁾	2 of 2
David Williams	6 of 6
Derek Cowbourne	6 of 6
Paulette Kennedy	5 of 6
Vincent Brescia	6 of 6
Colum Bastable ⁽²⁾	4 of 4
Sara Gelgor ⁽²⁾	4 of 4
Isabel Meharry ⁽²⁾	4 of 4
Glenna Carr ⁽²⁾	4 of 4
Shelley Carroll	5 of 6
Josh Colle	3 of 6
Gloria Lindsay Luby	5 of 6

Notes:

- (1) Effective April 14, 2013, Clare Copeland ceased to be a director and Chair of the Board and Patricia Callon, Brian Chu and Shoba Khetrapal ceased to be directors of the Corporation and only two meetings of the Board were held prior to that time.
- (2) Effective April 15, 2013, Colum Bastable, Glenna Carr, Sara Gelgor and Isabel Meharry were appointed directors of the Corporation and four meetings of the Board were held after that date.

PART 11- AUDIT COMMITTEE

11.1 Composition, Independence and Financial Literacy

The Audit Committee is comprised of Ms. Kennedy (Chair), Mr. Brescia and Ms. Meharry, each of whom is independent and financially literate within the meaning of applicable Canadian securities laws. Prior to April 15, 2013, the Audit Committee was comprised of Mr. Chu (Chair), Ms. Kennedy and Ms. Khetrpal.

11.2 Relevant Education and Experience

In addition to each member's general business experience, the education and experience of each Audit Committee member that is relevant to the performance of his or her responsibilities as an Audit Committee member is described below.

Mr. Chu holds a Juris Doctor from the University of Toronto and is a member of the Law Society of Upper Canada. Mr. Chu is a founding partner of the law firm of Bogart Robertson and Chu, practicing corporate and commercial real estate law. Mr. Chu served as Chair of the Audit Committee of Centennial College and as a member of the Finance Committee of the Ontario College of Art and Design. Mr. Chu served as the Chair of the Finance and Audit Committee of the Laidlaw Foundation. Mr. Chu serves on the Finance and Operations Committee of the Centennial Centre of Science and Technology (Ontario Science Centre). Mr. Chu has been a member of the Canadian Tax Foundation since 1986. Mr. Chu ceased to be an Audit Committee member effective April 14, 2013.

Ms. Khetrpal holds a Masters degree in Economics, is a certified director of the Institute of Corporate Directors and a member of the Toronto Chartered Financial Analysts Society. She is a member of the Board of Directors of Cancer Care Ontario and Vice Chair of its Audit Committee. She is also Vice Chair of the Board of Directors of The Public Accountants Council and a member of its governance committee. In addition, she is a member of the Canada Pension Plan Review Tribunal. Previous positions held include Vice President and Chief Financial Officer of Weekenders International, Vice President and Treasurer, Moore Corporation Limited, Director, Economics & Planning Canadian Pacific Enterprises Limited and member of the Boards of Directors of Moore Group Services BVBA-Belgium, Peak Technologies Canada Ltd., Moore Holdings Ltd. - Australia and the Ontario Casino Corporation. Ms. Khetrpal ceased to be an Audit Committee member effective April 14, 2013.

Ms. Kennedy is a chartered accountant and holds a Bachelor of Commerce degree from McMaster University. Ms. Kennedy has held a variety of senior financial management, regulatory and accounting positions including Commissioner of the Ontario Securities Commission, Chief Auditor and subsequently Chief Financial Officer at AEGON Canada Inc., Senior Vice-President and Chief Internal Auditor at Sobeys Inc., multiple roles including Chief Auditor, Chief Accountant and Vice-President Finance and Actuarial at Sun Life Financial Inc. Ms. Kennedy was also a member of the External Stakeholder Advisory Committee of the Financial Consumer Agency of Canada. Ms. Kennedy is currently a member of the Governing Council of the University of Toronto, Chair of the University of Toronto Audit Committee, a member of the Business Board and a member of the Pension Committee of the University of Toronto.

Mr. Brescia has a CMA designation from the Society of Management Accountants of Canada and holds a Masters of Arts in Economics from Lakehead University as well as an Honours Bachelor of Arts in Economics from the University of Western Ontario. Mr. Brescia is President of Wyse Meter Solutions Inc. and Director and Past-Chair of Canadian Federation of Apartment Associations. Previous positions held include President and Chief Executive Officer of Federation of Rental-Housing Providers of Ontario, Director of Municipal Property Assessment Corporation, and Director of Government Relations of Greater Toronto Home Builders' Association.

Ms. Meharry is a chartered accountant and holds a Masters of Business Administration from Schulich School of Business at York University and a Bachelor of Arts (Honours Economics) from the University of Toronto. Ms. Meharry has held a variety of senior financial positions including President and Chief Executive Officer of Financial Executive International, Executive Consultant for SunLife Financial of Canada and Executive Vice President at Aviva Insurance Company of Canada. Ms. Meharry is a former member of the Governing Council of the Institute of Chartered Accountants of Ontario, and a former Board member and former Chair of the Audit Committee and former Chair of the Credit and Risk Committee of Ontario Infrastructure and Lands Corporation. Ms. Meharry is currently the Chief Financial Officer of Green Shield Canada, a Board member and Chair of the

Audit Committee of APRIO Inc., a Board member and Chair of the Audit Committee for Hope Air, and a Board member, Past Chair and Chair of the Nominating Committee for Kerry's Place Autism Services. Ms. Meharry was awarded the FCA designation in 2009.

11.3 Audit Committee Charter

Under the terms of its charter, the Audit Committee is responsible for: managing the relationship between the Corporation and its external auditors; overseeing the external audit; overseeing the internal audit; reviewing, approving and recommending to the Board for approval the financial statements, management's discussion and analysis and interim reports of the Corporation, the annual information form and other public disclosure of financial information extracted from the Financial Statements of the Corporation; overseeing internal financial control structure and financial risk management systems; and establishing and reviewing certain procedures.

The full text of Corporation's Audit Committee Charter is attached as Annex A.

11.4 Policy on the Provision of Services by the External Auditors

The Audit Committee has developed a Policy on the Provision of Services by the External Auditors. Under the terms of the Policy:

- the external auditors may not provide services to Toronto Hydro that impair or have the potential to impair the independence and objectivity of the external auditors in relation to the external audit function (generally, prohibited services include services where the external auditors participate in activities that are normally undertaken by management of Toronto Hydro, are remunerated through a "success fee" structure, act in an advocacy role for Toronto Hydro or may be required to audit their own work);
- the Audit Committee has pre-approved certain audit and permitted non-audit services as services that the auditors may provide to Toronto Hydro, including: services that constitute the agreed scope of the external audit or interim reviews of Toronto Hydro; services that are outside the agreed scope of, but are consistent with, the external audit or interim reviews of Toronto Hydro; tax services that do not compromise the independence and objectivity of the external auditors in relation to the external audit; and other services of an advisory nature that do not compromise the independence and objectivity of the external auditors in relation to the external audit work; and
- an authorization process has been established which provides, among other things: the Chief Financial Officer may authorize in advance all engagements of the external auditors to provide pre-approved services (other than audit services) to Toronto Hydro up to a maximum of \$25,000 for any engagement and up to a maximum of \$100,000 for all engagements in any fiscal quarter (the Chief Financial Officer must report all such authorized engagements to the Audit Committee at its next meeting); the Chair of the Audit Committee may authorize in advance all engagements of the external auditors to provide pre-approved services (other than audit services) to Toronto Hydro up to a maximum of \$50,000 for any engagement and up to a maximum of \$100,000 for all engagements in any fiscal quarter (the Chair must report all such authorized engagements to the Audit Committee at its next meeting); and the Audit Committee must authorize in advance all engagements of the external auditors to provide pre-approved services to Toronto Hydro above the prescribed thresholds and all engagements to provide services that are not pre-approved services regardless of the dollar value of the services.

Exceptions can be made to this Policy where the exceptions are in the interests of Toronto Hydro and appropriate arrangements are established to ensure the independence and objectivity of the external auditors in relation to the external audit. Any exception must be authorized by the Audit Committee and must be reported to the Board.

11.5 External Auditors Service Fees

On April 12, 2011, KPMG LLP was appointed as the external auditor of the Corporation, replacing the former external audit firm of Ernst & Young LLP.

The table below sets out the fees billed by the Corporation's auditors for each of last two fiscal years in respect of the services noted below.

	Year ended December 31,			
	2013		2012	
	KPMG	E&Y	KPMG	E&Y
Audit fees ⁽¹⁾	\$530,795	-	\$557,981	-
Audit-related fees ⁽²⁾	-	-	-	-
Tax fees ⁽³⁾	-	-	-	-
All other fees ⁽⁴⁾	\$325,362	-	\$125,398	\$53,947

Notes:

- (1) Fees for audit services and interim reviews, including CPAB levy.
- (2) Fees for assurance and related services that are reasonably related to the performance of the audit or review of the Corporation's financial statements and are not reported under (1) above.
- (3) Fees for professional services rendered for tax compliance.
- (4) Fees for professional services rendered in connection with business development, review of IFRS reconciliation to the City, the MTN Program and other miscellaneous fees.

PART 12- EXECUTIVE COMPENSATION

12.1 Compensation Governance

(a) Human Resources Committee

(i) *Composition and Independence*

As a result of the amalgamation of the former Compensation and Health and Safety Committees of the Board on May 16, 2013 (as described in Section 10.6 (e) Human Resources Committee), the Corporation's executive compensation program is supervised by the Human Resources Committee under the direction of the Board. The Human Resources Committee is comprised of Mr. Bastable (Chair), Councillor Colle, and Mr. Williams. Mr. Bastable and Mr. Williams are each independent within the meaning of applicable Canadian securities laws. Councillor Colle is a member of the City Council. Since the City is the sole shareholder of the Corporation, Councillor Colle is not independent within the meaning of applicable Canadian securities laws. The appointment of one of the City Council directors to the Human Resources Committee is a requirement under the Shareholder Direction. Mr. Bastable is also Chair of the Board of Directors of LDC. Prior to April 15, 2013, the Compensation Committee was comprised of Ms. Callon (Chair), Mr. Copeland, Mr. Bastable and Ms. Beed.

(ii) *Relevant Education and Experience*

The general business experience, education, skills and expertise of each Human Resources Committee member, together with the education, experience, skills and expertise of the other members of the Human Resources Committee, enable the Human Resources Committee to make decisions on the suitability of Toronto Hydro's compensation policies and practices. The relevant experience, education, skills and expertise of each Human Resources Committee member is described below.

Ms. Callon holds a law degree from the University of Western Ontario and is a member of the Law Society of Upper Canada. She is currently Chief Legal Officer of the Canadian Securities Transition Office, the organization established by the federal government to implement a national securities regulator. Ms. Callon has held a variety of senior positions, including Vice-President & Associate General Counsel, Canadian Imperial Bank of Commerce and advisor to the Ontario Securities Commission. In 2012, she obtained the Human Resources and Compensation Committee Certified (H.R.C.C.C.) designation from The Directors College (a joint venture of McMaster University and The Conference Board of Canada). In 2005, she graduated from the Directors Education Program sponsored by the Institute of Corporate Directors Corporate Governance College and the Rotman School of Management which

included specific training on the board's role in enhancing human performance, including the appointment, evaluation, compensation and renewal of an organization's executive team. She is a member of the Board of Directors of Community MicroSkills Development Centre and Chair of its corporate governance committee which is responsible for, among other things, succession planning and performance evaluation of the Community MicroSkills Development Centre's executive director. Ms. Callon was a member of the Compensation Committee until April 14, 2013.

Mr. Copeland has a wide range of experience in Executive Compensation. He has held the position of Chairman of the Compensation Committee on several companies including Toronto Hydro Corporation, RioCan Real Estate Investment Trust, Danier Leather Inc., Chesswood Group Limited, The Pioneer Group Inc., MDC Partners Inc. and Entertainment One Ltd. Mr. Copeland is well versed and up-to-date with compensation systems and benefit programs at all levels. Mr. Copeland has also been the Chief Executive Officer of several organizations and in that role has the business experience of being the ultimate decision maker, together with the organizations' boards of directors and compensation committees, as applicable, regarding compensation issues. Mr. Copeland was a member of the Compensation Committee until April 14, 2013.

Ms. Beed holds a Master's of Science degree in Nursing from the University of Toronto and has held many senior positions in the health care field including Vice-President, Clinical Programs and Organizational Development at the Princess Margaret Hospital / Ontario Cancer Institute, and Chief Operating Officer at the University Health Network. Ms. Beed has also been a Global Partner with Deloitte Consulting Inc., where her focus was Change Management and Strategic Business Development in both the Energy and Consumer industry groups. Ms. Beed is currently the President and Chief Executive Officer of Markham Stouffville Hospital. Ms. Beed currently is a member of the Board of Directors at ventureLAB Inc., a member of the Board of Governors at Character Community Foundation of York Region, and a member of the Dean's Advisory Council of the Faculty of Health at York University. Ms. Beed is a former director of the Corporation. Ms. Beed was a member of the Compensation Committee until April 14, 2013.

Mr. Bastable has considerable experience in executive compensation matters from his years as the Chief Executive Officer of a publicly traded company, and as a member of the compensation committees of several boards on which he serves or has served as a director. Mr. Bastable is a Fellow of the Institute of Chartered Accountants in Ireland. He is currently Chairman of Cushman & Wakefield Ltd. His past business experience includes positions as President and Chief Executive Officer at Cushman & Wakefield Ltd., and Chief Financial Officer and Chief Executive Officer of Royal LePage Ltd. He currently serves as a trustee of Brookfield Canada Office Properties REIT and is a member of its Audit Committee, and Chair of its Governance and Nominating Committee. He is also a member of the Independent Review Committee of Brandes Investment Partners & Co. He has significant board and committee experience with not-for-profit organizations including as Chair of the Board of Governors and member of the compensation committee of McMaster University in Hamilton, Ontario. He is familiar with the structure of compensation systems and related benefit programs, and is experienced in executive performance evaluation.

Councillor Colle has gained executive compensation experience through his involvement in several senior roles and directorships in the private and public sectors. Councillor Colle is a Commissioner of the Toronto Transit Commission. He is Vice Chair of the City Council's Planning and Growth Management Committee, a member of the Toronto Food Policy Council, and a member of the North York Community Council. Mr. Colle is the former Vice President of Bridgepoint Group Ltd. and a former Manager of Government Relations of the Greater Toronto Airport Authority. Councillor Colle is currently the City Councillor for Ward 15 (Eglinton-Lawrence).

Mr. Williams has a wide range of experience in executive compensation. Mr. Williams is currently the Chair of the Board at Morrison Lamothe Inc., a director at Shoppers Drug Mart Corporation, the Lead Director at Mattamy Homes Corporation and a director at Mitel Networks Corporation. He has extensive business experience in both the private and public sectors. His past business experience includes positions as Interim President, Chief Executive Officer and Chair at Shoppers Drug Mart Corporation, President and Chief Executive Officer at Workplace Safety and Insurance Board, and President at National Grocers Limited. Mr. Williams also earned a CGA designation from the Institute of Certified General Accounts and is an ICD.D with the Institute of Corporate Directors Designation. Mr. Williams is well versed and up-to-date with compensation systems and benefit programs at all levels. Through his vast experience as a chief executive, Mr. Williams has the business experience of being the ultimate decision maker, together with the organizations' boards of directors and compensation committees, as applicable, regarding compensation issues.

(iii) *Human Resources Committee Charter*

The Human Resources Committee operates under a written charter adopted by the Board. One of the primary functions of the Human Resources Committee is to advise and assist the Board in overseeing Toronto Hydro's compensation program and assessing the performance and compensation of the CEO and the other officers of the Corporation. Specifically, under the terms of its charter, the Human Resources Committee is responsible for assisting the Board in fulfilling its responsibilities with respect to: the recruitment and assessment of the performance of the CEO; the review and approval of the compensation of the CEO and the other executive officers of Toronto Hydro; the review and approval of executive compensation disclosure; and the general oversight of the compensation structure and benefit plans and programs for Toronto Hydro.

(b) Compensation Risk Oversight

Toronto Hydro has a rigorous risk management and governance structure in place to assist the Board with its oversight and management of all of the Corporation's risks, including risks related to Toronto Hydro's compensation policies and practices. While the Board and the Human Resources Committee have not conducted a formal assessment of the implications of risks specifically associated with the Corporation's compensation policies and practices, the Human Resources Committee has and continues to consider the Corporation's strategic objectives, plans and risk strategy in its review and recommendations regarding Toronto Hydro's compensation program. In addition to the Corporation's Enterprise Risk Management Program, the practices, processes and systems in place to identify and mitigate compensation policies and practices that could encourage an executive officer to take inappropriate or excessive risks include: the periodic review and audit of the Corporation's executive compensation program by the Corporation's internal auditor; the development and application of a management control reporting system providing transparency and control to compensation measures; the use of a balanced scorecard of corporate, divisional and individual performance objectives; the periodic benchmarking of the Corporation's compensation program; the review of the Corporation's compensation program by an independent compensation consultant and, from time to time, the OEB; and the application of maximum payout amounts for achievement of individual performance goals. See sections 8.1 under the heading "Risk Oversight" and 10.9 under the heading "Board Oversight and Management of Risks" for more information on the Corporation's Enterprise Risk Management Program, section 12.2(c)(ii) under the heading "Benchmarking" for more information on the Corporation's benchmarking of its compensation program, section 12.2(c)(iii) under the heading "Compensation Consultants and Advisors" for more information on the Corporation's compensation consultant and section 12.2(d)(ii) under the heading "Performance-Based Incentive Compensation" for more information on the Corporation's performance-based incentive compensation program.

12.2 Compensation Discussion and Analysis

(a) Named Executive Officers

This Compensation Discussion and Analysis describes and explains all significant elements of compensation awarded to, earned by, paid to, or payable to the NEOs for the financial year ended December 31, 2013. The NEOs are:

- (i) **Anthony Haines**
President and Chief Executive Officer, Toronto Hydro Corporation
- (ii) **Jean-Sebastien Couillard**
Executive Vice-President and Chief Financial Officer, Toronto Hydro Corporation
- (iii) **Dino Priore**
Executive Vice-President and Chief Engineering and Construction Officer, Toronto Hydro-Electric System Limited
- (iv) **Ben La Pianta**
Executive Vice-President and Chief Electric Operations and Procurement Officer, Toronto Hydro-Electric System Limited

- (v) **Ivano Labricciosa**
Executive Vice-President and Chief Business Development Officer, Toronto Hydro-Electric System Limited

(b) General Objectives of Compensation Program

The Corporation's executive compensation program is designed to attract and retain executives who have the skills and experience to help the Corporation achieve its strategic goals, to motivate executives to achieve such corporate goals and to reward executives for superior performance and achievement of corporate, divisional and individual objectives.

(c) Process for Establishing Compensation

(i) Policies and Practices

The Corporation's overall executive compensation structure and program is developed and supervised by the Human Resources Committee with the assistance of a compensation consultant, and approved by the Board. See section 12.2(c)(iii) under the heading "Compensation Consultants and Advisors" for more information on the compensation consultant.

Pursuant to the terms of its charter, the Human Resources Committee has the responsibility to annually, and more frequently if appropriate, review and approve the individual performance-based incentive compensation goals and objectives related to the compensation of the CEO and to assess the CEO's performance against those goals and objectives. The Human Resources Committee also makes recommendations to the Board with respect to the overall compensation and benefits of the CEO. The Board ultimately sets and approves the CEO's compensation.

The CEO has the responsibility to annually, and more frequently if appropriate, review and approve the individual performance-based incentive compensation goals and objectives related to the compensation of the other executive officers, including the NEOs, and assess the other executive officers' performance against those goals and objectives. The CEO proposes the other executive officers' performance-based incentive compensation and overall compensation, subject to the Human Resources Committee's review and approval.

(ii) Benchmarking

The Corporation periodically benchmarks the compensation it provides to the NEOs to ensure reasonableness, competitiveness and effectiveness of the Corporation's compensation program, including the level and type of compensation provided. The Human Resources Committee engages Mercer to provide executive compensation benchmarking consulting services. See section 12.2(c)(iii) under the heading "Compensation Consultants and Advisors" for more information on services provided by Mercer.

NEO compensation is generally benchmarked against the executive compensation provided by other electricity distributors and other organizations that are selected and deemed relevant due to the fact that they are similar to the Corporation in scope, complexity and revenue. In particular, when benchmarking the NEOs' compensation with respect to the Corporation's revenue as compared to the revenue of other non-LDC companies in the benchmarking group, Mercer has taken a conservative approach and excluded the Corporation's flow through revenue for electricity transmission and generation. The benchmark group's compensation data is derived from the Mercer Benchmark Database, which includes data from industrial organizations located in the Greater Toronto Area, industrial organizations located across Canada, and organizations from the national public sector. Publicly-disclosed compensation information for executive officers is also considered. For the purposes of benchmarking the CFO's compensation, in addition to the above criteria, Mercer has included the cost of power in order to recognize accountability for total cash flow managed by the Corporation.

In addition, for the purposes of benchmarking the CEO's compensation, the Human Resources Committee has examined the executive compensation provided by the following companies: AltaGas Ltd., ATCO Ltd., British Columbia Hydro and Power Authority (operates as BC Hydro), Capital Power Corporation, Emera Inc., Enbridge Inc., ENMAX Corporation, Epcor Utilities Inc., Hydro One, IESO, OEB, Ontario Power Authority, OPG, SaskPower, TransAlta Corporation and Union Gas Limited.

The executive compensation information derived from the benchmarking analysis is designed to assist the Human Resources Committee in establishing, over a reasonable period of time, total compensation for NEOs in the range of the median total compensation of those companies within the benchmark group. Total compensation to NEOs may exceed the median of the marketplace when corporate, divisional and individual performance significantly exceeds objectives.

(iii) *Compensation Consultants and Advisors*

The Corporation began engaging the services of Mercer for executive compensation consulting services in 2005. In 2007, Mercer was retained directly by the then Compensation Committee for executive compensation consulting services. The services provided to the Human Resources Committee by Mercer include providing advice on the competitiveness and appropriateness of the Corporation's executive compensation program, compensation benchmarking services, and other compensation related matters that may arise from time to time.

The table below sets out the fees billed by Mercer for each of last two fiscal years in respect of the services noted below.

	Year ended December 31,	
	2013	2012
Executive Compensation – Related Fees ⁽¹⁾	\$153,299	\$207,096
All Other Fees ⁽²⁾	Nil	Nil

Notes:

- (1) Aggregate fees billed by Mercer, or any of its affiliates, for services related to determining compensation for any of the Corporation's directors and executive officers.
- (2) In the current year, there were no services provided by Mercer, or any of its affiliates, that are not reported under (1) above. In 2011, these fees related to workforce diversity consultation services performed at the request of management, and pursuant to a Board request. Other than certain approved services which are specified in the Corporation's policy on provision of services by compensation advisors, the Human Resources Committee must pre-approve other services Mercer or its affiliates provide to the Corporation at the request of management.

(d) Elements of Compensation

The principal components of compensation for NEOs are:

- base salary;
- performance-based incentive compensation;
- personal benefits and perquisites;
- pension plan;
- retirement benefits;
- retirement allowances; and
- termination payments.

As the Corporation has a single shareholder that is the registered and beneficial owner of all of its issued and outstanding shares, the Corporation is not able to offer an equity incentive plan or other stock-based compensation to its NEOs. The lack of an equity incentive is an underlying consideration of the Corporation in determining the NEOs overall compensation package from the above-noted components.

(i) *Base Salary*

In accordance with the general objectives and process for establishing compensation noted above, the Corporation provides NEOs with a base salary to compensate them for services rendered during the fiscal year. The Corporation provides reasonably competitive market-based base salaries to help attract, motivate, and retain NEOs who are critical to the Corporation's success.

Annually, adjustments to base salaries for NEOs are driven by market benchmarking data and the NEO's individual performance rating. The performance rating is determined, in the case of the CEO, by the Human Resources Committee and, in the case of the other NEOs, by the CEO, based on the achievement of performance-based incentive compensation objectives, knowledge, skills, and competencies related to day-to-day performance, as well as demonstration of desired corporate behaviours, subject to the Human Resources Committee's review.

(ii) *Performance-Based Incentive Compensation*

All NEOs receive a portion of their annual compensation in the form of performance-based cash payments. The performance-based incentive compensation is designed to retain, motivate and reward NEOs for reaching corporate, divisional and individual performance objectives established at the beginning of each calendar year.

The annual performance-based incentive compensation is calculated as a percentage of the NEO's base salary for the year and, if earned, paid in one lump sum in the next fiscal year.

In order for an NEO to earn and receive the performance-based incentive compensation, the Corporation and the NEO must each achieve certain pre-determined performance objectives. Each NEO's performance-based incentive compensation is based on a weighting of corporate, divisional and individual performance objectives, which weightings and objectives are determined at the start of each year and vary by role to reflect the performance focus of the role. The weighting and objectives are reviewed and set each year in order to reflect the Corporation's overall strategy and objectives.

Each year the board reviews and approves the Corporation's objectives. Each performance objective is weighted to reflect relative importance and includes threshold, target and outstanding expectations of performance. Specific performance targets are approved by the Board giving consideration to the Corporation's business plans and priorities for the upcoming year, prior year's performance and a review of forecasted results based on a historical analysis of performance. Similarly divisional objectives are approved by the CEO and reviewed by the Human Resources Committee to recognize unique divisional priorities and ensure alignment with the Corporation's overall objectives.

The CEO's individual objectives are reviewed and approved by the Board. The individual objectives of the other NEOs are reviewed and approved by the CEO. Each NEO's individual objectives are based on areas of strategic and operational emphasis related to their respective responsibilities and portfolios.

The NEO's individual objectives are intended to be reasonably difficult to attain and to encourage success in the NEO's performance. Individual objectives are often but not always achieved by an NEO in any given year. NEOs review their objectives and measurements throughout the year, with one formal mid-year review with the Chair of the Board (in the case of the CEO), and with the CEO (in the case of the other NEOs), to track achievement to-date and revise performance goals as may be necessary to reflect any change in corporate strategy or priorities.

In the case of the CEO, an annual performance evaluation in respect of his individual performance goals is conducted by the Chair of the Board who provides a recommendation to the Human Resources Committee regarding the performance-based incentive compensation to be paid to the CEO. The amount paid to the CEO is approved by the Board after review of the recommendation of the Human Resources Committee.

In the case of each of the other NEOs, an annual performance evaluation in respect of the individual objectives for each individual is conducted by the CEO, who proposes the amount of performance-based incentive compensation to be paid to each other NEO. The Human Resources Committee reviews and approves the amounts of performance-based incentive compensation to be paid to each of the other NEOs.

The Human Resources Committee may exercise its discretion to increase or reduce the performance-based incentive compensation paid to the CEO or NEOs, as applicable, including in certain circumstances absent attainment of a relevant performance goal or similar condition.

(iii) *Personal Benefits and Perquisites*

The Corporation provides NEOs with other personal benefits and perquisites that the Corporation believes are reasonable and consistent with its overall compensation program to better enable the Corporation to attract and retain superior employees for key positions. Benefits include group health, dental, group life insurance, short-term and long-term disability, accidental death & dismemberment, a fitness subsidy, and educational reimbursements, all of which are generally available to all salaried employees and do not discriminate in scope, terms or operation between employees of the same classification. The Corporation also previously provided NEOs with vehicles as part of the NEOs' personal benefits and perquisites, which benefit was eliminated effective February 28, 2012.

(iv) *Pension Plan*

All full-time employees of the Corporation, including the NEOs, are required to participate in the OMERS pension plan. Pursuant to the terms of the OMERS pension plan, NEOs are required to make plan contributions based on their pensionable earnings. In 2013, the Corporation and each NEO was required to contribute 9.0% equally of the first \$51,100 of pensionable earnings and thereafter 14.6% equally on all earnings over \$51,100 and up to \$156,794. Beyond the \$156,794 maximum, contributions continue equally of 14.6% towards a Retirement Compensation Arrangement (RCA), which is governed separately under the Canadian Income Tax Act. The OMERS pension plan is generally available to all other salaried employees and does not discriminate in scope, terms or operation between employees of the same classification. See section 4.6 (a) under the heading "Employees" for more information on the OMERS pension plan.

(v) *Retirement Benefits*

NEOs are eligible to receive post-retirement health, dental and life insurance after a minimum of five years of service with the Corporation if they retire from the Corporation and begin collecting under the OMERS pension plan upon retirement. The post-retirement benefits provided to eligible NEOs are the same as are generally available to all other salaried employees and do not discriminate in scope, terms or operation between employees of the same classification. Post-retirement benefits aid in attracting and retaining key executives to ensure the long-term success of the Corporation.

(vi) *Retirement Allowances*

From time to time, in certain circumstances, the Corporation enters into retirement allowance agreements with its NEOs. The retirement allowance agreements are designed in recognition of service and to promote retention, stability and continuity of the NEOs. These agreements are made on a case-by-case basis based on an NEO's years of service and position. Any retirement allowance provided to the CEO is approved by the Board after review of the recommendation of the Human Resources Committee. In the case of each of the other NEOs, any retirement allowance agreement is proposed by the CEO and reviewed and approved by the Human Resources Committee. Retirement allowance payments are typically paid in one or two lump sum instalments following termination or retirement of the NEO.

(vii) *Termination Payments*

From time to time, the Corporation enters into agreements with NEOs which provide for payments upon termination. These agreements are made on a case-by-case basis based on the NEO's age, years of service and position. Any such agreement for the CEO is approved by the Board after review of the recommendation of the Human Resources Committee. In the case of each of the other NEOs, any such agreement is proposed by the CEO and reviewed and approved by the Human Resources Committee. Typically, termination payments are paid either as a lump sum or as salary continuation for an agreed period following termination.

12.3 Compensation of Named Executive Officers

(a) Summary Compensation Table

The following table provides a summary of the compensation earned during the years ended December 31, 2011, 2012 and 2013, by the NEOs:

Summary Compensation Table⁽¹⁾

NEO Name and Principal Position	Year	Salary ⁽²⁾ (\$)	Non-Equity Incentive Plan Compensation ⁽³⁾ (\$)	All Other Compensation ⁽⁴⁾ (\$)	Total Compensation (\$)
Anthony Haines President and Chief Executive Officer, Toronto Hydro Corporation	2013	\$484,965	\$465,175	\$8,882	\$959,022
	2012	\$471,702	\$445,899	\$17,900	\$935,501
	2011	\$421,702	\$371,378	\$58,903	\$851,983
Jean-Sebastien Couillard Executive Vice-President and Chief Financial Officer, Toronto Hydro Corporation	2013	\$274,113	\$159,218	\$3,440	\$436,771
	2012	\$267,357	\$155,253	\$7,972	\$430,582
	2011	\$257,934	\$141,152	\$30,337	\$429,423
Dino Priore Executive Vice-President and Chief Engineering and Construction Officer, Toronto Hydro –Electric System Limited	2013	\$259,124	\$153,915	\$3,888	\$416,927
	2012	\$252,757	\$149,572	\$7,980	\$410,309
	2011	\$244,104	\$134,121	\$20,140	\$398,365
Ben La Pianta Executive Vice-President and Chief Electric Operations and Procurement Officer, Toronto Hydro –Electric System Limited	2013	\$247,193	\$147,847	\$4,550	\$399,590
	2012	\$239,981	\$140,921	\$5,100	\$386,002
	2011	\$231,712	\$118,421	\$31,440	\$381,573
Ivano Labricciosa Executive Vice-President and Business Development Officer, Toronto Hydro –Electric System Limited	2013	\$236,733	\$132,084	\$3,888	\$372,705
	2012	\$230,890	\$133,947	\$6,384	\$371,221
	2011	\$222,813	\$118,482	\$31,356	\$372,652

Notes:

- (1) Amounts shown in this table are in Canadian dollars and have been rounded to the nearest dollar.
- (2) Amounts shown reflect actual amounts paid during the year.
- (3) Each NEO's annual performance-based incentive compensation for a fiscal year is determined and paid in the next fiscal year. Accordingly, amounts reflected in respect of a particular year (i.e. 2012) represent the annual performance-based incentive compensation earned by the NEO for the achievement of performance objectives in respect of that fiscal year (i.e. 2012) but which amounts are paid in the following fiscal year (i.e. 2013).
- (4) Amounts shown in this column reflect all other compensation earned by the NEO during the year. The amounts shown include the aggregate value of perquisites and other personal benefits provided to the NEO, where such perquisites and personal benefits are not generally available to all employees and have been calculated by using the actual cost. In 2012, perquisites and personal benefits were not worth \$50,000 or more for any NEO, nor were they worth 10% or more of any NEO's total salary for the year. In 2011 and 2010 there were perquisites and personal benefits not generally available to all employees reported for NEOs that were worth \$50,000 or more, or were worth 10% or more of the NEO's total salary.

(b) Compensation of NEOs in 2013 – Narrative Discussion

(i) Base Salaries

The NEOs' annual base salaries for 2013 were: \$485,466 in the case of Mr. Haines, \$274,396 in the case of Mr. Couillard, \$259,392 in the case of Mr. Priore, \$247,498 in the case of Mr. La Pianta, and \$236,978 in the case of Mr. Labricciosa.

(ii) Performance-Based Incentive Compensation

The respective target performance-based incentive compensation amounts for each NEO for 2013 were as follows: 65% of the base salary, in the case of Mr. Haines, 40% of the base salary in the case of Mr. Couillard, 40% of the base salary in the case of Mr. Priore, 40% of the base salary in the case of Mr. La Pianta, and 40% of the base salary in the case of Mr. Labricciosa. The performance-based incentive compensation amount payable to each NEO may exceed the respective target % of base salary indicated previously when results exceed corporate and divisional objectives and may be below the respective target % of base salary indicated previously when the corporate and divisional objectives are not achieved.

The weightings attributed to Mr. Haines' 2013 performance-based incentive compensation were as follows: 80% based on the performance of the Corporation and 20% based on the achievement of individual performance objectives. For all other NEOs, the performance-based incentive compensation weightings were as follows: 60% based on the performance of the Corporation, 20% based on the Corporation's achievement of divisional objectives, and 20% based on the NEO's achievement of individual performance objectives.

The performance objectives of the Corporation for 2013 were as follows:

Corporate Objective	Measure	Target	Weight (%)
Net Income (\$ millions)	Net Income per the Corporation's Consolidated Financial Statements.	\$106.6	30
LDC Regulated Capital (\$ millions)	Achievement of LDC capital work program as approved by the Board.	\$335.1	10
Worst Performing Feeders	Total number of feeders experiencing seven or more sustained outages in a year, with outages defined as interruptions greater than one minute.	38	5
System Average Interruption Duration Index (SAIDI) (in minutes)	Measure of the annual system average interruption duration per customer served, not including MED.	82.5	10
System Average Interruption Frequency Index (SAIFI) (in minutes)	Measure of the frequency of service interruptions per customer served, not including MED.	1.61	10
Conservation Demand Management	Annual summer peak demand savings through year over year MW reduction.	45.0	5
Enhanced Customer Engagement (ECE)	Increase in customer self-serve transactions / engagements using various self-serve options.	120%	5
Call Centre Service Response	Average of call centre responses within thirty seconds.	76.0%	5
Safety	Number of recordable injuries x 200,000 / exposure hours.	2.98	10
Employee Engagement	Average number of employee engagement sessions per employee per year, including company-wide, divisional and departmental.	8	10

The divisional performance objectives for 2013 were as follows:

Divisional Objective	FINANCE		DISTRIBUTION SERVICES		DISTRIBUTION GRID MANAGEMENT		ASSET MANAGEMENT	
	Jean-Sebastien Couillard		Dino Priore		Ben La Pianta		Ivano Labricciosa	
	Target	Weight (%)	Target	Weight (%)	Target	Weight (%)	Target	Weight (%)
Net Income before restructuring charges (\$ millions)	\$106.6	30	N/A	N/A	N/A	N/A	N/A	N/A
Operating Expense per the Divisional & Corporate budgets (\$ millions)	\$271.14	25	\$46.52	5	\$64.05	10	26.0	5
THESL Regulated Capital (\$ millions)	\$335.1	20	\$335.1	10	\$335.1	5	\$335.1	10
Worst Performing Feeders	N/A	N/A	38	15	38	15	38	15
System Average Interruption Duration Index (SAIDI) (in minutes)	N/A	N/A	82.5	15	82.5	15	82.5	15
System Average Interruption Frequency Index (SAIFI) (in minutes)	N/A	N/A	1.61	15	1.61	15	1.61	15
Conservation Demand Management	45.0	5	N/A	N/A	N/A	N/A	N/A	N/A

Divisional Objective	FINANCE		DISTRIBUTION SERVICES		DISTRIBUTION GRID MANAGEMENT		ASSET MANAGEMENT	
	Jean-Sebastien Couillard		Dino Priore		Ben La Pianta		Ivano Labricciosa	
	Target	Weight (%)	Target	Weight (%)	Target	Weight (%)	Target	Weight (%)
Enhanced Customer Engagement (ECE)	N/A	N/A	N/A	N/A	N/A	N/A	120%	5
Safety	2.98	5	2.98	15	2.98	15	2.98	10
Safety Leadership (safety inspections completed as a percentage of plan) per division	N/A	N/A	95%	5	95%	5	95%	10
Employee Engagement	8	10	8	10	8	10	8	10
Attendance (average days absent per employee per division)	3.0	5	7.0	10	8.2	10	4.5	5

The Corporation exceeded all of its 2013 corporate and divisional objectives. Each of the NEOs met or exceeded his individual performance objectives for 2013. Each of the corporate, divisional and individual performance objectives were reasonably difficult to attain and served to encourage success in the NEO performance and in the Corporation's financial and operational results.

The percentage of total compensation that relates to the achievement of each NEO's individual performance objectives were as follows: 9% for Mr. Haines, 7% for Mr. Couillard, 7% for Mr. Priore, 7% for Mr. La Pianta and 5% for Mr. Labricciosa.

(iii) *Personal Benefits and Perquisites*

In 2013, the NEOs received personal benefits and perquisites as described in section 12.2(d)(iii) under the heading "Personal Benefits and Perquisites", and as quantified in the Summary Compensation Table in section 12.3(a) above.

(iv) *Pension Plan*

In 2013, each of the NEOs participated in the OMERS pension plan. The OMERS pension plan is a group pension plan that is generally available to all salaried employees and does not discriminate in scope, terms or operation between employees of the same classification. See section 4.6(a) under the heading "Employees" and section 12.2(d)(iv) under the heading "Pension Plan" for further information on the OMERS pension plan.

(v) *Retirement Benefits*

As of December 31, 2013, Mr. Haines, Mr. Couillard, Mr. Priore, Mr. La Pianta and Mr. Labricciosa have each provided Toronto Hydro with more than five years of service and are therefore eligible for post-retirement medical, dental, and life insurance benefits if they retire from the Corporation and begin collecting under the OMERS pension plan upon retirement.

(vi) *Retirement Allowance*

Mr. Haines is the only NEO entitled to retirement allowances, which allowances are calculated based on completed years of service and are payable in the form of lump-sum cash payments following Mr. Haines' termination (without cause) or retirement from the Corporation.

Under the terms of Mr. Haines' existing retirement allowance (the "Existing Allowance"), if Mr. Haines is terminated (without cause) or retires from the Corporation during 2014, he will receive a \$230,000 retirement allowance. The amount of the Existing Allowance payable to Mr. Haines will thereafter be increased by an

additional \$90,000 per year (from 2014 to 2016) and \$125,000 per year (from 2017 to 2020) for each full calendar year of service completed. The maximum Existing Allowance payable to Mr. Haines is \$1,000,000, which Mr. Haines will earn if he remains in active service for the Corporation until December 31, 2020. In the event that Mr. Haines becomes permanently disabled while in active service for the Corporation, he will be deemed to remain in active service for the Corporation until December 31, 2020, at which point he will be considered to have retired and earned the maximum Existing Allowance of \$1,000,000. In the event of the death of Mr. Haines while in active service for the Corporation, the Existing Allowance which Mr. Haines would have earned as of the date of his death will be paid to his designated beneficiary or to the legal representative of Mr. Haines' estate.

As part of his compensation package, Mr. Haines also participates in the OMERS defined benefit pension plan. See “Pension Plan” above in section 12.3(b)(iv). OMERS has recently made significant unilateral changes to its defined benefit pension plan that significantly reduce the value of Mr. Haines’ pension benefit under the OMERS pension plan. The changes made by OMERS do not significantly impact the other NEOs. In order to mitigate the impact of these changes in a manner consistent with the terms of his existing employment relationship with the Corporation, the Corporation has awarded Mr. Haines a second retirement allowance (the “Second Allowance”). Under the terms of the Second Allowance, if Mr. Haines is terminated (without cause) or retires from the Corporation during 2014, he will receive a \$100,000 retirement allowance. The amount of the Second Allowance payable to Mr. Haines will thereafter be increased by an additional \$100,000 per year (for 2015) and \$225,000 per year (from 2016 to 2021) for each full calendar year of service completed. The maximum Second Allowance payable to Mr. Haines is \$1,650,000, which Mr. Haines will earn if he remains in active service for the Corporation until December 31, 2021. In the event that Mr. Haines becomes permanently disabled while in active service for the Corporation, he will be deemed to remain in active service for the Corporation until December 31, 2021, at which point he will be considered to have retired and earned the maximum Second Allowance of \$1,650,000. The provisions relating to entitlement on death are identical to those established for the Existing Allowance.

(vii) *Termination Payments*

Both Mr. Haines and Mr. Couillard have entered into agreements with the Corporation which provide for certain payments upon termination.

If the employment of Mr. Haines is terminated without cause by the Corporation, then Mr. Haines is entitled to a payment equal to 24 months of base salary and performance pay that would have been paid had he continued to work for 24 months (approximately \$1,825,901 as at December 31, 2013), with the performance pay calculated based on the average annual performance pay earned by Mr. Haines during the 3 years preceding the date of termination. Mr. Haines would also be entitled to continued group health and dental benefit coverage for a period of 24 months from the date of termination.

If the employment of Mr. Couillard is terminated without cause by the Corporation then he is entitled to a payment equal to 18 months of base salary and performance pay that would have been paid had he continued to work for 18 months (approximately \$639,365 as at December 31, 2013), with the performance pay calculated based on the average annual performance pay earned by Mr. Couillard during the 3 years preceding the date of termination. Mr. Couillard would also be entitled to continued group health and dental benefit coverage for a period of 18 months from the date of termination.

12.4 Compensation of Directors

(a) Director Compensation Table

Director Name	Fees Earned (\$)	All other compensation (\$)	Total (\$)
Clare Copeland ⁽¹⁾	\$37,500	\$448 ⁽⁹⁾	\$37,948
Patricia Callon ⁽²⁾	\$10,125	Nil	\$10,125
Brian Chu ⁽³⁾	\$8,125	Nil	\$8,125
Derek Cowbourne	\$22,500	Nil	\$22,500
Paulette Kennedy	\$23,500	Nil	\$23,500
Shoba Khetrapal ⁽⁴⁾	\$8,125	Nil	\$8,125
David Williams	\$62,375	\$987 ⁽¹⁰⁾	\$63,362
Vincent Brescia	\$22,500	Nil	\$22,500
Colum Bastable ⁽⁵⁾	\$26,500	Nil	\$26,500
Sara Gelgor ⁽⁶⁾	\$16,375	Nil	\$16,375
Isabel Meharry ⁽⁷⁾	\$17,375	Nil	\$17,375
Glenna Carr ⁽⁸⁾	\$16,375	Nil	\$16,375
Councillor Shelley Carroll	Nil	Nil	Nil
Councillor Josh Colle	Nil	Nil	Nil
Councillor Gloria Lindsay Luby	Nil	Nil	Nil

Notes:

- (1) Clare Copeland ceased to be a director of the Corporation effective April 15, 2013.
- (2) Patricia Callon ceased to be a director of the Corporation effective April 14, 2013.
- (3) Brian Chu ceased to be a director of the Corporation effective April 14, 2013.
- (4) Shoba Khetrapal ceased to be a director of the Corporation effective April 14, 2013.
- (5) Colum Bastable became a director of the Corporation effective April 15, 2013.
- (6) Sara Gelgor became a director of the Corporation effective April 15, 2013.
- (7) Isabel Meharry became a director of the Corporation effective April 15, 2013.
- (8) Glenna Carr became a director of the Corporation effective April 15, 2013.
- (9) Includes amounts in respect of medical exams.
- (10) Includes amounts in respect of travel reimbursements for board meeting attendance.

(b) Compensation of Directors – Narrative Discussion

Directors of the Corporation, other than Councillors of the City, are compensated for their services as directors through a combination of retainer fees and meeting attendance fees. These fees are set by the sole shareholder of the Corporation, the City. The annual retainer fees are as follows: chair of the Board – \$75,000 and each of the other directors – \$12,500. The meeting attendance fees are as follows: each meeting of the Board and the subsidiaries attended – \$1,000 and each meeting of the Audit Committee, Corporate Governance Committee, Human Resources Committee (and prior to May 16, 2013 for each meeting of the Health and Safety Committee and Compensation Committee) attended — \$1,000, subject to annual maximum fees per committee member of \$5,000 for the Audit Committee, Corporate Governance Committee, and the Human Resources Committee (and prior to May 16, 2013,

\$4,000 for the Compensation Committee and \$5,000 for the Health and Safety Committee). The Chair receives no meeting attendance fees. Councillors receive no remuneration for their services as directors of the Corporation.

PART 13 - LEGAL PROCEEDINGS

In the ordinary course of business, Toronto Hydro is subject to various legal actions and claims with customers, suppliers, former employees and other parties. On an ongoing basis, Toronto Hydro assesses the likelihood of any adverse judgments or outcomes as well as potential ranges of probable costs and losses. A determination of the provision required, if any, for these contingencies is made after an analysis of each individual issue. The provision may change in the future due to new developments in each matter or changes in approach, such as a change in settlement strategy. If damages were awarded under these actions, Toronto Hydro would make a claim under their liability insurance which Toronto Hydro believes would cover any damages which may become payable by Toronto Hydro in connection with these actions.

13.1 Christian Helm Class Action

On December 6, 2010, a statement of claim in a proposed class action was issued against LDC. The claim sought general and special damages in the amount of \$100.0 million for disgorgement of unjust gains allegedly resulting from the receipt of interest on overdue accounts in contravention of the Interest Act. On April 30, 2012, a settlement reached by the parties was approved by Order of the Ontario Superior Court of Justice. Pursuant to the terms of the Order, LDC was required to pay the amount of \$5.8 million plus costs in settlement of all claims, substantially all of which had been paid as at December 31, 2012. The Corporation accrued a liability to cover the expected settlement in 2010. The action has been dismissed, and the claims by all class members have been released.

13.2 2 Secord Avenue

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the Class Proceedings Act, 1992 (Ontario) seeking damages in the amount of \$30.0 million as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence and third party claim have been served by LDC and a third party defence and counterclaim against LDC seeking damages in the amount of \$51.0 million have been filed. A certification order has been issued. Affidavits of documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. A mediation took place on January 15, 2014 and the parties have agreed to settle the action of the class plaintiffs by the payment by LDC of the total amount of \$6.5 million, including all taxes and legal fees, subject to approval by the Ontario Superior Court of Justice. LDC will make a claim under its liability insurance which the Corporation believes will cover the settlement payment. A settlement approval hearing will be scheduled. If the settlement is approved by the court, the main actions commenced by the class plaintiffs will be dismissed without costs, however the claims, counterclaims and third party claims amongst the various defendants to the class action will continue. Given the preliminary status of the remaining unsettled actions, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

On December 20, 2010, LDC was served with a statement of claim by the City seeking damages in the amount of \$2.0 million as a result of the fire at 2 Secord Avenue. A statement of defence and a third party claim have been served. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

By order of the court dated January 24, 2012, the above actions and a smaller non-class action commenced in April 2009 involving the same incident will be tried at the same time or consecutively.

13.3 2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of \$30.0 million as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action seeks general damages in the amount of \$10.0 million and special damages in the amount of \$20.0 million from LDC. The proposed class action is at a preliminary stage. The plaintiff cancelled its certification motion set for November 2013 and advised it intends to reschedule. Cross-examinations for a certification motion have commenced, but have not been completed. Statements of defence to the main action and to the third party claim have not been filed. Given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with these actions.

On August 29, 2011, LDC was served with a statement of claim by the owner of the building and the property management company for the building seeking damages in the amount of \$2.0 million as a result of the fire at 2369 Lakeshore Boulevard West. LDC has filed a statement of defence and counterclaim. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

13.4 Adamopoulos

An action was commenced against LDC in November 2004 in the Ontario Superior Court of Justice seeking damages in the amount of \$7.8 million as compensation for damages allegedly suffered as a result of a motor vehicle accident involving an LDC vehicle on January 9, 2001. The plaintiff's motion increasing its claim for damages to \$23.8 million was granted on July 7, 2010. This matter has been settled and a court order has been issued dismissing the action and all related claims by payment of a total amount of approximately \$4.6 million. LDC's liability insurance covered the settlement amount.

13.5 Late Payment Charges Class Action

By Order dated July 22, 2010, the Ontario Superior Court of Justice consolidated and approved the settlement of two class actions against LDC, one commenced in 1994 and the other, against all MEUs, in 1998. The actions sought \$500.0 million and \$64.0 million, respectively, in restitution for late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. The claims made against LDC and the definition of the plaintiff classes were identical in both actions such that any damages payable by LDC in the first action would reduce the damages payable by LDC in the second action, and vice versa.

The July 22, 2010 court order formalized a settlement pursuant to which the defendant MEUs will pay the amount of \$17.0 million plus costs and taxes in settlement of all claims. The amount allocated for payment by each MEU is its proportionate share of the settlement amount based on its percentage of distribution service revenue over the period for which it has exposure for repayment of late payment penalties exceeding the interest rate limit in the Criminal Code. Under the settlement, all of the MEUs involved in the settlement, including LDC, requested an order from the OEB allowing for the future recovery from customers of all costs related to the settlement. On February 22, 2011, the OEB issued its final decision allowing LDC to recover its share of the settlement in the amount of \$7.5 million from customers. The payment to settle LDC's portion of the class action suit was made on June 30, 2011. On July 7, 2011, the OEB authorized LDC to begin the recovery of the balance on August 1, 2011. The full recovery of the balance had been done over a 21-month period ending April 30, 2013.

PART 14 - MATERIAL CONTRACTS

Except for the indenture and the supplemental indentures under which the Debentures were issued, Toronto Hydro has not entered into any material contract (other than contracts entered into in the ordinary course of business) in the most recently completed financial year, or before the most recently completed financial year, if such contract is still in effect.

Copies of these material contracts are available on the SEDAR website at www.sedar.com.

PART 15 - NAMED AND INTERESTS OF EXPERTS

The external auditor of the Corporation is KPMG LLP. KPMG LLP is independent within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario.

PART 16 - TRANSFER AGENTS AND REGISTRARS

The trustee and registrar for the Corporation is BNY Trust Company of Canada, located in Toronto, Ontario.

PART 17 - ADDITIONAL INFORMATION

Additional information relating to the Corporation, including copies of the Consolidated Financial Statements and Management's Discussion and Analysis, are available on the SEDAR website at www.sedar.com.

ANNEX A - AUDIT COMMITTEE CHARTER

1. General

- (a) The board of directors (**Board**) of Toronto Hydro Corporation (**Corporation**) has established the Audit Committee (**Committee**) to assist the Board in fulfilling its corporate governance and oversight responsibilities with respect to financial reporting, internal financial control structure, financial risk management systems, internal audit and external audit functions.
- (b) The composition, responsibilities and authority of the Committee are set out in this Charter.
- (c) This Charter and the by-laws of the Corporation and such other procedures, not inconsistent therewith, as the Committee may adopt from time to time shall govern the meetings and procedures of the Committee.

2. Composition

- (a) The Committee shall be composed of at least three directors of the Corporation (**Members**):
 - (i) all Members shall be *independent* (as determined by the Board in accordance with the rules of the Canadian Securities Administrators with respect to the role and composition of audit committees); and
 - (ii) at least one of whom, including the chair of the Committee (Chair) is *financially literate* (ie, have the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the accounting issues that can reasonably be expected to be raised by the financial statements of the Corporation).
- (b) Members shall be appointed by the Board on the recommendation of the Chair of the Board and shall serve until they resign, cease to be a director or are removed or replaced by the Board.
- (c) The Board shall designate one of the Members as Chair.
- (d) The Secretary of the Corporation shall be secretary of the Committee (**Secretary**).

3. Responsibilities

The Committee shall assist the Board in fulfilling its corporate governance and oversight responsibilities with respect to financial reporting, internal financial control structure, financial risk management systems, internal audit functions and external audit functions.

The Committee shall have the responsibilities set out below.

(a) ***Managing the Relationship between the Corporation and its External Auditors***

The Committee shall be responsible for managing the relationship between the Corporation and its external auditors, including:

- (i) appointing and replacing the external auditors, subject to shareholder approval;
- (ii) setting the compensation of the external auditors subject to the approval of the board of directors or shareholder, as applicable;

- (iii) overseeing the work of the external auditors, including resolving disagreements between management and the external auditors with respect to financial reporting;
 - (iv) pre-approving all audit services and permitted non-audit services to be provided to the Corporation and its subsidiary entities by the external auditors in accordance with the "Policy on the Provision of services by the External Auditors";
 - (v) having the external auditors report to the Committee in a timely manner with respect to all required matters, including those set out in paragraph 3(2);
 - (vi) reviewing and approving the hiring policies of the Corporation with respect to present and former partners and employees of the external auditors;
 - (vii) ensuring the rotation of the audit partner having primary responsibility for the external audit of the Corporation, the audit partner responsible for reviewing the external audit and the external auditors at such intervals as may be required; and
 - (viii) reviewing and assessing the performance, independence and objectivity of the external auditors.
- (b) ***Overseeing the External Audit***

The Committee shall be responsible for overseeing the external audit of the Corporation, including:

- (i) reviewing and approving the engagement letter and the audit plan, including financial risk areas identified by the external auditors and management;
- (ii) reviewing and assessing the accounting and reporting practices and principles used by the Corporation in preparing its financial statements, including:
 - (1) all significant accounting policies and practices used, including changes from preceding years and any proposed changes for future years;
 - (2) all significant financial reporting issues, estimates and judgments made;
 - (3) all alternative treatments of financial information discussed by the external auditors and management, the results of such discussions and the treatments preferred by the external auditors;
 - (4) any major issues identified by the external auditors with respect to the adequacy of internal control systems and procedures and any special audit steps adopted in light of material deficiencies and weaknesses;
 - (5) the effect of regulatory and accounting initiatives and off-balance sheet transactions or structures on the financial statements;
 - (6) any errors or omissions in, and any required restatement of, the financial statements for preceding years;
 - (7) all significant tax issues;
 - (8) the reporting of all material contingent liabilities; and
 - (9) any material written communications between the external auditors and management;

- (iii) reviewing and assessing the results of the external audit and the external auditors' opinion on the financial statements;
- (iv) reviewing and discussing with the external auditors and management any management or internal control letters issued or proposed to be issued by the external auditors;
- (v) reviewing and discussing with the external auditors any problems or difficulties encountered by them in the course of their audit work and management's response (including any restrictions on the scope of activities or access to requested information and any significant disagreements with management); and
- (vi) reviewing and discussing with legal counsel any legal matters that may have a material impact on the financial statements, operations, assets or compliance policies of the Corporation and any material reports or enquiries received by the Corporation and its subsidiary entities from regulators or government agencies.

(c) ***Overseeing the Internal Audit***

The Committee shall be responsible for overseeing the internal audit of the Corporation, including:

- (i) periodically reviewing the Internal Audit Charter and making recommendations to the Board;
- (ii) reviewing and approving the audit plan, including significant risk exposures identified by the internal auditor and management;
- (iii) reviewing and discussing with the internal auditor and management the results of any internal audits;
- (iv) reviewing and discussing with the internal auditors any problems or difficulties encountered by them in the course of their audit work and management's response (including any restrictions on the scope of activities or access to requested information and any significant disagreements with management);
- (v) appointing and replacing the internal auditor;
- (vi) reviewing and assessing the performance of the internal auditor;
- (vii) ensure the Committee is kept informed of emerging trends and successful practices in internal auditing; and
- (viii) confirm there is effective and efficient coordination of activities between internal and external auditors.

(d) ***Reviewing and Approving and Recommending to the Board for Approval the Financial Statements, MD&A and Interim Reports of the Corporation***

The Committee shall review and approve, and where required recommend to the Board for approval, the financial statements, management's discussion and analysis of financial condition and results of operations (**MD&A**) and interim financial reports of the Corporation, annual information form (**AIF**) and other public disclosure of financial information extracted from the financial statements of the Corporation with particular focus on:

- (i) the quality and appropriateness of accounting and reporting practices and principles and any changes thereto;

- (ii) major estimates or judgments, including alternative treatments of financial information discussed by management and the external auditors, the results of such discussions and the treatment preferred by the external auditors;
- (iii) material financial risks;
- (iv) material transactions;
- (v) material adjustments;
- (vi) compliance with loan agreements;
- (vii) material off-balance sheet transactions and structures;
- (viii) compliance with accounting standards;
- (ix) compliance with legal and regulatory requirements; and
- (x) disagreements with management.

(e) ***Overseeing Internal Financial Control Structure and Financial Risk Management Systems***

The Committee shall be responsible for overseeing the internal financial control structure and financial risk management systems of the Corporation, including:

- (i) reviewing and discussing with management and the external auditors the quality and adequacy of internal control over financial reporting structures of the Corporation, including any major deficiencies or weakness and the steps taken by management to rectify these deficiencies or weaknesses;
- (ii) reviewing and discussing with management, the internal auditor and the external auditors the risk assessment and risk management policies of the Corporation, the major financial risk exposures of the Corporation and the steps taken by management to monitor and control these exposures;
- (iii) reviewing and discussing with the Chief Executive Officer and the Chief Financial Officer of the Corporation the procedures undertaken by them in connection with the certifications required to be given by them in connection with annual and other filings required to be made by the Corporation under applicable securities laws; and
- (iv) periodically reviewing the Treasury Policy and signing policies for the Corporation and its subsidiaries, making recommendations to the Board in respect of such policies and reviewing performance under those policies with Management.

(f) ***Establish and Review Certain Procedures***

The Committee shall establish adequate policies and procedures, or require that adequate policies and procedures are established, with respect to the following and shall annually assess the adequacy of these procedures:

- (i) the review of the public disclosure of financial information extracted from the financial statements of the Corporation;
- (ii) the receipt, retention and treatment of complaints received by the Corporation with respect to accounting, internal controls or auditing matters; and

- (iii) the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.

4. Authority

- (a) The Committee is authorized to carry out its responsibilities as set out in this Charter and to make recommendations to the Board arising therefrom.
- (b) The Committee may delegate by written policy to the Chair and the Chief Financial Officer of the Corporation (**CFO**) the authority, within specified limits, to authorize in advance all engagements of the external auditors to provide pre-approved services to the Corporation and its subsidiary entities. The Chair and the CFO shall report all engagements authorized by them to the Committee at its next meeting.
- (c) The Committee shall have direct and unrestricted access to the external and internal auditors, officers and employees and information and records of the Corporation.
- (d) The Committee is authorized to retain, and to set and pay the compensation of, independent legal counsel and other advisors if it considers this appropriate.
- (e) The Committee is authorized to invite officers and employees of the Corporation and outsiders with relevant experience and expertise to attend or participate in its meetings and proceedings if it considers this appropriate.
- (f) The external auditors shall have direct and unrestricted access to the Committee and shall report directly to the Committee.
- (g) The Corporation shall pay directly or reimburse the Committee for the expenses incurred by the Committee in carrying out its responsibilities.

5. Meetings and Proceedings

- (a) The Committee shall meet as frequently as required but not less frequently than four times each year.
- (b) Any Member or the Secretary may call a meeting of the Committee. The external auditors or the CFO may ask a Member to call a meeting of the Committee.
- (c) The Chair shall approve the agenda of each meeting of the Committee, including input from the officers and employees of the Corporation, external auditors, other Members and other directors of the Corporation as appropriate. Meetings will include presentations by management or professional advisors and consultants when appropriate and allow sufficient time to permit a full and open discussion of agenda items.
- (d) Unless waived by all Members, a notice of each meeting of the Committee confirming the date, time, place and agenda of the meeting, together with any supporting materials, shall be forwarded to each Member at least three days before the date of the meeting.
- (e) The quorum for each meeting of the Committee is two Members. In the absence of the Chair, the other Members may appoint one of their number as chair of a meeting. The Chair of a meeting shall not have a second or casting vote.
- (f) The Chair or a delegate of the Chair shall report to the Board following each meeting of the Committee.
- (g) The Secretary or a delegate of the Secretary shall keep minutes of all meetings of the Committee, including all resolutions passed by the Committee. Minutes of all meetings shall be distributed to the Members. The

minutes shall be available for review by the other directors of the Corporation after approval thereof by the Committee.

- (h) An individual who is not a Member may be invited to attend a meeting of the Committee for all or part of the meeting. A standing invitation to all meetings shall be given to the Chairman of the Board, the President and Chief Executive Officer of the Corporation, the CFO except where the meeting, or part of the meeting, is for Members only or a private session with the internal auditor or the external auditors. A standing invitation should be given to the internal auditor and the engagement partners of the external auditors for all meetings where financial information is reviewed and approved..
- (i) The Committee shall meet regularly alone and in private sessions with the internal audit leader, the external auditors and management of the Corporation to facilitate full communication.

6. Review

- (a) This Charter shall be reviewed by the Corporate Governance Committee of the Corporation every 2 years and any recommended changes shall be referred first to the Audit Committee for review and comment and second, after consideration of the input from the Audit Committee, to the Board of the Corporation for consideration and disposition.

1 **PUBLIC OFFERING INFORMATION**

2

3 In accordance with section 2.4.3 of the OEB's Filing Requirements (July 17, 2013), this
4 schedule includes the following information about Toronto Hydro's recent public
5 offerings:

- 6 • Appendix A: Prospectus, issued 10 December 2012;
- 7 • Appendix B: 8th Supplemental Trust Indenture, issued November 2011;
- 8 • Appendix C: 9th Supplemental Trust Indenture, issued April 2013; and
- 9 • Appendix D: 10th Supplemental Trust Indenture, issued April 2013.

No securities regulatory authority has expressed an opinion about these securities and it is an offence to claim otherwise.

This short form prospectus has been filed under legislation in each of the provinces of Canada that permits certain information about these securities to be determined after this prospectus has become final and that permits the omission from this prospectus of that information. The legislation requires the delivery to purchasers of a prospectus supplement containing the omitted information within a specified period of time after agreeing to purchase any of these securities.

This short form prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. The securities to be issued hereunder have not been and will not be registered under the United States Securities Act of 1933, as amended, and, subject to certain exceptions, may not be offered or sold within the United States or to United States persons. See "Plan of Distribution".

Information has been incorporated by reference in this short form prospectus from documents filed with securities commissions or similar authorities in Canada. Copies of the documents incorporated herein by reference may be obtained on request without charge from the Chief Financial Officer, Toronto Hydro Corporation, 14 Carlton Street, Toronto, Ontario, M5B 1K5, (416) 542-3100 and are also available electronically at www.sedar.com.

SHORT FORM BASE SHELF PROSPECTUS

New Issue

December 10, 2012



TORONTO HYDRO CORPORATION

\$1,500,000,000 DEBENTURES

(unsecured)

Toronto Hydro Corporation (the "Corporation") may offer and issue from time to time unsecured debentures (the "Debentures") in one or more series in an aggregate principal amount of up to \$1,500,000,000 (or the equivalent thereof in foreign currencies or currency units if any of the Debentures are denominated in foreign currencies or currency units) during the twenty-five months from the date of this prospectus. The Debentures will be offered pursuant to an MTN program established by the Corporation.

The Debentures will be issued under a trust indenture dated May 7, 2003 (as supplemented from time to time by supplemental indentures), will be direct unsecured obligations of the Corporation and will rank equally (except as to sinking funds and to the extent prescribed by law) with all other unsecured and unsubordinated indebtedness of the Corporation. The Debentures will have a term to maturity of not less than one year and will be issuable in denominations of \$1,000 or more. The Debentures may be issued in Canadian dollars or any foreign currency or currency unit determined at the time of issue.

The specific terms of an offering of Debentures (including the aggregate principal amount of the Debentures being offered, the currency or currencies, the issue and delivery date, the form, the maturity date, the interest rate, the issue price, the interest payment date(s), any redemption or repayment provisions, any provisions entitling the Corporation to extend the maturity date of the Debentures, the name(s) of the dealer(s) offering the Debentures, the commission payable to such dealer(s), the method of distribution and the net proceeds to the Corporation) will be set forth in a pricing supplement which will be delivered to purchasers together with this prospectus. The Corporation reserves the right to set forth in a pricing supplement specific terms of Debentures which are not within the parameters set forth in this prospectus.

The sole shareholder of the Corporation is the City of Toronto. **The Debentures will not be obligations of, and will not be guaranteed in any manner by, the City of Toronto.**

There is no market through which the Debentures may be sold and purchasers may not be able to resell Debentures purchased under this prospectus. This may affect the pricing of the Debentures in the secondary market, the transparency and availability of trading prices, the liquidity of the Debentures and the extent of issuer regulation. See "Risk Factors". Unless otherwise indicated in a pricing supplement, the Debentures will not be listed on any securities exchange.

RATES ON APPLICATION

(continued from cover)

The Debentures may be offered by one or more dealers as selected from time to time by the Corporation (collectively, the “Dealers”), in each case, acting as agent of the Corporation or as principal. Where the Debentures are offered by the Dealer(s) as agent(s), the commissions payable by the Corporation in connection with sales of such Debentures shall be agreed from time to time between the Corporation and any such Dealer(s). Where the Debentures are purchased by the Dealer(s) as principal, the Debentures shall be purchased at such prices and with such commissions as may be agreed from time to time between the Corporation and any such Dealer(s) for resale to the public at prices to be negotiated with each purchaser. Such resale prices may vary during the distribution period and as between purchasers. Each Dealer’s compensation will increase or decrease by the amount by which the aggregate price paid for Debentures by purchasers exceeds or is less than the price paid by the Dealer, acting as principal, to the Corporation. The commissions payable in connection with sales of Debentures will be set forth in a pricing supplement which will be delivered to purchasers together with this prospectus. The Corporation may also offer the Debentures directly to potential purchasers pursuant to applicable statutory exemptions at prices and upon terms negotiated between the purchaser and the Corporation. The Corporation and, if applicable, the Dealers, may reject any offer to purchase the Debentures in whole or in part. The Corporation also reserves the right to withdraw, cancel or modify the offering of the Debentures under this prospectus without notice. The Dealers may over-allot or effect transactions which stabilize or maintain the market price of the Debentures offered at a level above that which might otherwise prevail in the open market. See “Plan of Distribution”.

The offering of the Debentures is subject to the approval of certain legal matters on behalf of the Corporation by McMillan LLP.

The registered and head office of the Corporation is located at 14 Carlton Street, Toronto, Ontario, M5B 1K5.

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DOCUMENTS INCORPORATED BY REFERENCE

The following documents of the Corporation filed with the provincial securities regulatory authorities in Canada are incorporated by reference in this prospectus for the purposes of the offering of Debentures hereunder:

- (a) the annual information form (the "AIF") of the Corporation dated March 29, 2012;
- (b) the comparative audited consolidated financial statements of the Corporation together with the auditors' report thereon and the notes thereto as at and for the years ended December 31, 2011 and December 31, 2010;
- (c) management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2011;
- (d) the comparative unaudited interim consolidated financial statements of the Corporation together with the notes thereto as at and for the three-month and nine-month periods ended September 30, 2012 and September 30, 2011 and management's discussion and analysis relating thereto;
- (e) earnings coverage ratios for the twelve-month periods ended December 31, 2011 and September 30, 2012; and
- (f) the Ernst & Young LLP auditors' report on the financial statements as at and for the year ended December 31, 2010 referred to in item (b).

All material change reports, business acquisition reports and unaudited interim consolidated financial statements of the Corporation (and management's discussion and analysis relating thereto) filed by the Corporation after the date of this prospectus with the securities regulatory authorities in Canada will be deemed to be incorporated by reference in this prospectus for the purposes of the offering of Debentures hereunder.

Updated earnings coverage ratios will be filed quarterly with the provincial securities regulatory authorities in Canada and will be deemed to be incorporated by reference in this prospectus for the purposes of the offering of Debentures hereunder.

When new documents of the type referred to in paragraphs (a), (b) and (c) above are filed by the Corporation with and, where required, accepted by the provincial securities regulatory authorities in Canada during the currency of this prospectus, such documents will be deemed to be incorporated by reference in this prospectus and the previous documents of the type referred to in paragraphs (a), (b) and (c) above and all material change reports, business acquisition reports, unaudited interim consolidated financial statements (and management's discussion and analysis relating thereto) and prospectus supplements filed by the Corporation with the provincial securities regulatory authorities in Canada before the commencement of the Corporation's financial year in which the new documents are

filed will no longer be deemed to be incorporated by reference in this prospectus for the purposes of the future offering of Debentures hereunder.

A pricing supplement containing the specific variable terms for an issue of Debentures will be delivered to purchasers of such Debentures together with this prospectus and will be deemed to be incorporated by reference in this prospectus as of the date of the pricing supplement, solely for the purposes of the Debentures issued under that pricing supplement.

Any statement contained in this prospectus or in a document incorporated or deemed to be incorporated by reference herein will be deemed to be modified or superseded, for purposes of this prospectus, to the extent that a statement contained herein or in a document incorporated or deemed to be incorporated by reference herein modifies or supersedes such prior statement. The modifying or superseding statement need not state that it has modified or superseded a prior statement or include any other information set forth in the document that it modifies or supersedes. The making of a modifying or superseding statement will not be deemed an admission for any purposes that the modified or superseded statement, when made, constituted a misrepresentation, an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made. Any statement so modified or superseded will not constitute a part of this prospectus, except as so modified or superseded.

FORWARD-LOOKING INFORMATION

Certain information included or incorporated by reference in this prospectus constitutes “forward-looking information”. The purpose of the forward-looking information is to provide management’s expectations regarding the Corporation’s future results of operations, performance, business prospects and opportunities and may not be appropriate for other purposes. The words “anticipates”, “believes”, “budgets”, “could”, “estimates”, “expects”, “forecasts”, “intends”, “may”, “might”, “plans”, “projects”, “schedule”, “should”, “will”, “would” or the negative or other variations of these words or other comparable words or phrases, are intended to identify forward-looking information. The forward-looking information is based on estimates and assumptions made by the Corporation’s management in light of past experience and perception of historical trends, current conditions and expected future developments, as well as other factors that management believes to be reasonable in the circumstances. The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from historical results or results anticipated by the forward-looking information, including, without limitation, the following factors: the outcome of outstanding rate applications and other proceedings before the OEB, the timing and amount of future cash flows generated by the Corporation’s investments, market liquidity and the quality of the underlying assets and financial instruments; the timing and extent of changes in prevailing interest rates; inflation levels; legislative, judicial and regulatory developments that could affect revenues, accounting policies or the business carried on by Toronto Hydro; LDC’s ability to continue to maintain and operate the distribution system reliably and safely in the future; LDC’s ability to develop, maintain and manage a complex information technology systems infrastructure; the volume of electricity consumed by LDC’s customers; credit risk with respect to customer non-payment; the Corporation’s ability to arrange sufficient and cost-effective debt financing; Toronto Hydro’s ability to attract and retain the required workforce; the effects of natural and other unexpected occurrences; Toronto Hydro’s ability to obtain or maintain adequate insurance to cover all losses or liabilities that might arise at rates it considers reasonable; Toronto Hydro’s compliance with Canadian federal, provincial and municipal environmental regulation (changes in environmental regulation or enforcement may impose material additional costs on Toronto Hydro); material changes in Toronto Hydro’s assessment of the estimated fair value of its investments; a credit rating change; Toronto Hydro’s ability to develop plans and approaches that are acceptable to its labour unions; the risks associated with being controlled by the City of Toronto as well as potential conflicts of interest that may arise between Toronto Hydro, the City of Toronto and related parties; Toronto Hydro’s ability to obtain formal access agreements with respect to certain terminal stations and municipal substations located on lands owned by the Province of Ontario, the City of Toronto and others; and more than one distribution licence could be issued for the same area and there is a possibility that in the future some business functions or activities could be separated from LDC and made open to more competition from non-regulated business entities, or that defined geographical areas within LDC’s service area may be electrically supplied by a means other than through LDC’s system. All of the forward-looking information included or incorporated by reference in this prospectus is qualified by these cautionary statements and those made in the “Risk Factors” section of this prospectus and the comparable sections of the documents incorporated or deemed to be incorporated by reference in this prospectus (including the Corporation’s annual information form and the management’s discussion and analysis of financial condition and results of operations accompanying the financial statements of the Corporation). These factors are not intended to represent a complete list of the factors that could affect the Corporation; however, these factors should be considered carefully and readers should not place undue reliance on forward-looking information

made herein or in the documents incorporated by reference. The Corporation has no intention and undertakes no obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required by law.

Capitalized terms used in this section without definition, have the meanings given to them elsewhere in this prospectus.

CURRENCY

Unless otherwise specified, all references to dollars contained in this prospectus are to Canadian dollars.

TORONTO HYDRO

Toronto Hydro Corporation (the “Corporation” and, together with its subsidiaries, “Toronto Hydro”) is a holding company which, through its wholly-owned subsidiaries:

- *Toronto Hydro-Electric System Limited* (“LDC”) – distributes electricity and engages in conservation and demand management activities; and
- *Toronto Hydro Energy Services Inc.* – provides street lighting services.

The principal business of Toronto Hydro is the distribution of electricity by LDC. LDC owns and operates an electricity distribution system located in the City of Toronto. LDC is the largest municipal electricity distribution company in Canada. The business of LDC is regulated by the Ontario Energy Board (“OEB”) which has broad powers relating to licensing and standards of conduct and service and the regulation of rates charged by LDC and other electricity distributors.

The sole shareholder of the Corporation is the City of Toronto.

USE OF PROCEEDS

The net proceeds from the sale of Debentures will be used by the Corporation for general corporate purposes. Proceeds from the sale of the Debentures may also be used to reduce indebtedness that the Corporation may have with the bank affiliates of one or more of the Dealers (as defined below).

PLAN OF DISTRIBUTION

The Debentures may be offered by one or more dealers as selected from time to time by the Corporation (collectively, the “Dealers”), in each case, acting as agent of the Corporation or as principal. Where the Debentures are offered by the Dealer(s) as agent(s), the commissions payable by the Corporation in connection with sales of such Debentures shall be agreed from time to time between the Corporation and any such Dealer(s). Where the Debentures are purchased by the Dealer(s) as principal, the Debentures shall be purchased at such prices and with such commissions as may be agreed from time to time between the Corporation and any such Dealer(s) for resale to the public at prices to be negotiated with each purchaser. Such resale prices may vary during the distribution period and as between purchasers. Each Dealer’s compensation will increase or decrease by the amount by which the aggregate price paid for Debentures by purchasers exceeds or is less than the price paid by the Dealer, acting as principal, to the Corporation. The commissions payable in connection with sales of Debentures will be set forth in a pricing supplement which will be delivered to purchasers together with this prospectus. The Corporation may also offer the Debentures directly to potential purchasers pursuant to applicable statutory exemptions at prices and upon terms negotiated between the purchaser and the Corporation.

The Corporation may enter into one or more dealer agreements with the Dealers relating to the sale of Debentures under this prospectus. A copy of the dealer agreement(s) will be filed with the securities regulatory authorities in each of the provinces of Canada following its execution.

The Corporation and, if applicable, the Dealers, may reject any offer to purchase the Debentures in whole or in part. The Corporation also reserves the right to withdraw, cancel or modify the offering of the Debentures under this prospectus without notice.

In connection with any offering of Debentures, the Dealers may over-allot or effect transactions which stabilize or maintain the market price of the Debentures offered at a level above that which might otherwise prevail in the open market. Such transactions, if commenced, may be discontinued at any time. In addition, the Dealers may from time to time purchase and sell the Debentures in the secondary market but are not obliged to do so. There can be no assurance that there will be a secondary market for the Debentures. The offering price and other terms for such sales in the secondary market may, from time to time, be varied by the Dealers.

The Debentures have not and will not be registered under the United States *Securities Act of 1933*, as amended (the “U.S. Securities Act”), or any state securities laws, and may not be offered or sold within the United States or to United States persons unless registered under the U.S. Securities Act and applicable state securities laws or an exemption therefrom is available. Each of the Dealers will agree not to buy or offer to buy, to sell or offer to sell, or

solicit any offer to buy any Debentures in the United States of America, its territories or possessions, or to or for the account or benefit of United States persons, except to “qualified institutional buyers” in accordance with Rule 144A under the U.S. Securities Act. Debentures issued to qualified institutional buyers pursuant to Rule 144A under the U.S. Securities Act will be represented by definitive certificates and will be subject to certain restrictions on transfer set forth therein and in the supplemental indenture and will bear a legend regarding such restrictions as set forth in the supplemental indenture. This prospectus does not constitute an offer to sell or a solicitation of an offer to buy any of the Debentures in the United States. In addition, until 40 days after the commencement of the offering of an issue of Debentures, an offer or sale of that issue within the United States by any Dealer (whether or not participating in the offering) may violate the registration requirements of the U.S. Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A under the U.S. Securities Act.

RATINGS

The Debentures have been assigned a rating of “A (high)” with a stable trend by DBRS Limited (“DBRS”) and “A” by Standard & Poor’s (“S&P”).

DBRS rates long-term debt instruments by rating categories ranging from a high of “AAA” to a low of “D”. A DBRS rating may be modified by the addition of “high” or “low” to indicate relative standing within the major rating categories. Long-term debt instruments which are rated in the “A” category by DBRS are considered to be of “good credit quality”, with substantial capacity for the payment of financial obligations. Entities in the “A” category, however, are considered to be more vulnerable to future events, but qualifying negative factors are considered manageable. An A rating is the second of the three sub-categories within the third of the ten rating categories. S&P rates long-term debt instruments by rating categories ranging from a high of “AAA” to a low of “D”. An S&P rating may be modified by the addition of a plus or minus sign to indicate relative standing within the major rating categories. Long-term debt instruments which are rated in the “A” category by S&P are considered somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories; however, the obligor’s capacity to meet its financial commitment on the obligation is still strong. An A rating is the second of the three sub-categories within the third of the ten rating categories.

Credit ratings are intended to provide investors with an independent measure of the credit quality of an issue of securities. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the rating agency.

DESCRIPTION OF THE DEBENTURES

The Debentures will be issued in one or more series under a trust indenture dated May 7, 2003 between the Corporation and BNY Trust Company of Canada (the “Trustee” which term shall include, unless the context requires otherwise, its successors), as supplemented from time to time by supplemental indentures (together, the “Indenture”). The Indenture permits the issuance of an unlimited principal amount of debentures of the Corporation in one or more series. The terms of each series of debentures issued pursuant to the Indenture will be specified in a supplemental indenture to the Indenture. A copy of the Indenture is available electronically at www.sedar.com.

The specific terms of an offering of Debentures (including the aggregate principal amount of the Debentures being offered, the currency or currencies, the issue and delivery date, the form, the maturity date, the interest rate, the issue price, the interest payment date(s), any redemption or repayment provisions, any provisions entitling the Corporation to extend the maturity date of the Debentures, the name(s) of the Dealer(s) offering the Debentures, the commission payable to such Dealer(s), the method of distribution and the net proceeds to the Corporation) will be set forth in a pricing supplement which will be delivered to purchasers together with this prospectus. Unless otherwise indicated in a pricing supplement, the Debentures will not be listed on any securities exchange. The Corporation reserves the right to set forth in a pricing supplement specific terms of Debentures which are not within the parameters set forth in this prospectus.

The following is a summary of the material attributes of the Debentures. This summary does not purport to be complete. For a complete description of the Debentures, reference should be made to the Indenture. Certain capitalized terms used in this summary are defined below under “Definitions”.

Term, Denomination and Currency

The Debentures will have a term to maturity of not less than one year and will be issuable in denominations of \$1,000 or more. The Debentures may be issued in Canadian dollars or any foreign currency or currency unit determined at the time of issue.

Interest

The Debentures will bear interest at fixed or floating rates as set out in the applicable pricing supplement to this prospectus.

Rank

The Debentures will be direct unsecured obligations of the Corporation and will rank equally (except as to sinking funds and to the extent prescribed by law) with all other unsecured and unsubordinated indebtedness of the Corporation, including indebtedness of the Corporation under a \$600 million revolving credit facility with a syndicate of Canadian banks (the “THC Revolving Credit Facility”), two bilateral credit facilities under which up to \$95 million is available from two Canadian banks (the “Bilateral Credit Facilities”) and debentures of every other series issued pursuant to the Indenture.

The Debentures will not be obligations of, and will not be guaranteed in any manner by, the City of Toronto.

Redemption

If so specified in the applicable pricing supplement, a series of Debentures may be redeemed, at the Corporation’s option, in whole at any time or in part from time to time, prior to maturity, on not more than 60 and not less than 15 business days prior notice, at the redemption price, together in each case with accrued and unpaid interest to, but not including, the date fixed for redemption. The applicable pricing supplement will specify the redemption price (or the manner of calculating the redemption price), if any, for the series of Debentures.

If less than all Debentures of any series of Debentures are to be redeemed, the Debentures to be redeemed will be selected by the Trustee on a *pro rata* basis or by lot or such other means as the Trustee may deem equitable and expedient.

Purchase for Cancellation

The Corporation may, at any time, purchase Debentures for cancellation, in the open market, by tender or by private contract, at any price.

Covenants

Negative Pledge

The Corporation will not, and will not permit any Designated Subsidiary to, create, assume or suffer to exist any Security Interest, other than Permitted Encumbrances, on or over any of its assets (present or future) to secure any Obligation, unless at the same time it shall secure equally and rateably therewith all the debentures issued pursuant to the Indenture then outstanding.

Limitation on Funded Indebtedness

The Corporation will not, and will not permit any Designated Subsidiary to, directly or indirectly, issue, incur, assume or otherwise become liable for or in respect of any Funded Indebtedness unless, after giving effect thereto, Consolidated Funded Indebtedness would not exceed 75% of Total Consolidated Capitalization. This covenant will not operate to prevent the Corporation or a Designated Subsidiary from issuing, incurring, assuming or otherwise becoming liable for or in respect of any Inter-Company Indebtedness and Non-Speculative Financial Instrument Obligations. This covenant will operate to prevent the Corporation or a Designated Subsidiary from assigning any Inter-Company Indebtedness to a person other than the Corporation or a Designated Subsidiary.

Limitation on Designated Subsidiary Indebtedness

The Corporation will not permit a Designated Subsidiary to, directly or indirectly, issue, incur, assume or otherwise become liable for or in respect of any Indebtedness except:

- (a) Inter-Company Indebtedness of the Designated Subsidiary;
- (b) Non-Recourse Debt of the Designated Subsidiary;
- (c) Non-Speculative Financial Instrument Obligations of the Designated Subsidiary;
- (d) Permitted Capital Lease Obligations of the Designated Subsidiary;
- (e) Prudential and Bilateral Credit Support Obligations of the Designated Subsidiary;
- (f) Purchase Money Obligations of the Designated Subsidiary; and
- (g) any other Indebtedness of the Designated Subsidiary (in addition to the Indebtedness referred to in paragraphs (a) to (f)) if, after giving effect to the Indebtedness, the aggregate amount of all Indebtedness of all Designated Subsidiaries permitted by this paragraph (g) only would not exceed 5% of Consolidated Net Worth.

For the purposes of this covenant, the assignment by the Corporation to a third party of Inter-Company Indebtedness owing by a Designated Subsidiary will be considered to be an incurrence of Indebtedness by such Designated Subsidiary.

Designation of Subsidiaries as Designated Subsidiaries

LDC is a Designated Subsidiary. The board of directors of the Corporation may designate a subsidiary of the Corporation in addition to LDC as a Designated Subsidiary if:

- (a) at the time of and after giving effect to the designation, no Event of Default or event that, with the passing of time or the giving of notice or both, would constitute an Event of Default has occurred and is continuing;
- (b) after giving effect to the designation, the Corporation would be entitled under the Indenture to issue Funded Indebtedness in the amount of at least \$1.00; and
- (c) none of the shares of the subsidiary is owned by another subsidiary of the Corporation that is not a Designated Subsidiary.

The board of directors of the Corporation may terminate the designation of a subsidiary of the Corporation other than LDC as a Designated Subsidiary if:

- (a) at the time of and after giving effect to the termination, no Event of Default or event that, with the passing of time or the giving of notice or both, would constitute an Event of Default has occurred and is continuing;
- (b) after giving effect to the termination, the Corporation would be entitled under the Indenture to issue Funded Indebtedness in the amount of at least \$1.00; and
- (c) the subsidiary does not own any Funded Indebtedness of the Corporation or any shares or Funded Indebtedness of any other Designated Subsidiary.

Restriction on Mergers and Dispositions

The Corporation will not, directly or indirectly through a Designated Subsidiary, enter into a transaction or series of transactions in which all or substantially all of the undertaking, property and assets of the Corporation and its Designated Subsidiaries determined on a consolidated basis would become the property of any other person, whether by way of reorganization, consolidation, amalgamation, arrangement, merger, transfer, sale, lease or otherwise, unless:

- (a) the person is a corporation organized and existing under the laws of Canada or a province or territory thereof and expressly assumes, by a supplemental indenture satisfactory in form to the Trustee and its counsel and executed and delivered to the Trustee, all of the covenants and obligations of the Corporation under the Indenture and all debentures issued pursuant to the Indenture; and
- (b) at the time of and after giving effect to the reorganization, consolidation, amalgamation, arrangement, merger, transfer, sale, lease or other transaction, no Event of Default or event that, with the passing of time or the giving of notice or both, would constitute an Event of Default has occurred and is continuing.

Events of Default

The following are Events of Default applicable to all series of debentures, including each series of Debentures, issued pursuant to the Indenture:

- (a) failure to pay principal or premium (if any) on the debentures when due;
- (b) failure to pay interest on the debentures when due if such failure continues for a period of 30 days;
- (c) the sale, transfer, lease or other disposition of all or substantially all of the property and assets of the Corporation and its Designated Subsidiaries determined on a consolidated basis other than in accordance with the covenants described above under “ – Covenants – Restriction on Mergers and Dispositions”;
- (d) failure to observe or perform any other covenant or condition contained in the Indenture if such failure continues for a period of 60 days after written notice thereof has been given to the Corporation by the Trustee or the holders of at least 25% in principal amount of the debentures of any affected series then outstanding;
- (e) failure by the Corporation or any Material Subsidiary to pay principal, premium (if any) or interest due on any Indebtedness, the principal amount of which is more than \$50 million in the aggregate, beyond the applicable grace period;
- (f) failure by the Corporation or any Material Subsidiary to observe or perform any provision of any agreement under which Indebtedness is created if such failure has the effect of causing more than \$50 million of such Indebtedness in the aggregate to become due and payable or to be required to be redeemed or repurchased before its stated maturity;
- (g) the rendering by a court of competent jurisdiction of one or more judgments against the Corporation or any Material Subsidiary in an aggregate amount of more than \$50 million if the judgments remain undischarged or unstayed for more than 30 days; and
- (h) specified events of bankruptcy, insolvency or reorganization affecting the Corporation or any Material Subsidiary.

Default

If an Event of Default described in paragraphs (a) to (g) above occurs and is continuing, the Trustee or the holders of not less than 25% of the principal amount of debentures of a series of debentures issued pursuant to the Indenture then outstanding may declare the principal amount of, and the premium (if any) and accrued and unpaid interest on all debentures of that series then outstanding to be due and payable immediately.

If an Event of Default described in paragraph (h) above occurs and is continuing, the principal amount of and the premium (if any) and accrued and unpaid interest on all debentures issued pursuant to the Indenture then outstanding shall be due and payable immediately without any declaration or other action by the Trustee or the holders of the debentures.

Protection of Trustee

Subject to the provisions of the Indenture relating to the duties of the Trustee, if an event of default applicable to a series of debentures issued pursuant to the Indenture occurs and is continuing, the Trustee will be under no

obligation to exercise any of its rights or powers under the Indenture at the request or direction of any holders of such debentures unless the Trustee is sufficiently indemnified in accordance with the provisions of the Indenture. Subject to the provisions of the Indenture providing for the indemnification of the Trustee, the holders of the requisite principal amount of such debentures will have the right to direct the time, method and place of conducting any proceedings for any remedy available to the Trustee or exercising any rights or powers of the Trustee in respect of such debentures.

Modification

The Indenture provides that certain rights, privileges, restrictions and conditions of debentures issued and outstanding under the Indenture may be modified if such modifications are authorized by extraordinary resolution.

The term “extraordinary resolution” is defined in the Indenture to mean:

- (a) in the case of modifications which affect a particular series of debentures issued pursuant to the Indenture, a resolution passed by the affirmative votes of the holders of not less than 66⅔% in principal amount of debentures of that series then outstanding represented and voting at a meeting or an instrument in writing signed by the holders of not less than 66⅔% in principal amount of debentures of that series then outstanding; and
- (b) in the case of modifications which affect all debentures issued pursuant to the Indenture, a resolution passed by the affirmative votes of the holders of not less than 66⅔% in principal amount of all debentures then outstanding represented and voting at a meeting or an instrument in writing signed by the holders of not less than 66⅔% in principal amount of all debentures then outstanding, treated in each case as a single class.

Defeasance

The Indenture requires the Trustee to release the Corporation from its obligations in respect of a series of debentures issued pursuant to the Indenture if specified conditions are met, including the deposit by the Corporation of cash or certain cash-equivalent securities for the payment of all principal and interest and any other amounts on the debentures of such series and the payment of the expenses of the Trustee.

Form, Transfer and Payment Mechanics

Except as described under “Plan of Distribution” or as set out in a pricing supplement, the Debentures will be represented by one or more global Debentures (collectively, the “Global Debenture”) registered in the name of CDS Clearing and Depository Services Inc. or a successor thereof (the “Depository”) or its nominee and held by or on behalf of the Depository as custodian for institutions (including the Dealers) which participate directly or indirectly in the Depository’s book-entry only registration system (“BEO Participants”). Interests in the Debentures represented by the Global Debenture will be evidenced by credits to book-entry accounts of BEO Participants maintained with the Depository. Interests of the owners of Debentures represented by the Global Debenture will be evidenced by credits to accounts maintained with such BEO Participants on behalf of such owners.

Except as described under “Plan of Distribution” and as described below or as set out in a pricing supplement, purchasers of Debentures represented by the Global Debenture will not be entitled to certificates or other instruments from the Corporation or the Depository evidencing their ownership of Debentures. Beneficial owners of Debentures represented by the Global Debenture will not be shown on the registers maintained by the Trustee or the records maintained by the Depository but will be shown through book-entry accounts of BEO Participants. The rights of beneficial owners of Debentures represented by the Global Debenture may be exercised only through the BEO Participants with which such book-entry accounts are maintained. Purchasers of Debentures represented by the Global Debenture will receive a customer confirmation of purchase from the selling Dealer.

Purchasers of Debentures represented by the Global Debenture will receive definitive Debentures registered in their name only:

- (a) if the Corporation determines that the Depository is no longer willing, able or qualified to discharge properly its responsibilities as holder of the Global Debenture in connection with the Debentures and the Corporation is unable to locate a qualified successor;

- (b) if the Corporation elects to terminate the book-entry only registration of Debentures through the Depository; or
- (c) in certain other specified circumstances.

Transfers of interests in Debentures represented by the Global Debenture will be effected through records maintained by the Depository or its nominee (with respect to interests of BEO Participants) and on the records of BEO Participants (with respect to interests of persons other than BEO Participants). Beneficial owners of Debentures represented by the Global Debenture who are not BEO Participants but who desire to transfer any interest in Debentures may do so only through BEO Participants.

Payments of interest and principal on the Global Debenture will be made to the Depository or its nominee as registered holder of the Global Debenture. As long as the Depository or its nominee is the registered owner of the Global Debenture, the Depository or its nominee will be considered the sole owner of the Global Debenture for the purposes of receiving payment on the Global Debenture and for all other purposes under the Indenture and the Global Debenture.

The Corporation expects that the Depository or its nominee, upon receipt of any payment of principal or interest in respect of the Global Debenture, will credit the accounts of BEO Participants, on the date principal or interest is payable, with payments in amounts proportionate to their respective interests in the principal amount of the Global Debenture as shown on the records of the Depository or its nominee. The Corporation also expects that payments of principal and interest by BEO Participants to the owners of interests in the Debentures represented by the Global Debenture held through accounts maintained with BEO Participants will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of BEO Participants. The responsibility and liability of the Corporation and the Trustee in respect of Debentures represented by the Global Debenture is limited to making payment of any principal and interest due on the Global Debenture to the Depository or its nominee.

Governing Law

The Indenture is and the Debentures will be governed by and construed in accordance with the laws of the Province of Ontario and the laws of Canada applicable therein.

Definitions

The following defined terms used in this section of the prospectus are defined in the Indenture substantially as set out below.

"Capital Lease" means, with respect to a person, a lease or other arrangement in respect of real or personal property that is required to be classified and accounted for as a capital lease on a balance sheet of the person in accordance with GAAP.

"Capital Lease Obligation" means, with respect to a person, the obligation of the person to pay rent or other amounts under a Capital Lease.

"Consolidated Funded Indebtedness" means the aggregate amount of all Funded Indebtedness of the Corporation and its Designated Subsidiaries determined on a consolidated basis in accordance with GAAP.

"Consolidated Net Worth" means the shareholder's equity of the Corporation and its Designated Subsidiaries determined on a consolidated basis in accordance with GAAP. For greater certainty, the shareholder's equity of a subsidiary of the Corporation that is not a Designated Subsidiary will not be included in making such determination.

"Contingent Liability" means, with respect to a person, any agreement, undertaking or arrangement by which the person guarantees, endorses or otherwise becomes or is contingently liable upon (by direct or indirect agreement, contingent or otherwise, to provide funds for payment, to supply funds to, or otherwise to invest in, a debtor, or otherwise to assure a creditor against loss) the obligation, debt or other liability of any other person (other than by endorsements of instruments in the course of collection), or guarantees the payment of dividends or other distributions upon the shares of any other person. The amount of any Contingent Liability will, subject to any limitation contained therein, be deemed to be the outstanding principal amount (or maximum principal amount, if larger) of the obligation, debt or other liability to which the Contingent Liability relates.

“Deferred Purchase Price Obligation” means, with respect to a person, an obligation issued, incurred or assumed by the person in connection with the acquisition by the person of an asset in respect of the deferred purchase price of the asset.

“Designated Subsidiary” means Toronto Hydro-Electric System Limited and, until such designation is terminated in accordance with the covenants described above under “– Covenants – Designation of Subsidiaries as Designated Subsidiaries”, any other subsidiary of the Corporation designated as a Designated Subsidiary by the board of directors of the Corporation in accordance with the covenants described above under “– Covenants – Designation of Subsidiaries as Designated Subsidiaries”.

“Event of Default” means an event of default under the Indenture.

“Financial Instrument Obligations” means, with respect to any person, obligations arising under:

- (a) interest rate swap agreements, forward rate agreements, floor, cap or collar agreements, futures or options, insurance or other similar agreements or arrangements, or any combination thereof, entered into or guaranteed by the person where the subject matter thereof is interest rates or the price, value or amount payable thereunder is dependent or based upon interest rates or fluctuations in interest rates in effect from time to time (but excluding conventional floating rate indebtedness);
- (b) currency swap agreements, cross-currency agreements, forward agreements, floor, cap or collar agreements, futures or options, insurance or other similar agreements or arrangements, or any combination thereof, entered into or guaranteed by the person where the subject matter thereof is currency exchange rates or the price, value or amount payable thereunder is dependent or based upon currency exchange rates or fluctuations in currency exchange rates in effect from time to time; and
- (c) any agreement for the making or taking of any commodity (including coal, natural gas, oil and electricity), swap agreement, floor, cap or collar agreement or commodity future or option or other similar agreement or arrangement, or any combination thereof, entered into or guaranteed by the person where the subject matter thereof is any commodity or the price, value or amount payable thereunder is dependent or based upon the price or fluctuations in the price of any commodity;

or any other similar transaction, including any option to enter into any of the foregoing, or any combination of the foregoing, in each case to the extent of the net amount due or accruing due by the person under the obligations determined by marking the obligations to market in accordance with their terms.

“Funded Indebtedness” means Indebtedness (other than Subordinated Indebtedness) that, on the date of issue or assumption of liability, has a term to maturity (including any right of extension or renewal) greater than 18 months.

“GAAP” means at any date of determination:

- (a) accounting principles which are generally recognized as being generally accepted in Canada, if the Corporation is then preparing its financial statements in accordance with such principles; or
- (b) accounting principles which are generally recognized as being generally accepted in the United States, if the Corporation is then preparing its financial statements in accordance with such principles.

“Indebtedness” means, with respect to a person, without duplication:

- (a) all obligations of the person for borrowed money, including obligations with respect to bankers’ acceptances and contingent reimbursement obligations relating to letters of credit and other financial instruments;
- (b) all Financial Instrument Obligations of the person;
- (c) all Deferred Purchase Price Obligations of the person;
- (d) all Capital Lease Obligations and Purchase Money Obligations of the person;
- (e) all Prudential and Bilateral Credit Support Obligations of the person; and

- (f) all Contingent Liabilities of the person with respect to obligations of another person if such obligations are of the type referred to in paragraphs (a) to (e).

“Inter-Company Indebtedness” means, with respect to the Corporation, indebtedness of the Corporation to a Designated Subsidiary and, with respect to a Designated Subsidiary, indebtedness of the Designated Subsidiary to the Corporation or to another Designated Subsidiary.

“Material Subsidiary” means a Designated Subsidiary and any other subsidiary of the Corporation:

- (a) the total assets of which represent more than 10% of the total assets of the Corporation and its Designated Subsidiaries determined on a consolidated basis in accordance with GAAP; or
- (b) the total revenues of which represent more than 10% of the total revenues of the Corporation and its Designated Subsidiaries determined on a consolidated basis in accordance with GAAP.

For greater certainty, the assets and revenues of a subsidiary of the Corporation that is not a Designated Subsidiary will not be included in making such determinations.

“Non-Recourse Debt” means, with respect to a person, any indebtedness incurred to finance the creation, development, construction or acquisition of an asset of the person (and any extensions, renewals or refunding of any such indebtedness) provided that the recourse of the obligee thereof against the person is limited in all circumstances (other than in respect of false or misleading representations or warranties) to the asset (including all rights and benefits related to or arising out of the asset).

“Non-Speculative Financial Instrument Obligations” means, with respect to a person, Financial Instrument Obligations of the person entered into by the person in the ordinary course of business for risk management purposes and not for speculative or capital raising purposes.

“Obligations” means, with respect to a person, without duplication, all items which, in accordance with GAAP, would be included as liabilities on the liability side of the balance sheet of the person and all Contingent Liabilities of the person.

“Permitted Capital Lease Obligations” means, with respect to a Designated Subsidiary, the obligation of the Designated Subsidiary to pay rent or other amounts under a Capital Lease, other than a Capital Lease entered into as part of a Sale and Leaseback Transaction unless:

- (a) the property which is the subject matter of the Sale and Leaseback Transaction is owned by the Designated Subsidiary;
- (b) the proceeds of sale of such property have been determined by the board of directors of the Designated Subsidiary to be at least equal to its fair value; and
- (c) either of the following is applicable:
 - (1) at the time of the Sale and Leaseback Transaction, the cost of acquiring such property could have been financed pursuant to a Purchase Money Obligation; or
 - (2) within 120 days after completion of the Sale and Leaseback Transaction, the Designated Subsidiary reduces its Indebtedness, other than Indebtedness permitted pursuant to paragraphs (a) to (e) above under “– Covenants – Limitation on Designated Subsidiary Indebtedness”, by an amount at least equal to the net proceeds from the Sale and Leaseback Transaction.

“Permitted Encumbrances” means:

- (a) any Security Interest securing Obligations of a Designated Subsidiary that:
 - (1) exists before and at the time that the Designated Subsidiary becomes a Designated Subsidiary;

- (2) was not created or assumed in contemplation or as a result of the Designated Subsidiary becoming a Designated Subsidiary; and
 - (3) immediately before and after the Designated Subsidiary becomes a Designated Subsidiary, does not attach to the assets or secure Obligations of the Corporation or any other Designated Subsidiary;
- (b) any Purchase Money Mortgage or Capital Lease of the Corporation or a Designated Subsidiary;
- (c) any Security Interest in an asset created or assumed by the Corporation or a Designated Subsidiary to secure Non-Recourse Debt of the Corporation or the Designated Subsidiary in respect of such asset;
- (d) any Security Interest in cash, marketable debt securities or accounts receivable created or assumed by the Corporation or a Designated Subsidiary to or in favour of a bank or other lending institution to secure indebtedness of the Corporation or the Designated Subsidiary that is payable on demand or that, on the date of issue or assumption of liability, has a term to maturity (including any right of extension or renewal) of 18 months or less and that is incurred by the Corporation or the Designated Subsidiary in the ordinary course of business and for the purpose of carrying on the same;
- (e) any Security Interest in cash or marketable debt securities created or assumed by the Corporation to secure Non-Speculative Financial Instrument Obligations of the Corporation if the aggregate value of such cash and marketable debt securities is not more than 105% of the aggregate amount of the Non-Speculative Financial Instrument Obligations;
- (f) any Security Interest created or assumed by a Designated Subsidiary in favour of the Corporation or any Wholly-Owned Designated Subsidiary;
- (g) any Security Interest in an asset acquired by the Corporation or a Designated Subsidiary that secures Obligations of any other person, whether or not such Obligations are assumed by the Corporation or the Designated Subsidiary provided that the Security Interest:
 - (1) exists before and at the time that the asset is acquired by the Corporation or the Designated Subsidiary;
 - (2) was not created or assumed in contemplation or as a result of the asset being acquired by the Corporation or the Designated Subsidiary; and
 - (3) immediately before and after the asset is acquired by the Corporation or the Designated Subsidiary, does not attach to the assets or secure Obligations of the Corporation or any other Designated Subsidiary;
- (h) any Security Interest in cash or marketable debt securities in a sinking fund account established by the Corporation in support of a series of debentures issued pursuant to the Indenture;
- (i) any Security Interest or deposit under workers' compensation, social security or similar legislation or in connection with bids, tenders, leases, contracts or expropriation proceedings or to secure public or statutory obligations, surety and appeal bonds or costs of litigation where required by law;
- (j) any Security Interest or privilege imposed by law, such as builders', mechanics, material men's, carriers', warehousemen's and landlords' liens and privileges; or any Security Interest or privilege arising out of judgments or awards with respect to which the Corporation or a Designated Subsidiary at the time is prosecuting an appeal or proceedings for review and with respect to which it has secured a stay of execution pending such appeal or proceedings for review; or any Security Interest for taxes, assessments or governmental charges or levies not at the time due and delinquent or the validity of which is being contested at the time by the Corporation or a Designated Subsidiary in good faith; or any undetermined or inchoate Security Interest or privilege incidental to current operations that has not been filed pursuant to law against the Corporation or a Designated Subsidiary or that relates to obligations not due or delinquent; or the deposit of cash or securities in connection with any Security Interest or privilege referred to in this paragraph (j);

- (k) any right reserved to or vested in any municipality or governmental or other public authority by the terms of any lease, licence, franchise, grant or permit held or acquired by the Corporation or a Designated Subsidiary, or by any statutory provision, to terminate the lease, licence, franchise, grant or permit or to purchase assets used in connection therewith or to require annual or other periodic payments as a condition of the continuance thereof;
- (l) any Security Interest or right of distress reserved in or exercisable under any lease for rent to which the Corporation or a Designated Subsidiary is a party and for compliance with the terms of the lease;
- (m) any Security Interest created or assumed by the Corporation or a Designated Subsidiary in favour of a public utility or any municipality or governmental or other public authority when required by the utility, municipality or other authority in connection with the operations of the Corporation or a Designated Subsidiary;
- (n) any reservations, limitations, provisos and conditions expressed in original grants from the Crown;
- (o) any minor encumbrances, such as easements, rights-of-way, servitudes or other similar rights in land granted to or reserved by other persons, rights-of-way for sewers, electric lines, telegraph and telephone lines, oil and natural gas pipelines and other similar purposes, or zoning or other restrictions applicable to the Corporation's or a Designated Subsidiary's use of real property, that do not in the aggregate materially detract from the value of the property or materially impair its use in the operation of the business of the Corporation or the Designated Subsidiary;
- (p) any extension, renewal, alteration, substitution or replacement, in whole or in part, of a Security Interest referred to in paragraphs (a) to (o) provided that the Security Interest is limited to all or part of the same assets, the principal amount of the secured Obligations is not increased by that action, the term of the secured Obligations is not shortened and the terms and conditions of the Security Interest are no more restrictive in any material respect than the Security Interest so extended; and
- (q) any other Security Interest created or assumed by the Corporation or a Designated Subsidiary (in addition to the Security Interests referred to in paragraphs (a) to (p)) if, after giving effect to the Security Interest, the aggregate amount of all Indebtedness secured by Security Interests permitted by this paragraph only does not at that time exceed 5% of Consolidated Net Worth.

“Prudential and Bilateral Credit Support Obligations” means, without duplication, the following obligations:

- (a) all contingent reimbursement obligations of the Corporation relating to letters of credit and other financial instruments and all Contingent Liabilities of the Corporation in respect of Obligations of a subsidiary of the Corporation for the purchase or sale of electricity or natural gas; and
- (b) all obligations of a Designated Subsidiary for borrowed money, including contingent reimbursement obligations relating to letters of credit and other financial instruments under credit facilities established for participants in the wholesale market for electricity administered by the Independent Electricity System Operator (“IESO”), in respect of the Obligations of the Designated Subsidiary for the purchase or sale of electricity or natural gas;

if such obligations were incurred or assumed to satisfy:

- (x) prescribed prudential requirements in the wholesale market for electricity administered by the IESO;
- (y) credit support arrangements required by electricity distribution companies under the terms of the Retail Settlement Code established by the OEB; or
- (z) credit support requirements of counterparties under bilateral contracts or customers under purchase contracts.

“Purchase Money Mortgage” means, with respect to a person, any Security Interest created or assumed by the person to secure a Purchase Money Obligation provided that such Security Interest is limited to the asset financed by such Purchase Money Obligation and is created or assumed not later than three months after such Purchase Money Obligation is issued, incurred or assumed.

“Purchase Money Obligation” means, with respect to a person, indebtedness of the person issued, incurred or assumed to finance all or part of the cost of acquiring any asset for the person, other than shares, bonds and other securities, or constructing, installing or improving any real property or fixtures of the person, provided that the indebtedness is issued, incurred or assumed within twelve months after such acquisition, construction, installation or improvement, and includes any extension, renewal or refunding of such indebtedness so long as the principal amount thereof outstanding on the date of such extension, renewal or refunding is not increased.

“Sale and Leaseback Transaction” means, with respect to a person, a transaction or series of transactions pursuant to which the person sells or transfers real or personal property owned by the person to a third party and subsequently leases such real or personal property.

“Security Interest” means any security interest, assignment by way of security, mortgage, charge (whether fixed or floating), hypothec, pledge, lien or other encumbrance on or interest in property or assets that secures the payment of Obligations.

“Subordinated Indebtedness” means all indebtedness of the Corporation in respect of which, upon any distribution of assets of the Corporation upon any dissolution, winding-up, liquidation or reorganization of the Corporation (whether in bankruptcy, insolvency or receivership proceedings or upon an assignment for the benefit of creditors, or any other marshalling of the assets and liabilities of the Corporation or otherwise), the payment of all indebtedness and liabilities of the Corporation in connection with all debentures issued pursuant to the Indenture including principal, interest, fees and expenses, must be satisfied in full prior to any amount being applied to such indebtedness.

“Total Consolidated Capitalization” means, without duplication, the sum of:

- (a) the principal amount of all Consolidated Funded Indebtedness;
- (b) the principal amount of all Subordinated Indebtedness; and
- (c) the Consolidated Net Worth;

in each case, as determined by the Corporation and its Designated Subsidiaries.

“Wholly-Owned Designated Subsidiary” means a Designated Subsidiary all of the outstanding shares in the capital of which are owned by the Corporation or one or more Wholly-Owned Designated Subsidiaries.

RISK FACTORS

In addition to the risks described in the documents incorporated or deemed to be incorporated by reference in this prospectus (including the Corporation’s annual information form and the management’s discussion and analysis of financial condition and results of operations accompanying the financial statements of the Corporation) and the section entitled “Forward-Looking Information” in each such document and this prospectus, prospective purchasers should consider the risks described below before purchasing Debentures.

Rank of Debentures and Holding Company Structure

The Debentures will be direct unsecured obligations of the Corporation and will rank equally with all other unsecured and unsubordinated indebtedness of the Corporation, including indebtedness of the Corporation under the THC Revolving Credit Facility and the Bilateral Credit Facilities. A default by the Corporation under the Indenture will constitute an event of default under the THC Revolving Credit Facility and an event of default or repayment event under the Bilateral Credit Facilities. There can be no assurance that sufficient funds would be available at the time of any such default to make any required payment under the Debentures.

The Corporation is a holding company and substantially all of its business activities are carried on by its subsidiaries. Because the Corporation is a holding company, the Debentures will be effectively subordinated to all existing and future liabilities, including trade payables and other indebtedness, of the Corporation's subsidiaries. In addition, as a holding company, the Corporation's ability to meet its financial obligations is dependent primarily upon the receipt of interest and principal, management fees, cash dividends and other payments from its subsidiaries, together with proceeds raised by the Corporation through the issuance of debt. The Corporation is wholly-owned by the City of Toronto and does not currently raise funds through the issuance of share capital. The Corporation's subsidiaries are distinct legal entities and have no legal obligation, contingent or otherwise, to pay any amount due under the Debentures

or to make any amounts available therefor. In addition, the payment of dividends and the making of loans, advances and other payments to the Corporation by its subsidiaries may be subject to statutory or contractual restrictions, will depend on the earnings of the subsidiaries and will be subject to various business and other considerations.

Absence of Public Market for the Debentures

The Debentures will be newly issued securities for which there is no existing trading market. The Corporation does not intend to list the Debentures on any Canadian, U.S. or other securities exchange. This may affect the pricing of the Debentures in the secondary market, the transparency and availability of trading prices, the liquidity of the Debentures and the extent of issuer regulation. There can be no assurance that a secondary market will develop for the Debentures or that any secondary market that does develop will continue. Accordingly, purchasers may not be able to sell the Debentures. In addition, if a trading market develops for the Debentures, the Debentures could trade at prices that may be higher or lower than their initial offering prices, depending on many factors, including prevailing interest rates, the Corporation's results of operations and financial position, the ratings assigned to the Debentures and the Corporation's other debt securities and the markets for similar debt securities.

Ratings

There is no assurance that any rating assigned to the Debentures issued hereunder will remain in effect for any given period of time or that any rating will not be lowered or withdrawn entirely by the relevant rating agency. A lowering or withdrawal of such rating may have an adverse effect on the market value of the Debentures.

Interest Rate Risks

Prevailing interest rates will affect the market price or value of the Debentures. Generally, the market price or value of the Debentures will decline as prevailing interest rates for comparable debt instruments rise and increase as prevailing interest rates for comparable debt instruments decline. Fluctuations in interest rates may also impact borrowing costs of the Corporation which may adversely affect its creditworthiness.

Risks Associated with Floating Rate Notes

The Debentures will bear interest at fixed or floating rates as set out in the applicable pricing supplement to this prospectus. Investments in floating rate Debentures entail risks not associated with investments in fixed rate Debentures. The resetting of the applicable rate on a floating rate Debenture may result in a lower interest rate as compared to a fixed rate Debenture issued at the same time. The applicable rate on a floating rate Debenture will fluctuate in accordance with fluctuations in the instrument or obligation or other measure on which the applicable rate is based, which in turn may fluctuate and be affected by a number of interrelated factors, including economic, financial and political events over which the Corporation has no control.

Foreign Currency Risks

An investment in Debentures that are denominated or payable in other than Canadian dollars entails significant risks that are not associated with a similar investment in a security denominated in Canadian dollars. Such risks include, without limitation, the possibility of significant changes in rates of exchange between the Canadian dollar and the applicable foreign currency unit, the possibility of the imposition or modification of foreign exchange controls by either the Canadian or foreign governments and potential illiquidity in the secondary market. These risks will vary depending upon the currency or currencies involved and, where appropriate, will be more fully described in a pricing supplement.

This prospectus does not describe all the risks of an investment in the Debentures denominated or payable other than in Canadian dollars and prospective investors should consult their own financial and legal advisor as to the risk entailed with respect thereto. Debentures denominated in other than Canadian dollars are not appropriate investments for investors who are unfamiliar with foreign currency transactions.

The Debentures will be governed by and construed in accordance with the laws of the Province of Ontario and the laws of Canada applicable therein. A judgment by a Canadian court relating to any Debenture may be awarded only in Canadian currency and such judgment may be based on a rate of exchange in existence on a day other than the day of payment.

Additional Debt Financing

The Corporation expects to borrow to repay the Debentures when required to do so under the terms of the Debentures and to finance the renewal of LDC's electricity infrastructure. The Corporation's ability to arrange sufficient and cost-effective debt financing could be adversely affected by a number of factors, including financial market conditions, the regulatory environment in Ontario, the Corporation's results of operations and financial condition, the ratings assigned to the Corporation and its debt securities by credit rating agencies, the current timing of debt maturities and general economic conditions.

Shareholder Direction

Council of the City of Toronto has adopted a shareholder direction (the "Shareholder Direction") which sets out certain corporate governance principles with respect to Toronto Hydro. The Shareholder Direction is summarized in the AIF under "Relationship with the City". The Shareholder Direction is not for the benefit of, or enforceable by, the holders of the Debentures.

LEGAL MATTERS

Certain legal matters relating to the offering will be passed on for the Corporation by McMillan LLP. The partners and associates of McMillan LLP beneficially own, directly or indirectly, less than one per cent of the securities of the Corporation or any associate or affiliate of the Corporation.

AUDITORS

The auditors of the Corporation are KPMG LLP, Chartered Accountants ("KPMG LLP"), at their office at Bay Adelaide Centre, 333 Bay Street, Suite 4600, Toronto, Ontario, M5H 2S5. KPMG LLP have been the auditors of the Corporation since April 12, 2011. KPMG LLP is independent in Ontario in accordance with its rules of professional conduct.

PURCHASERS' STATUTORY RIGHTS

Securities legislation in certain of the provinces of Canada provides purchasers with the right to withdraw from an agreement to purchase securities. This right may be exercised within two business days after receipt or deemed receipt of a prospectus, the accompanying prospectus supplement and any amendment. In several of the provinces, the securities legislation further provides a purchaser with remedies for rescission or, in some provinces, revision of the price or damages if the prospectus, the accompanying prospectus supplement and any amendment contain a misrepresentation or are not delivered to the purchaser, provided that the remedies for rescission, revision of the price or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province for the particulars of these rights or consult with a legal advisor.

AUDITORS' CONSENT

We have read the short form base shelf prospectus (the "Prospectus") of Toronto Hydro Corporation (the "Corporation") dated December 10, 2012 relating to the issuance in an aggregate principal amount of up to \$1,500,000,000 of Debentures of the Corporation. We have complied with Canadian generally accepted standards for an auditor's involvement with offering documents.

We consent to the incorporation by reference in the Prospectus of our report to the shareholder of the Corporation on the consolidated balance sheet of the Corporation as at December 31, 2011, and the consolidated statements of income, retained earnings and cash flows for the year ended December 31, 2011. Our report is dated March 2, 2012.

Toronto, Canada
December 10, 2012

(Signed) KPMG LLP
Chartered Accountants
Licensed Public Accountants

AUDITORS' CONSENT

We have read the short form base shelf prospectus (the "Prospectus") of Toronto Hydro Corporation (the "Corporation") dated December 10, 2012 relating to the issuance in an aggregate principal amount of up to \$1,500,000,000 of Debentures of the Corporation. We have complied with Canadian generally accepted standards for an auditor's involvement with offering documents.

We consent to the incorporation by reference in the Prospectus of our report to the shareholder of the Corporation on the consolidated balance sheet of the Corporation as at December 31, 2010, and the consolidated statements of income, retained earnings and cash flows for the year ended December 31, 2010. Our report is dated March 11, 2011.

Toronto, Canada
December 10, 2012

(Signed) ERNST & YOUNG LLP
Chartered Accountants
Licensed Public Accountants

CERTIFICATE OF THE CORPORATION

Dated: December 10, 2012

This short form prospectus, together with the documents incorporated in this prospectus by reference, will, as of the date of the last supplement to this prospectus relating to the securities offered by this prospectus and the supplement(s), constitute full, true and plain disclosure of all material facts relating to the securities offered by this prospectus and the supplement(s) as required by the securities legislation of all the provinces of Canada.

(Signed) ANTHONY HAINES
President and Chief Executive Officer

(Signed) JEAN-SEBASTIEN COUILLARD
Chief Financial Officer

On behalf of the Board of Directors

(Signed) CLARE R. COPELAND
Director

(Signed) BRIAN CHU
Director

EIGHTH SUPPLEMENTAL TRUST INDENTURE

Made as of November 18, 2011

Between

TORONTO HYDRO CORPORATION
as issuer

and

BNY TRUST COMPANY OF CANADA
as trustee

Supplementing the Trust Indenture

made as of May 7, 2003

and

providing for the issue of

3.54% Senior Unsecured Debentures
due 2021 (Series 7)

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EIGHTH SUPPLEMENTAL TRUST INDENTURE

THIS EIGHTH SUPPLEMENTAL TRUST INDENTURE made as of November 18, 2011,

B E T W E E N:

TORONTO HYDRO CORPORATION

a corporation incorporated under the laws of Ontario (the “Corporation”)

and

BNY TRUST COMPANY OF CANADA

a trust company existing under the laws of Canada (the “Trustee”)

RECITALS

- A. BNY Trust Company of Canada is the successor trustee of CIBC Mellon Trust Company;
- B. The Corporation has entered into a trust indenture with the Trustee made as of May 7, 2003, as amended, supplemented or restated from time to time (the “**Trust Indenture**”) which provides for the issuance of one or more series of unsecured Debentures of the Corporation by way of Supplemental Indentures;
- C. The Corporation entered into a first supplemental trust indenture made as of May 7, 2003 for the purpose of providing for the issue of \$225,000,000 aggregate principal amount of Series 1 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 1 Debentures;
- D. The Corporation entered into a second supplemental trust indenture made as of November 14, 2007 for the purpose of providing for the issue of \$250,000,000 aggregate principal amount of Series 2 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 2 Debentures;
- E. The Corporation entered into a third supplemental trust indenture made as of November 12, 2009 for the purpose of providing for the issue of \$250,000,000 aggregate principal amount of Series 3 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 3 Debentures;
- F. The City Note has been converted, in accordance with its terms, into the Series 4 Debentures and the Series 5 Debentures;
- G. The Corporation entered into a fourth supplemental trust indenture made as of April 1, 2010 for the purpose of providing for the issue of \$245,057,000 aggregate principal amount of Series 4 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 4 Debentures;

H. The Corporation entered into a fifth supplemental trust indenture made as of April 1, 2010 for the purpose of providing for the issue of \$245,057,000 aggregate principal amount of Series 5 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 5 Debentures;

I. The Corporation entered into a sixth supplemental trust indenture made as of May 20, 2010 for the purpose of providing for the issue of \$200,000,000 aggregate principal amount of Series 6 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 6 Debentures;

J. The Corporation entered into a seventh supplemental trust indenture made as of September 20, 2011 for the purpose of amending the definition of "GAAP" under the Trust Indenture; and

K. This Eighth Supplemental Trust Indenture is entered into for the purpose of providing for the issue of Series 7 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 7 Debentures.

NOW THEREFORE THIS EIGHTH SUPPLEMENTAL TRUST INDENTURE WITNESSES and it is hereby covenanted, agreed and declared as follows:

SECTION 1 INTERPRETATION

1.1 To Be Read With Trust Indenture

This Eighth Supplemental Trust Indenture is a Supplemental Indenture as that term is used in the Trust Indenture. The Trust Indenture and this Eighth Supplemental Trust Indenture shall be read together and shall have effect as though all the provisions of both indentures were contained in one instrument.

1.2 Headings etc.

The division of this Eighth Supplemental Trust Indenture into Sections and clauses, the provision of a table of contents and the insertion of headings are for convenience of reference only and shall not affect the interpretation thereof. Unless the context otherwise requires, the expression "Section" and "Schedule" followed by a number, letter or combination of numbers and letters refer to the specified Section of or Schedule to this Eighth Supplemental Trust Indenture.

1.3 Definitions

All terms which are defined in the Trust Indenture and used but not defined in this Eighth Supplemental Trust Indenture shall have the meanings ascribed to them in the Trust Indenture, as such meanings may be amended or supplemented with respect to Series 7 Debentures by this Eighth Supplemental Trust Indenture. In the event of any inconsistency between the meaning given to a term in the Trust Indenture and the meaning given to the same term in this Eighth Supplemental Trust Indenture, the meaning given to the term in this Eighth Supplemental Trust Indenture shall prevail to the extent of the inconsistency. Subject to the foregoing, in this Eighth Supplemental Trust Indenture and in the Series 7 Debentures, the following terms have the following meanings:

- (1) **Canada Yield** on any date means the yield to maturity on that date, compounded semi-annually, that a non-callable Government of Canada bond would carry if issued, in Canadian dollars in Canada, at 100% of its principal amount on that date with a term to maturity approximately equal to the remaining term to maturity of the Series 7 Debentures, such yield to maturity being the average of the yields provided by two major Canadian investment dealers specified by the Corporation.
- (2) **Canada Yield Price** means the price equal to the net present value of all scheduled payments of interest (other than accrued and unpaid interest) and principal on the Series 7 Debentures, using a discount rate equal to the sum of the Canada Yield and 34 basis points, calculated at 10:00 a.m. (Toronto, Ontario time) three Business Days prior to the Redemption Date of the Series 7 Debentures.
- (3) **Series 7 Debentures** means the 3.54% Senior Unsecured Debentures due 2021 (Series 7) referred to in Section 2.1.
- (4) **Series 7 Debentures Debt Account** means the deposit account established in respect of the Series 7 Debentures pursuant to Section 8.2 of the Trust Indenture that is designated in writing by the Corporation to the Trustee as the “Series 7 Debentures Debt Account”.
- (5) **Series 7 Debentures Interest Payment Date** means May 18 and November 18 in each year that the Series 7 Debentures are outstanding.
- (6) **Series 7 Debentures Interest Period** means the period commencing on and including the later of the date of issue of the Series 7 Debentures and the immediately preceding Series 7 Debentures Interest Payment Date and ending on and including the day immediately preceding the next Series 7 Debentures Interest Payment Date to occur in respect of which interest is payable.
- (7) **Trust Indenture** means the trust indenture made as of May 7, 2003 between the Corporation and the Trustee, as amended, supplemented or restated from time to time.

SECTION 2 SERIES 7 DEBENTURES

2.1 Creation and Designation

The Corporation is authorized in accordance with the Trust Indenture to issue under this Eighth Supplemental Trust Indenture, and hereby creates and issues, a series of debentures designated “3.54% Senior Unsecured Debentures due 2021 (Series 7)”, having the terms set out in this Eighth Supplemental Trust Indenture.

2.2 Limitation on Issue

The aggregate principal amount of Series 7 Debentures which may be issued under this Eighth Supplemental Trust Indenture including any supplement hereto will be limited to \$1,000,000,000.

2.3 Date of Issue and Maturity

The Series 7 Debentures shall be dated November 18, 2011 (being the applicable date of issue) and will become due and payable, together with all accrued interest and unpaid interest thereon, on November 18, 2021 (being the applicable Stated Maturity).

2.4 Concerning Interest

- (a) The Series 7 Debentures shall be issued in \$1,000 principal amount denominations or integral multiples thereof and shall bear interest on the unpaid principal amount thereof at a rate of 3.54% per annum from and including their date of issue, payable semi-annually in arrears, in equal instalments, on each Series 7 Debentures Interest Payment Date.
- (b) Interest shall be payable in respect of each Series 7 Debentures Interest Period (after as well as before maturity, default and judgment, with interest on overdue interest at the same rate) on each Series 7 Debentures Interest Payment Date in accordance with Section 2.8 of the Trust Indenture.

2.5 Interest Payments

The Corporation shall make payments of interest on the Series 7 Debentures in accordance with the provisions of Section 2.8 of the Trust Indenture.

2.6 Payment of Amounts Due on Maturity

In accordance with Section 8.2 of the Trust Indenture, the Corporation will deposit to the Series 7 Debentures Debt Account all amounts required to be paid to the order of Holders of Series 7 Debentures on maturity, prior to 9:00 a.m. (Toronto, Ontario time), on the Stated Maturity of the Series 7 Debentures. The deposit of such funds will satisfy and discharge the liability of the Corporation for principal of, and any accrued and unpaid interest on, the Series 7 Debentures to the extent of the sum represented thereby (plus the amount of any taxes deducted or withheld).

2.7 Redemption and Purchase of Series 7 Debentures

- (a) The Series 7 Debentures may be redeemed, at the Corporation's option when not in default under the Trust Indenture, in whole at any time prior to Stated Maturity, or in part at any time and from time to time prior to Stated Maturity, on not more than 60 Business Days and not less than 15 Business Days prior notice, at a price equal to the greater of the Canada Yield Price and par, together in each case with accrued and unpaid interest to (but excluding) the Redemption Date and in each case otherwise in accordance with Sections 5.1, 5.2, 5.3 and 5.4 of the Trust Indenture.
- (b) The Corporation will be entitled at any time when not in default under the Trust Indenture to purchase for cancellation all or any of the Series 7 Debentures in accordance with Section 5.5 of the Trust Indenture.
- (c) The Series 7 Debentures will not be subject to repurchase pursuant to any sinking fund provisions.

2.8 Form of Series 7 Debentures

- (a) Except as set out in 2.8(b) below, the Series 7 Debentures and the registration panel and the certificate of the Trustee endorsed thereon shall be issuable initially as one Global Debenture to be held by, or on behalf of, CDS as depository for its participants and registered in the name of CDS or its nominee. The Global Debenture shall be substantially in the form set out in Schedule 1 hereto with such appropriate additions, deletions, substitutions and variations as the Directors shall by resolution determine prior to the time of issue thereof and as the Trustee may approve and with such distinguishing letters and numbers as the Trustee may approve, with such approval in each case to be conclusively evidenced by the Trustee's certification of such Global Debenture.
- (b) The Trustee understands and acknowledges that the Series 7 Debentures have not been and will not be registered under the United States Securities Act of 1933, as amended (the "U.S. Securities Act"). Each Series 7 Debenture originally issued in the United States or to a U.S. Person will be represented by a definitive certificate in the form set out in Schedule 2 hereto which definitive certificate, and each Series 7 Debenture certificate issued in exchange therefor or in substitution thereof, shall bear the following legend:

"THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "U.S. SECURITIES ACT") OR UNDER ANY STATE SECURITIES LAWS. THE HOLDER HEREOF, BY PURCHASING SUCH SECURITIES, AGREES FOR THE BENEFIT OF THE CORPORATION THAT SUCH SECURITIES MAY BE OFFERED, SOLD OR OTHERWISE TRANSFERRED ONLY (A) TO THE CORPORATION, (B) OUTSIDE THE UNITED STATES IN ACCORDANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT, OR (C) INSIDE THE UNITED STATES IN ACCORDANCE WITH (1) RULE 144A UNDER THE U.S. SECURITIES ACT OR (2) RULE 144 UNDER THE U.S. SECURITIES ACT, IF AVAILABLE, OR (3) IN COMPLIANCE WITH CERTAIN OTHER PROCEDURES SATISFACTORY TO THE CORPORATION. A NEW CERTIFICATE BEARING NO LEGEND, DELIVERY OF WHICH WILL CONSTITUTE "GOOD DELIVERY", MAY BE OBTAINED FROM BNY TRUST COMPANY OF CANADA UPON DELIVERY OF THIS CERTIFICATE AND A DULY EXECUTED DECLARATION, IN A FORM SATISFACTORY TO BNY TRUST COMPANY OF CANADA AND THE CORPORATION, TO THE EFFECT THAT THE SALE OF THE SECURITIES REPRESENTED HEREBY IS BEING MADE IN COMPLIANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT."

If any Series 7 Debentures are being sold or transferred outside the United States in compliance with the requirements of Rule 904 of Regulation S under the U.S Securities Act, the legend may

be removed by providing a declaration to the Trustee to the following effect (or as the Corporation may prescribe from time to time),

“The undersigned (A) acknowledges that the sale of the securities to which this declaration relates is being made in reliance upon Rule 904 of Regulation S under the United States Securities Act of 1933, as amended (the “U.S. Securities Act”), and (B) certifies that (1) it is not an “affiliate” (as defined in Rule 405 under the U.S. Securities Act) of Toronto Hydro Corporation, (2) the offer of such securities was not made to a person in the United States and at the time the buy order was originated, the buyer was outside the United States, or the seller and any person acting on its behalf reasonably believe that the buyer was outside the United States and (3) neither the seller, nor any affiliate of the seller, nor any person acting on its or their behalf engaged in any directed selling efforts in connection with the offer and sale of such securities. Terms used herein have the meaning given to them by Regulation S under the U.S. Securities Act.”

If any Series 7 Debentures are being sold or transferred pursuant to Rule 144 of the U.S. Securities Act, the legend may be removed by delivery to the Trustee of a written opinion of Trustee Counsel to the effect that such legend is no longer required under applicable requirements of the U.S. Securities Act or state securities laws.

Prior to the issuance of Series 7 Debentures, the Corporation shall notify the Trustee, in writing, concerning which Series 7 Debentures are to be certificated and are to bear the legend described above. The Trustee will thereafter maintain a list of all registered holders from time to time of legended Series 7 Debentures.

2.9 Signatures on Series 7 Debentures

The Series 7 Debentures shall be signed in accordance with the provisions of Section 2.6 of the Trust Indenture.

2.10 Certification

- (a) No Series 7 Debenture issued shall be obligatory or shall entitle the Holder of such Series 7 Debenture to the benefits of this Eighth Supplemental Trust Indenture until it has been certified by manual signature by or on behalf of the Trustee by execution of the certificate of the Trustee appended thereto substantially in the form set out in Schedule 1 hereto, or in some other form approved by the Trustee, whose approval shall be conclusively evidenced by the Trustee’s execution of the certificate. Such certificate on any Series 7 Debenture shall be conclusive evidence that such Series 7 Debenture is duly issued and is a valid and binding obligation of the Corporation and that the Holder of such Series 7 Debenture is entitled to the benefits of the Trust Indenture, as supplemented by this Eighth Supplemental Trust Indenture, and such Series 7 Debenture.
- (b) The certificate of the Trustee on any Series 7 Debenture shall not be construed as a representation or warranty by the Trustee as to the validity of this Eighth

Supplemental Trust Indenture or of the Series 7 Debentures (except the due certification thereof and any other warranties implied by law) and the Trustee shall in no respect be liable or answerable for the use made of the Series 7 Debentures or any of them or the proceeds thereof.

2.11 Location of Register

With respect to the Series 7 Debentures, initially the Register referred to in Section 3.1 of the Trust Indenture shall be kept by the Trustee at the Corporate Trust Office and may thereafter be kept by the Trustee in such other place as the Corporation, with the approval of the Trustee, may designate.

2.12 Additional Amounts

The Corporation will not be required to pay an additional amount on the Series 7 Debentures in respect of any tax, assessment or government charge that is required by law to be withheld or deducted by it.

2.13 Trustees, etc.

The Trustee will be the Paying Agent and the Registrar for the Series 7 Debentures.

SECTION 3 MISCELLANEOUS

3.1 Acceptance of Trust

The Trustee accepts the trusts in this Eighth Supplemental Trust Indenture and agrees to carry out and discharge the same upon the terms and conditions set out in this Eighth Supplemental Trust Indenture and in accordance with the Trust Indenture.

3.2 Confirmation of Trust Indenture

The Trust Indenture as amended and supplemented by this Eighth Supplemental Trust Indenture is in all respects confirmed.

3.3 Counterparts

This Eighth Supplemental Trust Indenture may be executed in counterparts, each of which so executed shall be deemed to be original and such counterparts together shall constitute one and the same instrument.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF the parties hereto have executed this Eighth Supplemental Trust Indenture under the hands of their proper signatories in that behalf:

TORONTO HYDRO CORPORATION

By: Anthony Haines
Name: Anthony Haines
Title: President and
Chief Executive Officer

By: Jean-Sebastien Couillard
Name: Jean-Sebastien Couillard
Title: Chief Financial Officer

BNY TRUST COMPANY OF CANADA

By: Ismail Bawa
Name: Ismail Bawa
Title: Authorized Signatory

Schedule 1 – FORM OF GLOBAL DEBENTURE-SERIES 7

This Debenture is a Global Debenture within the meaning of the Trust Indenture hereinafter referred to and is registered in the name of a Depository or a nominee thereof. Unless this Debenture is presented by an authorized representative of CDS Clearing and Depository Services Inc. (“CDS”) to Toronto Hydro Corporation or its agent for registration of transfer, exchange or payment, and any debenture issued in respect thereof is registered in the name of CDS & CO., or in such other name as is requested by an authorized representative of CDS (and any payment is made to CDS & CO. or to such other entity as is requested by an authorized representative of CDS), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL since the registered holder hereof, CDS & CO., has a property interest in the securities represented by this debenture herein and it is a violation of its rights for another person to hold, transfer or deal with this debenture.

No. 7-000

\$●

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)

●% SENIOR UNSECURED DEBENTURES DUE 2021 (SERIES 7)

ISIN CA 89119ZAD56
CUSIP 89119ZAD5

Issue Date	●, 2011
Stated Maturity	●, 2021
Interest Rate Per Annum	●%
Interest Payment Dates	● and ● in each year
Initial Interest Payment Date	●, 2012
Principal Amount	\$●

TORONTO HYDRO CORPORATION (the “Corporation”) for value received hereby promises to pay to the registered holder hereof on the Stated Maturity, or on such earlier date as the Principal Amount (or a portion thereof) may become due in accordance with the provisions of the Trust Indenture (as defined below), on presentation and surrender of this ●% Senior Unsecured Debenture due ●, 2021 (Series 7) (the “**Series 7 Debenture**”), the Principal Amount in lawful money of Canada at the office of the Trustee (as defined below) at 11th Floor, 320 Bay Street, Toronto, Ontario M5H 4A6, and to pay interest on the Principal Amount at the Interest Rate Per Annum from and including the later of the Issue Date and the last Interest Payment Date on which interest has at that time most recently been paid on this Series 7 Debenture, at the

address of the registered holder hereof appearing on the register of Series 7 Debentures maintained by or at the direction of the Trustee (the “**Register**”), in like money semi-annually in arrears, in equal instalments on the Interest Payment Dates in each year, and if the Corporation at any time defaults in the payment of any principal or interest, to pay interest on the amount in default at the same rate, in like money, on demand, at the address of the registered holder hereof appearing on the Register. The Corporation will (i) on the day that is each Interest Payment Date, make payment by a wire transfer, or (ii) on the day that is two Business Days before each Interest Payment Date, forward or cause to be forwarded a cheque by same day delivery, to the address of the registered holder hereof appearing on the Register for interest due and payable to such holder on such Interest Payment Date, less any taxes required by law to be deducted or withheld, made payable to the order of such holder; provided, however that in case of payment of interest at maturity or redemption or as otherwise provided in the Trust Indenture, the time for payment of interest, less any such taxes, may at the option of the Corporation be determined based on the time that the certificate representing this Series 7 Debenture is presented and surrendered to the Trustee. The payment by such wire transfer or forwarding of such cheque (provided such cheque is paid on presentation) will satisfy and discharge the liability for interest upon such Series 7 Debenture to the extent of the sum represented thereby (plus the amount of any taxes deducted or withheld as aforesaid).

This Series 7 Debenture is one of an authorized issue of debentures designated as ●% Senior Unsecured Debentures due ●, 2021 (Series 7) and forming the series of debentures created and issued under an eighth supplemental trust indenture made as of ●, 2011 (the “**Eighth Supplemental Trust Indenture**”) to a trust indenture (the “**Indenture**”) made as of May 7, 2003, between the Corporation and BNY Trust Company of Canada (successor trustee of CIBC Mellon Trust Company) (the “**Trustee**”), as Trustee (the first supplemental trust indenture to the Indenture made as of May 7, 2003 between the Corporation and the Trustee, the second supplemental trust indenture to the Indenture made as of November 14, 2007 between the Corporation and the Trustee, the third supplemental trust indenture to the Indenture made as of November 12, 2009 between the Corporation and the Trustee, the fourth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the fifth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the sixth supplemental trust indenture to the Indenture made as of May 20, 2010 between the Corporation and the Trustee, the seventh supplemental trust indenture to the Indenture made as of September 20, 2011 between the Corporation and the Trustee, the Eighth Supplemental Trust Indenture and the Indenture (as amended, supplemented or restated from time to time) are collectively referred to herein as the “**Trust Indenture**”). The Trust Indenture specifies the terms and conditions upon which the Series 7 Debentures are created and issued or may be created, issued and held and the rights of the registered holders of the Series 7 Debentures, the Corporation and the Trustee, all of which terms and conditions are incorporated by reference in this Series 7 Debenture and to each of which the registered holder of this Series 7 Debenture, by acceptance hereof, agrees.

The aggregate principal amount of Series 7 Debentures that may be created and issued under the Trust Indenture is limited to \$1,000,000,000 in lawful money of Canada. Series 7 Debentures are issuable as fully registered debentures in denominations of \$1,000 and integral multiples thereof and, subject to the terms and conditions set forth in the Trust Indenture, are issued as book entry only debentures.

The Series 7 Debentures are direct unsecured obligations of the Corporation and will rank equally with each other and with all other debentures of every other series from time to time issued and outstanding pursuant to the Trust Indenture and, except to the extent prescribed by law, with all other unsecured and unsubordinated Indebtedness of the Corporation.

This Series 7 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole at any time or in part from time to time, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to the greater of the Canada Yield Price (as defined in the Trust Indenture) and par, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

At any time when the Corporation is not in default under the Trust Indenture, the Corporation may, subject to the terms and conditions set forth in the Trust Indenture, purchase Series 7 Debentures in the open market, by tender or by private contract, at any price. Series 7 Debentures purchased by the Corporation shall be cancelled and not reissued.

The Principal Amount may become or be declared due before the Stated Maturity on the conditions, in the manner, with the effect and at the times set forth in the Trust Indenture.

The Trust Indenture contains provisions for the holding of meetings of registered holders of debentures issued by the Corporation pursuant to the Trust Indenture and the making of resolutions at such meetings and the creation of instruments in writing signed by the registered holders of a specified majority of debentures issued and outstanding pursuant to the Trust Indenture. Such resolutions and instruments will be binding on and may affect the rights and entitlements of all holders of debentures issued by the Corporation pursuant to the Trust Indenture, subject to the provisions of the Trust Indenture.

This Series 7 Debenture may be transferred only upon compliance with the conditions prescribed in the Trust Indenture relating to the transfer of a Global Debenture (as defined in the Trust Indenture), and upon compliance with such reasonable requirements as the Trustee or other registrar may prescribe, and such transfer shall be duly noted hereon by the Trustee or other registrar.

This Series 7 Debenture shall not become obligatory for any purpose until it shall have been certified by the manual signature of the Trustee in accordance with the Trust Indenture.

IN WITNESS WHEREOF TORONTO HYDRO CORPORATION has caused this Series 7 Debenture to be signed by its ● and its ●.

TORONTO HYDRO CORPORATION

By: _____
Name: ●
Title: ●

By: _____
Name: ●
Title: ●

(FORM OF TRUSTEE'S CERTIFICATE)

This Debenture is one of the Series 7 Debentures referred to in the Trust Indenture referred to above.

BNY TRUST COMPANY OF CANADA

Trustee

By: _____
Authorized Signatory

(FORM OF REGISTRATION PANEL)

(NO WRITING HEREON EXCEPT BY THE TRUSTEE OR OTHER REGISTRAR)

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)

●% SENIOR UNSECURED DEBENTURES DUE 2021 (SERIES 7)

ISIN CA 89119ZAD56
CUSIP 89119ZAD5

DATE OF REGISTRATION	IN WHOSE NAME REGISTERED	AMOUNT OF DECREASE	AMOUNT OF INCREASE	AMOUNT OF SERIES 7 DEBENTURES OUTSTANDING FOLLOWING CHANGE	SIGNATURE OF TRUSTEE OR OTHER REGISTRAR

Schedule 2 – U.S. FORM OF DEFINITIVE DEBENTURE-SERIES 7

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “U.S. SECURITIES ACT”) OR UNDER ANY STATE SECURITIES LAWS. THE HOLDER HEREOF, BY PURCHASING SUCH SECURITIES, AGREES FOR THE BENEFIT OF THE CORPORATION THAT SUCH SECURITIES MAY BE OFFERED, SOLD OR OTHERWISE TRANSFERRED ONLY (A) TO THE CORPORATION, (B) OUTSIDE THE UNITED STATES IN ACCORDANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT, OR (C) INSIDE THE UNITED STATES IN ACCORDANCE WITH (1) RULE 144A UNDER THE U.S. SECURITIES ACT OR (2) RULE 144 UNDER THE U.S. SECURITIES ACT, IF AVAILABLE, OR (3) IN COMPLIANCE WITH CERTAIN OTHER PROCEDURES SATISFACTORY TO THE CORPORATION. A NEW CERTIFICATE BEARING NO LEGEND, DELIVERY OF WHICH WILL CONSTITUTE “GOOD DELIVERY”, MAY BE OBTAINED FROM BNY TRUST COMPANY OF CANADA UPON DELIVERY OF THIS CERTIFICATE AND A DULY EXECUTED DECLARATION, IN A FORM SATISFACTORY TO BNY TRUST COMPANY OF CANADA AND THE CORPORATION, TO THE EFFECT THAT THE SALE OF THE SECURITIES REPRESENTED HEREBY IS BEING MADE IN COMPLIANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT.

No. 7-000

\$●

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)

●% SENIOR UNSECURED DEBENTURES DUE ● (SERIES 7)

Issue Date	●, 2011
Stated Maturity	●, 2021
Interest Rate Per Annum	●%
Interest Payment Dates	● and ● in each year
Initial Interest Payment Date	●, 2012
Principal Amount	\$●

TORONTO HYDRO CORPORATION (the “**Corporation**”) for value received hereby promises to pay to the registered holder hereof on the Stated Maturity, or on such earlier date as the Principal Amount (or a portion thereof) may become due in accordance with the provisions of the Trust Indenture (as defined below), on presentation and surrender of this ●% Senior Unsecured Debenture due ●, 2021 (Series 7) (the “**Series 7 Debenture**”), the Principal Amount in lawful money of Canada at the office of the Trustee (as defined below) at 11th Floor, 320 Bay

Street, Toronto, Ontario M5H 4A6, and to pay interest on the Principal Amount at the Interest Rate Per Annum from and including the later of the Issue Date and the last Interest Payment Date on which interest has at that time most recently been paid on this Series 7 Debenture, at the address of the registered holder hereof appearing on the register of Series 7 Debentures maintained by or at the direction of the Trustee (the “**Register**”), in like money semi-annually in arrears, in equal instalments on the Interest Payment Dates in each year, and if the Corporation at any time defaults in the payment of any principal or interest, to pay interest on the amount in default at the same rate, in like money, on demand, at the address of the registered holder hereof appearing on the Register. The Corporation, on the day that is two Business Days before each Interest Payment Date, will forward or cause to be forwarded by same day delivery to the address of the registered holder hereof appearing on the Register a cheque for interest due and payable to such holder on such Interest Payment Date, less any taxes required by law to be deducted or withheld, made payable to the order of such holder; provided, however that in case of payment of interest at maturity or redemption or as otherwise provided in the Trust Indenture, the time for payment of interest, less any such taxes, may at the option of the Corporation be determined based on the time that the certificate representing this Series 7 Debenture is presented and surrendered to the Trustee. The forwarding of such cheque will satisfy and discharge the liability for interest upon such Series 7 Debenture to the extent of the sum represented thereby (plus the amount of any taxes deducted or withheld as aforesaid) unless such cheque is not paid on presentation.

This Series 7 Debenture is one of an authorized issue of debentures designated as ●% Senior Unsecured Debentures due ●, 2021 (Series 7) and forming the series of debentures created and issued under a eighth supplemental trust indenture made as of ●, 2011 (the “**Eighth Supplemental Trust Indenture**”) to a trust indenture (the “**Indenture**”) made as of May 7, 2003, between the Corporation and BNY Trust Company of Canada (successor trustee of CIBC Mellon Trust Company) (the “**Trustee**”), as Trustee (the first supplemental trust indenture to the Indenture made as of May 7, 2003 between the Corporation and the Trustee, the second supplemental trust indenture to the Indenture made as of November 14, 2007 between the Corporation and the Trustee, the third supplemental trust indenture to the Indenture made as of November 12, 2009 between the Corporation and the Trustee, the fourth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the fifth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the sixth supplemental trust indenture to the Indenture made as of May 20, 2010 between the Corporation and the Trustee, the seventh supplemental trust indenture to the Indenture made as of September 20, 2011 between the Corporation and the Trustee, the Eighth Supplemental Trust Indenture and the Indenture (as amended, supplemented or restated from time to time) are collectively referred to herein as the “**Trust Indenture**”). The Trust Indenture specifies the terms and conditions upon which the Series 7 Debentures are created and issued or may be created, issued and held and the rights of the registered holders of the Series 7 Debentures, the Corporation and the Trustee, all of which terms and conditions are incorporated by reference in this Series 7 Debenture and to each of which the registered holder of this Series 7 Debenture, by acceptance hereof, agrees.

The aggregate principal amount of Series 7 Debentures that may be created and issued under the Trust Indenture is limited to \$1,000,000,000 in lawful money of Canada. Series 7 Debentures are issuable as fully registered debentures in denominations of \$1,000 and integral multiples thereof.

The Series 7 Debentures are direct unsecured obligations of the Corporation and will rank equally with each other and with all other debentures of every other series from time to time issued and outstanding pursuant to the Trust Indenture and, except to the extent prescribed by law, with all other unsecured and unsubordinated Indebtedness of the Corporation.

This Series 7 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole at any time or in part from time to time, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to the greater of the Canada Yield Price (as defined in the Trust Indenture) and par, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

At any time when the Corporation is not in default under the Trust Indenture, the Corporation may, subject to the terms and conditions set forth in the Trust Indenture, purchase Series 7 Debentures in the open market, by tender or by private contract, at any price. Series 7 Debentures purchased by the Corporation shall be cancelled and not reissued.

The Principal Amount may become or be declared due before the Stated Maturity on the conditions, in the manner, with the effect and at the times set forth in the Trust Indenture.

The Trust Indenture contains provisions for the holding of meetings of registered holders of debentures issued by the Corporation pursuant to the Trust Indenture and the making of resolutions at such meetings and the creation of instruments in writing signed by the registered holders of a specified majority of debentures issued and outstanding pursuant to the Trust Indenture. Such resolutions and instruments will be binding on and may affect the rights and entitlements of all holders of debentures issued by the Corporation pursuant to the Trust Indenture, subject to the provisions of the Trust Indenture.

This Series 7 Debenture may be transferred only upon compliance with the conditions prescribed in the Trust Indenture by the registered holder hereof or the holder's legal representative or attorney duly appointed by an instrument in form and execution satisfactory to the Trustee, and upon compliance with such reasonable requirements as the Trustee or other registrar may prescribe, and such transfer shall be duly noted hereon by the Trustee or other registrar.

This Series 7 Debenture shall not become obligatory for any purpose until it shall have been certified by the manual signature of the Trustee in accordance with the Trust Indenture.

IN WITNESS WHEREOF TORONTO HYDRO CORPORATION has caused this Series 7 Debenture to be signed by its ● and its ●.

TORONTO HYDRO CORPORATION

By: _____
Name: ●
Title: ●

By: _____
Name: ●
Title: ●

(FORM OF TRUSTEE'S CERTIFICATE)

This Debenture is one of the Series 7 Debentures referred to in the Trust Indenture referred to above.

BNY TRUST COMPANY OF CANADA

Trustee

By: _____
Authorized Signatory

(FORM OF REGISTRATION PANEL)

(NO WRITING HEREON EXCEPT BY THE TRUSTEE OR OTHER REGISTRAR)

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)

●% SENIOR UNSECURED DEBENTURES DUE 2021 (SERIES 7)

DATE OF REGISTRATION	IN WHOSE NAME REGISTERED	SIGNATURE OF TRUSTEE OR OTHER REGISTRAR

NINTH SUPPLEMENTAL TRUST INDENTURE

Made as of April 9, 2013

Between

TORONTO HYDRO CORPORATION
as issuer

and

BNY TRUST COMPANY OF CANADA
as trustee

Supplementing the Trust Indenture

made as of May 7, 2003

and

providing for the issue of

2.91% Senior Unsecured Debentures
due 2023 (Series 8)

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NINTH SUPPLEMENTAL TRUST INDENTURE

THIS NINTH SUPPLEMENTAL TRUST INDENTURE made as of April 9, 2013,

B E T W E E N:

TORONTO HYDRO CORPORATION

a corporation incorporated under the laws of Ontario (the “Corporation”)

and

BNY TRUST COMPANY OF CANADA

a trust company existing under the laws of Canada (the “Trustee”)

RECITALS

A. BNY Trust Company of Canada is the successor trustee of CIBC Mellon Trust Company;

B. The Corporation has entered into a trust indenture with the Trustee made as of May 7, 2003, as amended, supplemented or restated from time to time (the “**Trust Indenture**”) which provides for the issuance of one or more series of unsecured Debentures of the Corporation by way of Supplemental Indentures;

C. The Corporation entered into a first supplemental trust indenture made as of May 7, 2003 for the purpose of providing for the issue of \$225,000,000 aggregate principal amount of Series 1 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 1 Debentures;

D. The Corporation entered into a second supplemental trust indenture made as of November 14, 2007 for the purpose of providing for the issue of \$250,000,000 aggregate principal amount of Series 2 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 2 Debentures;

E. The Corporation entered into a third supplemental trust indenture made as of November 12, 2009 for the purpose of providing for the issue of \$250,000,000 aggregate principal amount of Series 3 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 3 Debentures;

F. The City Note has been converted, in accordance with its terms, into the Series 4 Debentures and the Series 5 Debentures;

G. The Corporation entered into a fourth supplemental trust indenture made as of April 1, 2010 for the purpose of providing for the issue of \$245,057,000 aggregate principal amount of Series 4 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 4 Debentures;

H. The Corporation entered into a fifth supplemental trust indenture made as of April 1, 2010 for the purpose of providing for the issue of \$245,057,000 aggregate principal amount of Series 5 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 5 Debentures;

I. The Corporation entered into a sixth supplemental trust indenture made as of May 20, 2010 for the purpose of providing for the issue of \$200,000,000 aggregate principal amount of Series 6 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 6 Debentures;

J. The Corporation entered into a seventh supplemental trust indenture made as of September 20, 2011 for the purpose of amending the definition of “GAAP” under the Trust Indenture;

K. The Corporation entered into an eighth supplemental trust indenture made as of November 18, 2011 for the purpose of providing for the issue of \$300,000,000 aggregate principal amount of Series 7 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 7 Debentures; and

L. This Ninth Supplemental Trust Indenture is entered into for the purpose of providing for the issue of Series 8 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 8 Debentures.

NOW THEREFORE THIS NINTH SUPPLEMENTAL TRUST INDENTURE WITNESSES and it is hereby covenanted, agreed and declared as follows:

SECTION 1 INTERPRETATION

1.1 To Be Read With Trust Indenture

This Ninth Supplemental Trust Indenture is a Supplemental Indenture as that term is used in the Trust Indenture. The Trust Indenture and this Ninth Supplemental Trust Indenture shall be read together and shall have effect as though all the provisions of both indentures were contained in one instrument.

1.2 Headings etc.

The division of this Ninth Supplemental Trust Indenture into Sections and clauses, the provision of a table of contents and the insertion of headings are for convenience of reference only and shall not affect the interpretation thereof. Unless the context otherwise requires, the expression “Section” and “Schedule” followed by a number, letter or combination of numbers and letters refer to the specified Section of or Schedule to this Ninth Supplemental Trust Indenture.

1.3 Definitions

All terms which are defined in the Trust Indenture and used but not defined in this Ninth Supplemental Trust Indenture shall have the meanings ascribed to them in the Trust Indenture, as such meanings may be amended or supplemented with respect to Series 8 Debentures by this Ninth Supplemental Trust Indenture. In the event of any inconsistency between the meaning

given to a term in the Trust Indenture and the meaning given to the same term in this Ninth Supplemental Trust Indenture, the meaning given to the term in this Ninth Supplemental Trust Indenture shall prevail to the extent of the inconsistency. Subject to the foregoing, in this Ninth Supplemental Trust Indenture and in the Series 8 Debentures, the following terms have the following meanings:

- (1) **Canada Yield** on any date means the yield to maturity on that date, compounded semi-annually, that a non-callable Government of Canada bond would carry if issued, in Canadian dollars in Canada, at 100% of its principal amount on that date with a term to maturity approximately equal to the remaining term to maturity of the Series 8 Debentures, such yield to maturity being the average of the yields provided by two major Canadian investment dealers specified by the Corporation.
- (2) **Canada Yield Price** means the price equal to the net present value of all scheduled payments of interest (other than accrued and unpaid interest) and principal on the Series 8 Debentures, using a discount rate equal to the sum of the Canada Yield and 28 basis points, calculated at 10:00 a.m. (Toronto, Ontario time) three Business Days prior to the Redemption Date of the Series 8 Debentures.
- (3) **Series 8 Debentures** means the 2.91% Senior Unsecured Debentures due 2023 (Series 8) referred to in Section 2.1 below.
- (4) **Series 8 Debentures Debt Account** means the deposit account established in respect of the Series 8 Debentures pursuant to Section 8.2 of the Trust Indenture that is designated in writing by the Corporation to the Trustee as the “Series 8 Debentures Debt Account”.
- (5) **Series 8 Debentures Interest Payment Date** means October 10 and April 10 in each year that the Series 8 Debentures are outstanding with the exception of the first payment of interest which will be due on October 10, 2013 as provided in Section 2.4(a) below.
- (6) **Series 8 Debentures Interest Period** means the period commencing on and including the later of the date of issue of the Series 8 Debentures and the immediately preceding Series 8 Debentures Interest Payment Date and ending on and including the day immediately preceding the next Series 8 Debentures Interest Payment Date to occur in respect of which interest is payable.
- (7) **Trust Indenture** means the trust indenture made as of May 7, 2003 between the Corporation and the Trustee, as amended, supplemented or restated from time to time.

SECTION 2 SERIES 8 DEBENTURES

2.1 Creation and Designation

The Corporation is authorized in accordance with the Trust Indenture to issue under this Ninth Supplemental Trust Indenture, and hereby creates and issues, a series of debentures designated “2.91% Senior Unsecured Debentures due 2023 (Series 8)”, having the terms set out in this Ninth Supplemental Trust Indenture.

2.2 Limitation on Issue

The aggregate principal amount of Series 8 Debentures which may be issued under this Ninth Supplemental Trust Indenture including any supplement hereto will be limited to \$500,000,000.

2.3 Date of Issue and Maturity

The Series 8 Debentures shall be dated April 9, 2013 (being the applicable date of issue) and will become due and payable, together with all accrued interest and unpaid interest thereon, on April 10, 2023 (being the applicable Stated Maturity).

2.4 Concerning Interest

- (a) The Series 8 Debentures shall be issued in \$1,000 principal amount denominations or integral multiples thereof and shall bear interest on the unpaid principal amount thereof at a rate of 2.91% per annum from and including their date of issue, payable semi-annually in arrears, in equal instalments, on each Series 8 Debentures Interest Payment Date, with the exception of the first payment of interest which will be due on October 10, 2013 and which will be \$14.62972604 per \$1,000 principal amount of Series 8 Debentures.
- (b) Interest shall be payable in respect of each Series 8 Debentures Interest Period (after as well as before maturity, default and judgment, with interest on overdue interest at the same rate) on each Series 8 Debentures Interest Payment Date in accordance with Section 2.8 of the Trust Indenture.

2.5 Interest Payments

The Corporation shall make payments of interest on the Series 8 Debentures in accordance with the provisions of Section 2.8 of the Trust Indenture.

2.6 Payment of Amounts Due on Maturity

In accordance with Section 8.2 of the Trust Indenture, the Corporation will deposit to the Series 8 Debentures Debt Account all amounts required to be paid to the order of Holders of Series 8 Debentures on maturity, prior to 9:00 a.m. (Toronto, Ontario time), on the Stated Maturity of the Series 8 Debentures. The deposit of such funds will satisfy and discharge the liability of the Corporation for principal of, and any accrued and unpaid interest on, the Series 8 Debentures to the extent of the sum represented thereby (plus the amount of any taxes deducted or withheld).

2.7 Redemption and Purchase of Series 8 Debentures

- (a) The Series 8 Debentures may be redeemed, at the Corporation's option when not in default under the Trust Indenture, in whole at any time, or in part at any time and from time to time, prior to January 10, 2023, on not more than 60 Business Days and not less than 15 Business Days prior notice, at a price equal to the greater of the Canada Yield Price and par, together in each case with accrued and unpaid

interest to (but excluding) the Redemption Date and in each case otherwise in accordance with Sections 5.1, 5.2, 5.3 and 5.4 of the Trust Indenture.

- (b) The Series 8 Debentures may be redeemed, at the Corporation's option when not in default under the Trust Indenture, in whole, but not in part, at any time on or after January 10, 2023, on not more than 60 Business Days and not less than 15 Business Days prior notice, at a price equal to 100% of the principal amount of the Series 8 Debentures outstanding, together with accrued and unpaid interest to (but excluding) the Redemption Date and otherwise in accordance with Sections 5.1, 5.3 and 5.4 of the Trust Indenture.
- (c) The Corporation will be entitled at any time when not in default under the Trust Indenture to purchase for cancellation all or any of the Series 8 Debentures in accordance with Section 5.5 of the Trust Indenture.
- (d) The Series 8 Debentures will not be subject to repurchase pursuant to any sinking fund provisions.

2.8 Form of Series 8 Debentures

- (a) Except as set out in Section 2.8(b) below, the Series 8 Debentures and the registration panel and the certificate of the Trustee endorsed thereon shall be issuable initially as one Global Debenture to be held by, or on behalf of, CDS as depository for its participants and registered in the name of CDS or its nominee. The Global Debenture shall be substantially in the form set out in Schedule 1 hereto with such appropriate additions, deletions, substitutions and variations as the Directors shall by resolution determine prior to the time of issue thereof and as the Trustee may approve and with such distinguishing letters and numbers as the Trustee may approve, with such approval in each case to be conclusively evidenced by the Trustee's certification of such Global Debenture.
- (b) The Trustee understands and acknowledges that the Series 8 Debentures have not been and will not be registered under the United States Securities Act of 1933, as amended (the "U.S. Securities Act"). Each Series 8 Debenture originally issued in the United States or to a U.S. Person will be represented by a definitive certificate in the form set out in Schedule 2 hereto which definitive certificate, and each Series 8 Debenture certificate issued in exchange therefor or in substitution thereof, shall bear the following legend:

"THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "U.S. SECURITIES ACT") OR UNDER ANY STATE SECURITIES LAWS. THE HOLDER HEREOF, BY PURCHASING SUCH SECURITIES, AGREES FOR THE BENEFIT OF THE CORPORATION THAT SUCH SECURITIES MAY BE OFFERED, SOLD OR OTHERWISE TRANSFERRED ONLY (A) TO THE CORPORATION, (B) OUTSIDE THE UNITED STATES IN ACCORDANCE WITH RULE 904 OF REGULATION S UNDER THE

U.S. SECURITIES ACT, OR (C) INSIDE THE UNITED STATES IN ACCORDANCE WITH (1) RULE 144A UNDER THE U.S. SECURITIES ACT OR (2) RULE 144 UNDER THE U.S. SECURITIES ACT, IF AVAILABLE OR (3) IN COMPLIANCE WITH CERTAIN OTHER PROCEDURES SATISFACTORY TO THE CORPORATION. A NEW CERTIFICATE, BEARING NO LEGEND, DELIVERY OF WHICH WILL CONSTITUTE "GOOD DELIVERY" MAY BE OBTAINED FROM BNY TRUST COMPANY OF CANADA UPON DELIVERY OF THIS CERTIFICATE AND A DULY EXECUTED DECLARATION, IN A FORM SATISFACTORY TO BNY TRUST COMPANY OF CANADA AND THE CORPORATION, TO THE EFFECT THAT THE SALE OF THE SECURITIES REPRESENTED HEREBY IS BEING MADE IN COMPLIANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT."

If any Series 8 Debentures are being sold or transferred outside the United States in compliance with the requirements of Rule 904 of Regulation S under the U.S Securities Act, the legend may be removed by providing a declaration to the Trustee to the following effect (or as the Corporation may prescribe from time to time),

"The undersigned (A) acknowledges that the sale of the _____ Debentures, represented by certificate numbers _____ to which this declaration relates is being made in reliance on Rule 904 of Regulation S under the United States Securities Act of 1933, as amended (the "**U.S. Securities Act**") and (B) certifies that (1) it is not an "affiliate" (as defined in Rule 405 under the U.S. Securities Act) of Toronto Hydro Corporation, (2) the offer of such Debentures was not made to a person in the United States and at the time the buy order was originated, the buyer was outside the United States, or the seller and any person acting on its behalf reasonably believe that the buyer was outside the United States and (3) neither the seller, nor any affiliate of the seller, nor any person acting on its or their behalf engaged in any directed selling efforts in connection with the offer and sale of such Debentures. Terms used herein have the meanings given to them by Regulation S under the U.S. Securities Act."

If any Series 8 Debentures are being sold or transferred pursuant to Rule 144 of the U.S. Securities Act, the legend may be removed by delivery to the Trustee of a written opinion of Trustee Counsel to the effect that such legend is no longer required under applicable requirements of the U.S. Securities Act or state securities laws.

Prior to the issuance of Series 8 Debentures, the Corporation shall notify the Trustee, in writing, concerning which Series 8 Debentures are to be certificated and are to bear the legend described above. The Trustee will thereafter maintain a list of all registered holders from time to time of legended Series 8 Debentures.

2.9 Signatures on Series 8 Debentures

The Series 8 Debentures shall be signed in accordance with the provisions of Section 2.6 of the Trust Indenture.

2.10 Certification

- (a) No Series 8 Debenture issued shall be obligatory or shall entitle the Holder of such Series 8 Debenture to the benefits of this Ninth Supplemental Trust Indenture until it has been certified by manual signature by or on behalf of the Trustee by execution of the certificate of the Trustee appended thereto substantially in the form set out in Schedule 1 hereto, or in some other form approved by the Trustee, whose approval shall be conclusively evidenced by the Trustee's execution of the certificate. Such certificate on any Series 8 Debenture shall be conclusive evidence that such Series 8 Debenture is duly issued and is a valid and binding obligation of the Corporation and that the Holder of such Series 8 Debenture is entitled to the benefits of the Trust Indenture, as supplemented by this Ninth Supplemental Trust Indenture, and such Series 8 Debenture.
- (b) The certificate of the Trustee on any Series 8 Debenture shall not be construed as a representation or warranty by the Trustee as to the validity of this Ninth Supplemental Trust Indenture or of the Series 8 Debentures (except the due certification thereof and any other warranties implied by law) and the Trustee shall in no respect be liable or answerable for the use made of the Series 8 Debentures or any of them or the proceeds thereof.

2.11 Location of Register

With respect to the Series 8 Debentures, initially the Register referred to in Section 3.1 of the Trust Indenture shall be kept by the Trustee at the Corporate Trust Office and may thereafter be kept by the Trustee in such other place as the Corporation, with the approval of the Trustee, may designate.

2.12 Additional Amounts

The Corporation will not be required to pay an additional amount on the Series 8 Debentures in respect of any tax, assessment or government charge that is required by law to be withheld or deducted by it.

2.13 Trustees, etc.

The Trustee will be the Paying Agent and the Registrar for the Series 8 Debentures.

SECTION 3 MISCELLANEOUS

3.1 Acceptance of Trust

The Trustee accepts the trusts in this Ninth Supplemental Trust Indenture and agrees to carry out and discharge the same upon the terms and conditions set out in this Ninth Supplemental Trust Indenture and in accordance with the Trust Indenture.

3.2 Confirmation of Trust Indenture

The Trust Indenture as amended and supplemented by this Ninth Supplemental Trust Indenture is in all respects confirmed.

3.3 Counterparts

This Ninth Supplemental Trust Indenture may be executed in counterparts, each of which so executed shall be deemed to be original and such counterparts together shall constitute one and the same instrument.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF the parties hereto have executed this Ninth Supplemental Trust Indenture under the hands of their proper signatories in that behalf:

TORONTO HYDRO CORPORATION

By: Anthony Haines
Name: Anthony Haines
Title: President and
Chief Executive Officer

By: Jean-Sebastien Couillard
Name: Jean-Sebastien Couillard
Title: Chief Financial Officer

BNY TRUST COMPANY OF CANADA

By: Ismail Bawa
Name: Ismail Bawa
Title: Authorized Signatory

Schedule 1 – FORM OF GLOBAL DEBENTURE-SERIES 8

This Debenture is a Global Debenture within the meaning of the Trust Indenture hereinafter referred to and is registered in the name of a Depository or a nominee thereof. Unless this Debenture is presented by an authorized representative of CDS Clearing and Depository Services Inc. (“CDS”) to Toronto Hydro Corporation or its agent for registration of transfer, exchange or payment, and any debenture issued in respect thereof is registered in the name of CDS & CO., or in such other name as is requested by an authorized representative of CDS (and any payment is made to CDS & CO. or to such other entity as is requested by an authorized representative of CDS), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL since the registered holder hereof, CDS & CO., has a property interest in the securities represented by this debenture herein and it is a violation of its rights for another person to hold, transfer or deal with this debenture.

No. 8-000

\$●

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)
●% SENIOR UNSECURED DEBENTURES DUE 20● (SERIES 8)

ISIN CA 89119ZAE30
CUSIP 89119ZAE3

Issue Date	●, 2013
Stated Maturity	●, 20●
Interest Rate Per Annum	●%
Interest Payment Dates	● and ● in each year
Initial Interest Payment Date	●, 2013
Principal Amount	\$●

TORONTO HYDRO CORPORATION (the “Corporation”) for value received hereby promises to pay to the registered holder hereof on the Stated Maturity, or on such earlier date as the Principal Amount (or a portion thereof) may become due in accordance with the provisions of the Trust Indenture (as defined below), on presentation and surrender of this ●% Senior Unsecured Debenture due ●, 20● (Series 8) (the “**Series 8 Debenture**”), the Principal Amount in lawful money of Canada at the office of the Trustee (as defined below) at 11th Floor, 320 Bay Street, Toronto, Ontario M5H 4A6, and to pay interest on the Principal Amount at the Interest Rate Per Annum from and including the later of the Issue Date and the last Interest Payment Date on which interest has at that time most recently been paid on this Series 8 Debenture (with the

exception of the first payment of interest which will be due on ●, 20● and which will be \$● per \$1,000 principal amount of Series 8 Debentures), at the address of the registered holder hereof appearing on the register of Series 8 Debentures maintained by or at the direction of the Trustee (the “**Register**”), in like money semi-annually in arrears, in equal instalments on the Interest Payment Dates in each year, and if the Corporation at any time defaults in the payment of any principal or interest, to pay interest on the amount in default at the same rate, in like money, on demand, at the address of the registered holder hereof appearing on the Register. The Corporation will (i) on the day that is each Interest Payment Date, make payment by a wire transfer, or (ii) on the day that is two Business Days before each Interest Payment Date, forward or cause to be forwarded a cheque by same day delivery, to the address of the registered holder hereof appearing on the Register for interest due and payable to such holder on such Interest Payment Date, less any taxes required by law to be deducted or withheld, made payable to the order of such holder; provided, however that in case of payment of interest at maturity or redemption or as otherwise provided in the Trust Indenture, the time for payment of interest, less any such taxes, may at the option of the Corporation be determined based on the time that the certificate representing this Series 8 Debenture is presented and surrendered to the Trustee. The payment by such wire transfer or forwarding of such cheque (provided such cheque is paid on presentation) will satisfy and discharge the liability for interest upon such Series 8 Debenture to the extent of the sum represented thereby (plus the amount of any taxes deducted or withheld as aforesaid).

This Series 8 Debenture is one of an authorized issue of debentures designated as ●% Senior Unsecured Debentures due ●, 20● (Series 8) and forming the series of debentures created and issued under a ninth supplemental trust indenture made as of ●, 2013 (the “**Ninth Supplemental Trust Indenture**”) to a trust indenture (the “**Indenture**”) made as of May 7, 2003, between the Corporation and BNY Trust Company of Canada (successor trustee of CIBC Mellon Trust Company) (the “**Trustee**”), as Trustee (the first supplemental trust indenture to the Indenture made as of May 7, 2003 between the Corporation and the Trustee, the second supplemental trust indenture to the Indenture made as of November 14, 2007 between the Corporation and the Trustee, the third supplemental trust indenture to the Indenture made as of November 12, 2009 between the Corporation and the Trustee, the fourth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the fifth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the sixth supplemental trust indenture to the Indenture made as of May 20, 2010 between the Corporation and the Trustee, the seventh supplemental trust indenture to the Indenture made as of September 20, 2011 between the Corporation and the Trustee, the eighth supplemental trust indenture to the Indenture made as of November 18, 2011 between the Corporation and the Trustee, the Ninth Supplemental Trust Indenture and the Indenture (as amended, supplemented or restated from time to time) are collectively referred to herein as the “**Trust Indenture**”). The Trust Indenture specifies the terms and conditions upon which the Series 8 Debentures are created and issued or may be created, issued and held and the rights of the registered holders of the Series 8 Debentures, the Corporation and the Trustee, all of which terms and conditions are incorporated by reference in this Series 8 Debenture and to each of which the registered holder of this Series 8 Debenture, by acceptance hereof, agrees.

The aggregate principal amount of Series 8 Debentures that may be created and issued under the Trust Indenture is limited to \$● in lawful money of Canada. Series 8 Debentures are issuable as fully registered debentures in denominations of \$1,000 and integral multiples thereof

and, subject to the terms and conditions set forth in the Trust Indenture, are issued as book entry only debentures.

The Series 8 Debentures are direct unsecured obligations of the Corporation and will rank equally with each other and with all other debentures of every other series from time to time issued and outstanding pursuant to the Trust Indenture and, except to the extent prescribed by law, with all other unsecured and unsubordinated Indebtedness of the Corporation.

This Series 8 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole at any time, or in part at any time and from time to time, prior to ●, 20●, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to the greater of the Canada Yield Price (as defined in the Trust Indenture) and par, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

This Series 8 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole, but not in part, at any time on or after ●, 20●, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to 100% of the Principal Amount of the Series 8 Debentures outstanding, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

At any time when the Corporation is not in default under the Trust Indenture, the Corporation may, subject to the terms and conditions set forth in the Trust Indenture, purchase Series 8 Debentures in the open market, by tender or by private contract, at any price. Series 8 Debentures purchased by the Corporation shall be cancelled and not reissued.

The Principal Amount may become or be declared due before the Stated Maturity on the conditions, in the manner, with the effect and at the times set forth in the Trust Indenture.

The Trust Indenture contains provisions for the holding of meetings of registered holders of debentures issued by the Corporation pursuant to the Trust Indenture and the making of resolutions at such meetings and the creation of instruments in writing signed by the registered holders of a specified majority of debentures issued and outstanding pursuant to the Trust Indenture. Such resolutions and instruments will be binding on and may affect the rights and entitlements of all holders of debentures issued by the Corporation pursuant to the Trust Indenture, subject to the provisions of the Trust Indenture.

This Series 8 Debenture may be transferred only upon compliance with the conditions prescribed in the Trust Indenture relating to the transfer of a Global Debenture (as defined in the Trust Indenture), and upon compliance with such reasonable requirements as the Trustee or other registrar may prescribe, and such transfer shall be duly noted hereon by the Trustee or other registrar.

This Series 8 Debenture shall not become obligatory for any purpose until it shall have been certified by the manual signature of the Trustee in accordance with the Trust Indenture.

IN WITNESS WHEREOF TORONTO HYDRO CORPORATION has caused this Series 8 Debenture to be signed by its ● and its ●.

TORONTO HYDRO CORPORATION

By: _____
Name: ●
Title: ●

By: _____
Name: ●
Title: ●

(FORM OF TRUSTEE'S CERTIFICATE)

This Debenture is one of the Series 8 Debentures referred to in the Trust Indenture referred to above.

BNY TRUST COMPANY OF CANADA
Trustee

By: _____
Authorized Signatory

(FORM OF REGISTRATION PANEL)

(NO WRITING HEREON EXCEPT BY THE TRUSTEE OR OTHER REGISTRAR)

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)

●% SENIOR UNSECURED DEBENTURES DUE 20● (SERIES 8)

ISIN CA 89119ZAE30
CUSIP 89119ZAE3

DATE OF REGISTRATION	IN WHOSE NAME REGISTERED	AMOUNT OF DECREASE	AMOUNT OF INCREASE	AMOUNT OF SERIES 8 DEBENTURES OUTSTANDING FOLLOWING CHANGE	SIGNATURE OF TRUSTEE OR OTHER REGISTRAR

Schedule 2 – U.S. FORM OF DEFINITIVE DEBENTURE-SERIES 8

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “U.S. SECURITIES ACT”) OR UNDER ANY STATE SECURITIES LAWS. THE HOLDER HEREOF, BY PURCHASING SUCH SECURITIES, AGREES FOR THE BENEFIT OF THE CORPORATION THAT SUCH SECURITIES MAY BE OFFERED, SOLD OR OTHERWISE TRANSFERRED ONLY (A) TO THE CORPORATION, (B) OUTSIDE THE UNITED STATES IN ACCORDANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT, OR (C) INSIDE THE UNITED STATES IN ACCORDANCE WITH (1) RULE 144A UNDER THE U.S. SECURITIES ACT OR (2) RULE 144 UNDER THE U.S. SECURITIES ACT, IF AVAILABLE OR (3) IN COMPLIANCE WITH CERTAIN OTHER PROCEDURES SATISFACTORY TO THE CORPORATION. A NEW CERTIFICATE, BEARING NO LEGEND, DELIVERY OF WHICH WILL CONSTITUTE “GOOD DELIVERY” MAY BE OBTAINED FROM BNY TRUST COMPANY OF CANADA UPON DELIVERY OF THIS CERTIFICATE AND A DULY EXECUTED DECLARATION, IN A FORM SATISFACTORY TO BNY TRUST COMPANY OF CANADA AND THE CORPORATION, TO THE EFFECT THAT THE SALE OF THE SECURITIES REPRESENTED HEREBY IS BEING MADE IN COMPLIANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT.

No. 8-000

\$●

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)
●% SENIOR UNSECURED DEBENTURES DUE ● (SERIES 8)

Issue Date	●, 2013
Stated Maturity	●, 20●
Interest Rate Per Annum	●%
Interest Payment Dates	● and ● in each year
Initial Interest Payment Date	●, 2013
Principal Amount	\$●

TORONTO HYDRO CORPORATION (the “**Corporation**”) for value received hereby promises to pay to the registered holder hereof on the Stated Maturity, or on such earlier date as the Principal Amount (or a portion thereof) may become due in accordance with the provisions of the Trust Indenture (as defined below), on presentation and surrender of this ●% Senior Unsecured Debenture due ●, 20● (Series 8) (the “**Series 8 Debenture**”), the Principal Amount in lawful money of Canada at the office of the Trustee (as defined below) at 11th Floor, 320 Bay Street, Toronto, Ontario M5H 4A6, and to pay interest on the Principal Amount at the Interest

Rate Per Annum from and including the later of the Issue Date and the last Interest Payment Date on which interest has at that time most recently been paid on this Series 8 Debenture (with the exception of the first payment of interest which will be due on ●, 20● and which will be \$● per \$1,000 principal amount of Series 8 Debentures), at the address of the registered holder hereof appearing on the register of Series 8 Debentures maintained by or at the direction of the Trustee (the “**Register**”), in like money semi-annually in arrears, in equal instalments on the Interest Payment Dates in each year, and if the Corporation at any time defaults in the payment of any principal or interest, to pay interest on the amount in default at the same rate, in like money, on demand, at the address of the registered holder hereof appearing on the Register. The Corporation, on the day that is two Business Days before each Interest Payment Date, will forward or cause to be forwarded by same day delivery to the address of the registered holder hereof appearing on the Register a cheque for interest due and payable to such holder on such Interest Payment Date, less any taxes required by law to be deducted or withheld, made payable to the order of such holder; provided, however that in case of payment of interest at maturity or redemption or as otherwise provided in the Trust Indenture, the time for payment of interest, less any such taxes, may at the option of the Corporation be determined based on the time that the certificate representing this Series 8 Debenture is presented and surrendered to the Trustee. The forwarding of such cheque will satisfy and discharge the liability for interest upon such Series 8 Debenture to the extent of the sum represented thereby (plus the amount of any taxes deducted or withheld as aforesaid) unless such cheque is not paid on presentation.

This Series 8 Debenture is one of an authorized issue of debentures designated as ●% Senior Unsecured Debentures due ●, 20● (Series 8) and forming the series of debentures created and issued under a ninth supplemental trust indenture made as of ●, 2013 (the “**Ninth Supplemental Trust Indenture**”) to a trust indenture (the “**Indenture**”) made as of May 7, 2003, between the Corporation and BNY Trust Company of Canada (successor trustee of CIBC Mellon Trust Company) (the “**Trustee**”), as Trustee (the first supplemental trust indenture to the Indenture made as of May 7, 2003 between the Corporation and the Trustee, the second supplemental trust indenture to the Indenture made as of November 14, 2007 between the Corporation and the Trustee, the third supplemental trust indenture to the Indenture made as of November 12, 2009 between the Corporation and the Trustee, the fourth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the fifth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the sixth supplemental trust indenture to the Indenture made as of May 20, 2010 between the Corporation and the Trustee, the seventh supplemental trust indenture to the Indenture made as of September 20, 2011 between the Corporation and the Trustee, the eighth supplemental trust indenture to the Indenture made as of November 18, 2011 between the Corporation and the Trustee, the Ninth Supplemental Trust Indenture and the Indenture (as amended, supplemented or restated from time to time) are collectively referred to herein as the “**Trust Indenture**”). The Trust Indenture specifies the terms and conditions upon which the Series 8 Debentures are created and issued or may be created, issued and held and the rights of the registered holders of the Series 8 Debentures, the Corporation and the Trustee, all of which terms and conditions are incorporated by reference in this Series 8 Debenture and to each of which the registered holder of this Series 8 Debenture, by acceptance hereof, agrees.

The aggregate principal amount of Series 8 Debentures that may be created and issued under the Trust Indenture is limited to \$● in lawful money of Canada. Series 8 Debentures are issuable as fully registered debentures in denominations of \$1,000 and integral multiples thereof.

The Series 8 Debentures are direct unsecured obligations of the Corporation and will rank equally with each other and with all other debentures of every other series from time to time issued and outstanding pursuant to the Trust Indenture and, except to the extent prescribed by law, with all other unsecured and unsubordinated Indebtedness of the Corporation.

This Series 8 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole at any time, or in part at any time and from time to time, prior to ●, 20●, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to the greater of the Canada Yield Price (as defined in the Trust Indenture) and par, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

This Series 8 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole, but not in part, at any time on or after ●, 20●, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to 100% of the Principal Amount of the Series 8 Debentures outstanding, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

At any time when the Corporation is not in default under the Trust Indenture, the Corporation may, subject to the terms and conditions set forth in the Trust Indenture, purchase Series 8 Debentures in the open market, by tender or by private contract, at any price. Series 8 Debentures purchased by the Corporation shall be cancelled and not reissued.

The Principal Amount may become or be declared due before the Stated Maturity on the conditions, in the manner, with the effect and at the times set forth in the Trust Indenture.

The Trust Indenture contains provisions for the holding of meetings of registered holders of debentures issued by the Corporation pursuant to the Trust Indenture and the making of resolutions at such meetings and the creation of instruments in writing signed by the registered holders of a specified majority of debentures issued and outstanding pursuant to the Trust Indenture. Such resolutions and instruments will be binding on and may affect the rights and entitlements of all holders of debentures issued by the Corporation pursuant to the Trust Indenture, subject to the provisions of the Trust Indenture.

This Series 8 Debenture may be transferred only upon compliance with the conditions prescribed in the Trust Indenture by the registered holder hereof or the holder's legal representative or attorney duly appointed by an instrument in form and execution satisfactory to the Trustee, and upon compliance with such reasonable requirements as the Trustee or other registrar may prescribe, and such transfer shall be duly noted hereon by the Trustee or other registrar.

This Series 8 Debenture shall not become obligatory for any purpose until it shall have been certified by the manual signature of the Trustee in accordance with the Trust Indenture.

IN WITNESS WHEREOF TORONTO HYDRO CORPORATION has caused this Series 8 Debenture to be signed by its ● and its ●.

TORONTO HYDRO CORPORATION

By: _____
Name: ●
Title: ●

By: _____
Name: ●
Title: ●

(FORM OF TRUSTEE'S CERTIFICATE)

This Debenture is one of the Series 8 Debentures referred to in the Trust Indenture referred to above.

BNY TRUST COMPANY OF CANADA
Trustee

By: _____
Authorized Signatory

(FORM OF REGISTRATION PANEL)

(NO WRITING HEREON EXCEPT BY THE TRUSTEE OR OTHER REGISTRAR)

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)

●% SENIOR UNSECURED DEBENTURES DUE 20● (SERIES 8)

DATE OF REGISTRATION	IN WHOSE NAME REGISTERED	SIGNATURE OF TRUSTEE OR OTHER REGISTRAR

TENTH SUPPLEMENTAL TRUST INDENTURE

Made as of April 9, 2013

Between

TORONTO HYDRO CORPORATION
as issuer

and

BNY TRUST COMPANY OF CANADA
as trustee

Supplementing the Trust Indenture

made as of May 7, 2003

and

providing for the issue of

3.96% Senior Unsecured Debentures
due 2063 (Series 9)

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TENTH SUPPLEMENTAL TRUST INDENTURE

THIS TENTH SUPPLEMENTAL TRUST INDENTURE made as of April 9, 2013,

B E T W E E N:

TORONTO HYDRO CORPORATION

a corporation incorporated under the laws of Ontario (the “Corporation”)

and

BNY TRUST COMPANY OF CANADA

a trust company existing under the laws of Canada (the “Trustee”)

RECITALS

A. BNY Trust Company of Canada is the successor trustee of CIBC Mellon Trust Company;

B. The Corporation has entered into a trust indenture with the Trustee made as of May 7, 2003, as amended, supplemented or restated from time to time (the “**Trust Indenture**”) which provides for the issuance of one or more series of unsecured Debentures of the Corporation by way of Supplemental Indentures;

C. The Corporation entered into a first supplemental trust indenture made as of May 7, 2003 for the purpose of providing for the issue of \$225,000,000 aggregate principal amount of Series 1 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 1 Debentures;

D. The Corporation entered into a second supplemental trust indenture made as of November 14, 2007 for the purpose of providing for the issue of \$250,000,000 aggregate principal amount of Series 2 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 2 Debentures;

E. The Corporation entered into a third supplemental trust indenture made as of November 12, 2009 for the purpose of providing for the issue of \$250,000,000 aggregate principal amount of Series 3 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 3 Debentures;

F. The City Note has been converted, in accordance with its terms, into the Series 4 Debentures and the Series 5 Debentures;

G. The Corporation entered into a fourth supplemental trust indenture made as of April 1, 2010 for the purpose of providing for the issue of \$245,057,000 aggregate principal amount of Series 4 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 4 Debentures;

H. The Corporation entered into a fifth supplemental trust indenture made as of April 1, 2010 for the purpose of providing for the issue of \$245,057,000 aggregate principal amount of Series 5 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 5 Debentures;

I. The Corporation entered into a sixth supplemental trust indenture made as of May 20, 2010 for the purpose of providing for the issue of \$200,000,000 aggregate principal amount of Series 6 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 6 Debentures;

J. The Corporation entered into a seventh supplemental trust indenture made as of September 20, 2011 for the purpose of amending the definition of “GAAP” under the Trust Indenture;

K. The Corporation entered into an eighth supplemental trust indenture made as of November 18, 2011 for the purpose of providing for the issue of \$300,000,000 aggregate principal amount of Series 7 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 7 Debentures;

L. The Corporation entered into a ninth supplemental trust indenture made as of April 9, 2013 for the purpose of providing for the issue of Series 8 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 8 Debentures; and

M. This Tenth Supplemental Trust Indenture is entered into for the purpose of providing for the issue of Series 9 Debentures pursuant to the Trust Indenture and establishing the terms, provisions and conditions of the Series 9 Debentures.

NOW THEREFORE THIS TENTH SUPPLEMENTAL TRUST INDENTURE WITNESSES and it is hereby covenanted, agreed and declared as follows:

SECTION 1 INTERPRETATION

1.1 To Be Read With Trust Indenture

This Tenth Supplemental Trust Indenture is a Supplemental Indenture as that term is used in the Trust Indenture. The Trust Indenture and this Tenth Supplemental Trust Indenture shall be read together and shall have effect as though all the provisions of both indentures were contained in one instrument.

1.2 Headings etc.

The division of this Tenth Supplemental Trust Indenture into Sections and clauses, the provision of a table of contents and the insertion of headings are for convenience of reference only and shall not affect the interpretation thereof. Unless the context otherwise requires, the expression “Section” and “Schedule” followed by a number, letter or combination of numbers and letters refer to the specified Section of or Schedule to this Tenth Supplemental Trust Indenture.

1.3 Definitions

All terms which are defined in the Trust Indenture and used but not defined in this Tenth Supplemental Trust Indenture shall have the meanings ascribed to them in the Trust Indenture, as such meanings may be amended or supplemented with respect to Series 9 Debentures by this Tenth Supplemental Trust Indenture. In the event of any inconsistency between the meaning given to a term in the Trust Indenture and the meaning given to the same term in this Tenth Supplemental Trust Indenture, the meaning given to the term in this Tenth Supplemental Trust Indenture shall prevail to the extent of the inconsistency. Subject to the foregoing, in this Tenth Supplemental Trust Indenture and in the Series 9 Debentures, the following terms have the following meanings:

- (1) **Canada Yield** on any date means the yield to maturity on that date, compounded semi-annually, that a non-callable Government of Canada bond would carry if issued, in Canadian dollars in Canada, at 100% of its principal amount on that date with a term to maturity approximately equal to the remaining term to maturity of the Series 9 Debentures, such yield to maturity being the average of the yields provided by two major Canadian investment dealers specified by the Corporation.
- (2) **Canada Yield Price** means the price equal to the net present value of all scheduled payments of interest (other than accrued and unpaid interest) and principal on the Series 9 Debentures, using a discount rate equal to the sum of the Canada Yield and 38 basis points, calculated at 10:00 a.m. (Toronto, Ontario time) three Business Days prior to the Redemption Date of the Series 9 Debentures.
- (3) **Series 9 Debentures** means the 3.96% Senior Unsecured Debentures due 2063 (Series 9) referred to in Section 2.1.
- (4) **Series 9 Debentures Debt Account** means the deposit account established in respect of the Series 9 Debentures pursuant to Section 8.2 of the Trust Indenture that is designated in writing by the Corporation to the Trustee as the "Series 9 Debentures Debt Account".
- (5) **Series 9 Debentures Interest Payment Date** means October 9 and April 9 in each year that the Series 9 Debentures are outstanding.
- (6) **Series 9 Debentures Interest Period** means the period commencing on and including the later of the date of issue of the Series 9 Debentures and the immediately preceding Series 9 Debentures Interest Payment Date and ending on and including the day immediately preceding the next Series 9 Debentures Interest Payment Date to occur in respect of which interest is payable.
- (7) **Trust Indenture** means the trust indenture made as of May 7, 2003 between the Corporation and the Trustee, as amended, supplemented or restated from time to time.

SECTION 2 SERIES 9 DEBENTURES

2.1 Creation and Designation

The Corporation is authorized in accordance with the Trust Indenture to issue under this Tenth Supplemental Trust Indenture, and hereby creates and issues, a series of debentures designated “3.96% Senior Unsecured Debentures due 2063 (Series 9)”, having the terms set out in this Tenth Supplemental Trust Indenture.

2.2 Limitation on Issue

The aggregate principal amount of Series 9 Debentures which may be issued under this Tenth Supplemental Trust Indenture including any supplement hereto will be limited to \$500,000,000.

2.3 Date of Issue and Maturity

The Series 9 Debentures shall be dated April 9, 2013 (being the applicable date of issue) and will become due and payable, together with all accrued interest and unpaid interest thereon, on April 9, 2063 (being the applicable Stated Maturity).

2.4 Concerning Interest

- (a) The Series 9 Debentures shall be issued in \$1,000 principal amount denominations or integral multiples thereof and shall bear interest on the unpaid principal amount thereof at a rate of 3.96% per annum from and including their date of issue, payable semi-annually in arrears, in equal instalments, on each Series 9 Debentures Interest Payment Date.
- (b) Interest shall be payable in respect of each Series 9 Debentures Interest Period (after as well as before maturity, default and judgment, with interest on overdue interest at the same rate) on each Series 9 Debentures Interest Payment Date in accordance with Section 2.8 of the Trust Indenture.

2.5 Interest Payments

The Corporation shall make payments of interest on the Series 9 Debentures in accordance with the provisions of Section 2.8 of the Trust Indenture.

2.6 Payment of Amounts Due on Maturity

In accordance with Section 8.2 of the Trust Indenture, the Corporation will deposit to the Series 9 Debentures Debt Account all amounts required to be paid to the order of Holders of Series 9 Debentures on maturity, prior to 9:00 a.m. (Toronto, Ontario time), on the Stated Maturity of the Series 9 Debentures. The deposit of such funds will satisfy and discharge the liability of the Corporation for principal of, and any accrued and unpaid interest on, the Series 9 Debentures to the extent of the sum represented thereby (plus the amount of any taxes deducted or withheld).

2.7 Redemption and Purchase of Series 9 Debentures

- (a) The Series 9 Debentures may be redeemed, at the Corporation's option when not in default under the Trust Indenture, in whole at any time, or in part at any time and from time to time, prior to October 9, 2062, on not more than 60 Business Days and not less than 15 Business Days prior notice, at a price equal to the greater of the Canada Yield Price and par, together in each case with accrued and unpaid interest to (but excluding) the Redemption Date and in each case otherwise in accordance with Sections 5.1, 5.2, 5.3 and 5.4 of the Trust Indenture.
- (b) The Series 9 Debentures may be redeemed, at the Corporation's option when not in default under the Trust Indenture, in whole, but not in part, at any time on or after October 9, 2062, on not more than 60 Business Days and not less than 15 Business Days prior notice, at a price equal to 100% of the principal amount of the Series 9 Debentures outstanding, together with accrued and unpaid interest to (but excluding) the Redemption Date and otherwise in accordance with Sections 5.1, 5.3 and 5.4 of the Trust Indenture.
- (c) The Corporation will be entitled at any time when not in default under the Trust Indenture to purchase for cancellation all or any of the Series 9 Debentures in accordance with Section 5.5 of the Trust Indenture.
- (d) The Series 9 Debentures will not be subject to repurchase pursuant to any sinking fund provisions.

2.8 Form of Series 9 Debentures

- (a) Except as set out in 2.8(b) below, the Series 9 Debentures and the registration panel and the certificate of the Trustee endorsed thereon shall be issuable initially as one Global Debenture to be held by, or on behalf of, CDS as depository for its participants and registered in the name of CDS or its nominee. The Global Debenture shall be substantially in the form set out in Schedule 1 hereto with such appropriate additions, deletions, substitutions and variations as the Directors shall by resolution determine prior to the time of issue thereof and as the Trustee may approve and with such distinguishing letters and numbers as the Trustee may approve, with such approval in each case to be conclusively evidenced by the Trustee's certification of such Global Debenture.
- (b) The Trustee understands and acknowledges that the Series 9 Debentures have not been and will not be registered under the United States Securities Act of 1933, as amended (the "U.S. Securities Act"). Each Series 9 Debenture originally issued in the United States or to a U.S. Person will be represented by a definitive certificate in the form set out in Schedule 2 hereto which definitive certificate, and each Series 9 Debenture certificate issued in exchange therefor or in substitution thereof, shall bear the following legend:

“THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN
REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF

1933, AS AMENDED (THE “**U.S. SECURITIES ACT**”) OR UNDER ANY STATE SECURITIES LAWS. THE HOLDER HEREOF, BY PURCHASING SUCH SECURITIES, AGREES FOR THE BENEFIT OF THE CORPORATION THAT SUCH SECURITIES MAY BE OFFERED, SOLD OR OTHERWISE TRANSFERRED ONLY (A) TO THE CORPORATION, (B) OUTSIDE THE UNITED STATES IN ACCORDANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT, OR (C) INSIDE THE UNITED STATES IN ACCORDANCE WITH (1) RULE 144A UNDER THE U.S. SECURITIES ACT OR (2) RULE 144 UNDER THE U.S. SECURITIES ACT, IF AVAILABLE OR (3) IN COMPLIANCE WITH CERTAIN OTHER PROCEDURES SATISFACTORY TO THE CORPORATION. A NEW CERTIFICATE, BEARING NO LEGEND, DELIVERY OF WHICH WILL CONSTITUTE “GOOD DELIVERY” MAY BE OBTAINED FROM BNY TRUST COMPANY OF CANADA UPON DELIVERY OF THIS CERTIFICATE AND A DULY EXECUTED DECLARATION, IN A FORM SATISFACTORY TO BNY TRUST COMPANY OF CANADA AND THE CORPORATION, TO THE EFFECT THAT THE SALE OF THE SECURITIES REPRESENTED HEREBY IS BEING MADE IN COMPLIANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT.”

If any Series 9 Debentures are being sold or transferred outside the United States in compliance with the requirements of Rule 904 of Regulation S under the U.S Securities Act, the legend may be removed by providing a declaration to the Trustee to the following effect (or as the Corporation may prescribe from time to time),

“The undersigned (A) acknowledges that the sale of the _____ Debentures, represented by certificate numbers _____ to which this declaration relates is being made in reliance on Rule 904 of Regulation S under the United States Securities Act of 1933, as amended (the “**U.S. Securities Act**”) and (B) certifies that (1) it is not an “affiliate” (as defined in Rule 405 under the U.S. Securities Act) of Toronto Hydro Corporation, (2) the offer of such Debentures was not made to a person in the United States and at the time the buy order was originated, the buyer was outside the United States, or the seller and any person acting on its behalf reasonably believe that the buyer was outside the United States and (3) neither the seller, nor any affiliate of the seller, nor any person acting on its or their behalf engaged in any directed selling efforts in connection with the offer and sale of such Debentures. Terms used herein have the meanings given to them by Regulation S under the U.S. Securities Act.”

If any Series 9 Debentures are being sold or transferred pursuant to Rule 144 of the U.S. Securities Act, the legend may be removed by delivery to the Trustee of a written opinion of Trustee Counsel to the effect that such legend is no longer required under applicable requirements of the U.S. Securities Act or state securities laws.

Prior to the issuance of Series 9 Debentures, the Corporation shall notify the Trustee, in writing, concerning which Series 9 Debentures are to be certificated and are to bear the legend described above. The Trustee will thereafter maintain a list of all registered holders from time to time of legended Series 9 Debentures.

2.9 Signatures on Series 9 Debentures

The Series 9 Debentures shall be signed in accordance with the provisions of Section 2.6 of the Trust Indenture.

2.10 Certification

- (a) No Series 9 Debenture issued shall be obligatory or shall entitle the Holder of such Series 9 Debenture to the benefits of this Tenth Supplemental Trust Indenture until it has been certified by manual signature by or on behalf of the Trustee by execution of the certificate of the Trustee appended thereto substantially in the form set out in Schedule 1 hereto, or in some other form approved by the Trustee, whose approval shall be conclusively evidenced by the Trustee's execution of the certificate. Such certificate on any Series 9 Debenture shall be conclusive evidence that such Series 9 Debenture is duly issued and is a valid and binding obligation of the Corporation and that the Holder of such Series 9 Debenture is entitled to the benefits of the Trust Indenture, as supplemented by this Tenth Supplemental Trust Indenture, and such Series 9 Debenture.
- (b) The certificate of the Trustee on any Series 9 Debenture shall not be construed as a representation or warranty by the Trustee as to the validity of this Tenth Supplemental Trust Indenture or of the Series 9 Debentures (except the due certification thereof and any other warranties implied by law) and the Trustee shall in no respect be liable or answerable for the use made of the Series 9 Debentures or any of them or the proceeds thereof.

2.11 Location of Register

With respect to the Series 9 Debentures, initially the Register referred to in Section 3.1 of the Trust Indenture shall be kept by the Trustee at the Corporate Trust Office and may thereafter be kept by the Trustee in such other place as the Corporation, with the approval of the Trustee, may designate.

2.12 Additional Amounts

The Corporation will not be required to pay an additional amount on the Series 9 Debentures in respect of any tax, assessment or government charge that is required by law to be withheld or deducted by it.

2.13 Trustees, etc.

The Trustee will be the Paying Agent and the Registrar for the Series 9 Debentures.

SECTION 3 MISCELLANEOUS

3.1 Acceptance of Trust

The Trustee accepts the trusts in this Tenth Supplemental Trust Indenture and agrees to carry out and discharge the same upon the terms and conditions set out in this Tenth Supplemental Trust Indenture and in accordance with the Trust Indenture.

3.2 Confirmation of Trust Indenture

The Trust Indenture as amended and supplemented by this Tenth Supplemental Trust Indenture is in all respects confirmed.

3.3 Counterparts

This Tenth Supplemental Trust Indenture may be executed in counterparts, each of which so executed shall be deemed to be original and such counterparts together shall constitute one and the same instrument.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF the parties hereto have executed this Tenth Supplemental Trust Indenture under the hands of their proper signatories in that behalf:

TORONTO HYDRO CORPORATION

By: Anthony Haines
Name: Anthony Haines
Title: President and
Chief Executive Officer

By: Jean-Sebastien Couillard
Name: Jean-Sebastien Couillard
Title: Chief Financial Officer

BNY TRUST COMPANY OF CANADA

By: Ismail Bawa
Name: Ismail Bawa
Title: Authorized Signatory

Schedule 1 – FORM OF GLOBAL DEBENTURE-SERIES 9

This Debenture is a Global Debenture within the meaning of the Trust Indenture hereinafter referred to and is registered in the name of a Depository or a nominee thereof. Unless this Debenture is presented by an authorized representative of CDS Clearing and Depository Services Inc. (“CDS”) to Toronto Hydro Corporation or its agent for registration of transfer, exchange or payment, and any debenture issued in respect thereof is registered in the name of CDS & CO., or in such other name as is requested by an authorized representative of CDS (and any payment is made to CDS & CO. or to such other entity as is requested by an authorized representative of CDS), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL since the registered holder hereof, CDS & CO., has a property interest in the securities represented by this debenture herein and it is a violation of its rights for another person to hold, transfer or deal with this debenture.

No. 9-000

\$●

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)
●% SENIOR UNSECURED DEBENTURES DUE 20● (SERIES 9)

ISIN CA 89119ZAF05
CUSIP 89119ZAF0

Issue Date	●, 2013
Stated Maturity	●, 20●
Interest Rate Per Annum	●%
Interest Payment Dates	● and ● in each year
Initial Interest Payment Date	●, 2013
Principal Amount	\$●

TORONTO HYDRO CORPORATION (the “**Corporation**”) for value received hereby promises to pay to the registered holder hereof on the Stated Maturity, or on such earlier date as the Principal Amount (or a portion thereof) may become due in accordance with the provisions of the Trust Indenture (as defined below), on presentation and surrender of this ●% Senior Unsecured Debenture due ●, 20● (Series 9) (the “**Series 9 Debenture**”), the Principal Amount in lawful money of Canada at the office of the Trustee (as defined below) at 11th Floor, 320 Bay Street, Toronto, Ontario M5H 4A6, and to pay interest on the Principal Amount at the Interest Rate Per Annum from and including the later of the Issue Date and the last Interest Payment Date on which interest has at that time most recently been paid on this Series 9 Debenture, at the

address of the registered holder hereof appearing on the register of Series 9 Debentures maintained by or at the direction of the Trustee (the “**Register**”), in like money semi-annually in arrears, in equal instalments on the Interest Payment Dates in each year, and if the Corporation at any time defaults in the payment of any principal or interest, to pay interest on the amount in default at the same rate, in like money, on demand, at the address of the registered holder hereof appearing on the Register. The Corporation will (i) on the day that is each Interest Payment Date, make payment by a wire transfer, or (ii) on the day that is two Business Days before each Interest Payment Date, forward or cause to be forwarded a cheque by same day delivery, to the address of the registered holder hereof appearing on the Register for interest due and payable to such holder on such Interest Payment Date, less any taxes required by law to be deducted or withheld, made payable to the order of such holder; provided, however that in case of payment of interest at maturity or redemption or as otherwise provided in the Trust Indenture, the time for payment of interest, less any such taxes, may at the option of the Corporation be determined based on the time that the certificate representing this Series 9 Debenture is presented and surrendered to the Trustee. The payment by such wire transfer or forwarding of such cheque (provided such cheque is paid on presentation) will satisfy and discharge the liability for interest upon such Series 9 Debenture to the extent of the sum represented thereby (plus the amount of any taxes deducted or withheld as aforesaid).

This Series 9 Debenture is one of an authorized issue of debentures designated as ●% Senior Unsecured Debentures due ●, 20● (Series 9) and forming the series of debentures created and issued under a tenth supplemental trust indenture made as of ●, 2013 (the “**Tenth Supplemental Trust Indenture**”) to a trust indenture (the “**Indenture**”) made as of May 7, 2003, between the Corporation and BNY Trust Company of Canada (successor trustee of CIBC Mellon Trust Company) (the “**Trustee**”), as Trustee (the first supplemental trust indenture to the Indenture made as of May 7, 2003 between the Corporation and the Trustee, the second supplemental trust indenture to the Indenture made as of November 14, 2007 between the Corporation and the Trustee, the third supplemental trust indenture to the Indenture made as of November 12, 2009 between the Corporation and the Trustee, the fourth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the fifth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the sixth supplemental trust indenture to the Indenture made as of May 20, 2010 between the Corporation and the Trustee, the seventh supplemental trust indenture to the Indenture made as of September 20, 2011 between the Corporation and the Trustee, the eighth supplemental trust indenture to the Indenture made as of November 18, 2011 between the Corporation and the Trustee, the ninth supplemental trust indenture to the Indenture made as of April ●, 2013 between the Corporation and the Trustee, the Tenth Supplemental Trust Indenture and the Indenture (as amended, supplemented or restated from time to time) are collectively referred to herein as the “**Trust Indenture**”). The Trust Indenture specifies the terms and conditions upon which the Series 9 Debentures are created and issued or may be created, issued and held and the rights of the registered holders of the Series 9 Debentures, the Corporation and the Trustee, all of which terms and conditions are incorporated by reference in this Series 9 Debenture and to each of which the registered holder of this Series 9 Debenture, by acceptance hereof, agrees.

The aggregate principal amount of Series 9 Debentures that may be created and issued under the Trust Indenture is limited to \$● in lawful money of Canada. Series 9 Debentures are issuable as fully registered debentures in denominations of \$1,000 and integral multiples thereof

and, subject to the terms and conditions set forth in the Trust Indenture, are issued as book entry only debentures.

The Series 9 Debentures are direct unsecured obligations of the Corporation and will rank equally with each other and with all other debentures of every other series from time to time issued and outstanding pursuant to the Trust Indenture and, except to the extent prescribed by law, with all other unsecured and unsubordinated Indebtedness of the Corporation.

This Series 9 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole at any time, or in part at any time and from time to time, prior to ●, 20●, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to the greater of the Canada Yield Price (as defined in the Trust Indenture) and par, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

This Series 9 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole, but not in part, at any time on or after ●, 20●, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to 100% of the Principal Amount of the Series 9 Debentures outstanding, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

At any time when the Corporation is not in default under the Trust Indenture, the Corporation may, subject to the terms and conditions set forth in the Trust Indenture, purchase Series 9 Debentures in the open market, by tender or by private contract, at any price. Series 9 Debentures purchased by the Corporation shall be cancelled and not reissued.

The Principal Amount may become or be declared due before the Stated Maturity on the conditions, in the manner, with the effect and at the times set forth in the Trust Indenture.

The Trust Indenture contains provisions for the holding of meetings of registered holders of debentures issued by the Corporation pursuant to the Trust Indenture and the making of resolutions at such meetings and the creation of instruments in writing signed by the registered holders of a specified majority of debentures issued and outstanding pursuant to the Trust Indenture. Such resolutions and instruments will be binding on and may affect the rights and entitlements of all holders of debentures issued by the Corporation pursuant to the Trust Indenture, subject to the provisions of the Trust Indenture.

This Series 9 Debenture may be transferred only upon compliance with the conditions prescribed in the Trust Indenture relating to the transfer of a Global Debenture (as defined in the Trust Indenture), and upon compliance with such reasonable requirements as the Trustee or other registrar may prescribe, and such transfer shall be duly noted hereon by the Trustee or other registrar.

This Series 9 Debenture shall not become obligatory for any purpose until it shall have been certified by the manual signature of the Trustee in accordance with the Trust Indenture.

IN WITNESS WHEREOF TORONTO HYDRO CORPORATION has caused this Series 9 Debenture to be signed by its ● and its ●.

TORONTO HYDRO CORPORATION

By: _____
Name: ●
Title: ●

By: _____
Name: ●
Title: ●

(FORM OF TRUSTEE'S CERTIFICATE)

This Debenture is one of the Series 9 Debentures referred to in the Trust Indenture referred to above.

BNY TRUST COMPANY OF CANADA

Trustee

By: _____
Authorized Signatory

(FORM OF REGISTRATION PANEL)

(NO WRITING HEREON EXCEPT BY THE TRUSTEE OR OTHER REGISTRAR)

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)

●% SENIOR UNSECURED DEBENTURES DUE 20● (SERIES 9)

ISIN CA 89119ZAF05
CUSIP 89119ZAF0

DATE OF REGISTRATION	IN WHOSE NAME REGISTERED	AMOUNT OF DECREASE	AMOUNT OF INCREASE	AMOUNT OF SERIES 9 DEBENTURES OUTSTANDING FOLLOWING CHANGE	SIGNATURE OF TRUSTEE OR OTHER REGISTRAR

Schedule 2 – U.S. FORM OF DEFINITIVE DEBENTURE-SERIES 9

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “U.S. SECURITIES ACT”) OR UNDER ANY STATE SECURITIES LAWS. THE HOLDER HEREOF, BY PURCHASING SUCH SECURITIES, AGREES FOR THE BENEFIT OF THE CORPORATION THAT SUCH SECURITIES MAY BE OFFERED, SOLD OR OTHERWISE TRANSFERRED ONLY (A) TO THE CORPORATION, (B) OUTSIDE THE UNITED STATES IN ACCORDANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT, OR (C) INSIDE THE UNITED STATES IN ACCORDANCE WITH (1) RULE 144A UNDER THE U.S. SECURITIES ACT OR (2) RULE 144 UNDER THE U.S. SECURITIES ACT, IF AVAILABLE OR (3) IN COMPLIANCE WITH CERTAIN OTHER PROCEDURES SATISFACTORY TO THE CORPORATION. A NEW CERTIFICATE, BEARING NO LEGEND, DELIVERY OF WHICH WILL CONSTITUTE “GOOD DELIVERY” MAY BE OBTAINED FROM BNY TRUST COMPANY OF CANADA UPON DELIVERY OF THIS CERTIFICATE AND A DULY EXECUTED DECLARATION, IN A FORM SATISFACTORY TO BNY TRUST COMPANY OF CANADA AND THE CORPORATION, TO THE EFFECT THAT THE SALE OF THE SECURITIES REPRESENTED HEREBY IS BEING MADE IN COMPLIANCE WITH RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT.

No. 9-000

\$●

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)
●% SENIOR UNSECURED DEBENTURES DUE ● (SERIES 9)

Issue Date	●, 2013
Stated Maturity	●, 20●
Interest Rate Per Annum	●%
Interest Payment Dates	● and ● in each year
Initial Interest Payment Date	●, 2013
Principal Amount	\$●

TORONTO HYDRO CORPORATION (the “**Corporation**”) for value received hereby promises to pay to the registered holder hereof on the Stated Maturity, or on such earlier date as the Principal Amount (or a portion thereof) may become due in accordance with the provisions of the Trust Indenture (as defined below), on presentation and surrender of this ●% Senior Unsecured Debenture due ●, 20● (Series 9) (the “**Series 9 Debenture**”), the Principal Amount in lawful money of Canada at the office of the Trustee (as defined below) at 11th Floor, 320 Bay Street, Toronto, Ontario M5H 4A6, and to pay interest on the Principal Amount at the Interest

Rate Per Annum from and including the later of the Issue Date and the last Interest Payment Date on which interest has at that time most recently been paid on this Series 9 Debenture, at the address of the registered holder hereof appearing on the register of Series 9 Debentures maintained by or at the direction of the Trustee (the “**Register**”), in like money semi-annually in arrears, in equal instalments on the Interest Payment Dates in each year, and if the Corporation at any time defaults in the payment of any principal or interest, to pay interest on the amount in default at the same rate, in like money, on demand, at the address of the registered holder hereof appearing on the Register. The Corporation, on the day that is two Business Days before each Interest Payment Date, will forward or cause to be forwarded by same day delivery to the address of the registered holder hereof appearing on the Register a cheque for interest due and payable to such holder on such Interest Payment Date, less any taxes required by law to be deducted or withheld, made payable to the order of such holder; provided, however that in case of payment of interest at maturity or redemption or as otherwise provided in the Trust Indenture, the time for payment of interest, less any such taxes, may at the option of the Corporation be determined based on the time that the certificate representing this Series 9 Debenture is presented and surrendered to the Trustee. The forwarding of such cheque will satisfy and discharge the liability for interest upon such Series 9 Debenture to the extent of the sum represented thereby (plus the amount of any taxes deducted or withheld as aforesaid) unless such cheque is not paid on presentation.

This Series 9 Debenture is one of an authorized issue of debentures designated as ●% Senior Unsecured Debentures due ●, 20● (Series 9) and forming the series of debentures created and issued under a tenth supplemental trust indenture made as of ●, 2013 (the “**Tenth Supplemental Trust Indenture**”) to a trust indenture (the “**Indenture**”) made as of May 7, 2003, between the Corporation and BNY Trust Company of Canada (successor trustee of CIBC Mellon Trust Company) (the “**Trustee**”), as Trustee (the first supplemental trust indenture to the Indenture made as of May 7, 2003 between the Corporation and the Trustee, the second supplemental trust indenture to the Indenture made as of November 14, 2007 between the Corporation and the Trustee, the third supplemental trust indenture to the Indenture made as of November 12, 2009 between the Corporation and the Trustee, the fourth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the fifth supplemental trust indenture to the Indenture made as of April 1, 2010 between the Corporation and the Trustee, the sixth supplemental trust indenture to the Indenture made as of May 20, 2010 between the Corporation and the Trustee, the seventh supplemental trust indenture to the Indenture made as of September 20, 2011 between the Corporation and the Trustee, the eighth supplemental trust indenture to the Indenture made as of November 18, 2011 between the Corporation and the Trustee, the ninth supplemental trust indenture to the Indenture made as of April ●, 2013 between the Corporation and the Trustee, the Tenth Supplemental Trust Indenture and the Indenture (as amended, supplemented or restated from time to time) are collectively referred to herein as the “**Trust Indenture**”). The Trust Indenture specifies the terms and conditions upon which the Series 9 Debentures are created and issued or may be created, issued and held and the rights of the registered holders of the Series 9 Debentures, the Corporation and the Trustee, all of which terms and conditions are incorporated by reference in this Series 9 Debenture and to each of which the registered holder of this Series 9 Debenture, by acceptance hereof, agrees.

The aggregate principal amount of Series 9 Debentures that may be created and issued under the Trust Indenture is limited to \$● in lawful money of Canada. Series 9 Debentures are issuable as fully registered debentures in denominations of \$1,000 and integral multiples thereof.

The Series 9 Debentures are direct unsecured obligations of the Corporation and will rank equally with each other and with all other debentures of every other series from time to time issued and outstanding pursuant to the Trust Indenture and, except to the extent prescribed by law, with all other unsecured and unsubordinated Indebtedness of the Corporation.

This Series 9 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole at any time, or in part at any time and from time to time, prior to ●, 20●, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to the greater of the Canada Yield Price (as defined in the Trust Indenture) and par, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

This Series 9 Debenture is redeemable, at the option of the Corporation when not in default under the Trust Indenture, in whole, but not in part, at any time on or after ●, 20●, subject to the terms and conditions set forth in the Trust Indenture, at a price equal to 100% of the Principal Amount of the Series 9 Debentures outstanding, together with accrued and unpaid interest to (but excluding) the date fixed for redemption.

At any time when the Corporation is not in default under the Trust Indenture, the Corporation may, subject to the terms and conditions set forth in the Trust Indenture, purchase Series 9 Debentures in the open market, by tender or by private contract, at any price. Series 9 Debentures purchased by the Corporation shall be cancelled and not reissued.

The Principal Amount may become or be declared due before the Stated Maturity on the conditions, in the manner, with the effect and at the times set forth in the Trust Indenture.

The Trust Indenture contains provisions for the holding of meetings of registered holders of debentures issued by the Corporation pursuant to the Trust Indenture and the making of resolutions at such meetings and the creation of instruments in writing signed by the registered holders of a specified majority of debentures issued and outstanding pursuant to the Trust Indenture. Such resolutions and instruments will be binding on and may affect the rights and entitlements of all holders of debentures issued by the Corporation pursuant to the Trust Indenture, subject to the provisions of the Trust Indenture.

This Series 9 Debenture may be transferred only upon compliance with the conditions prescribed in the Trust Indenture by the registered holder hereof or the holder's legal representative or attorney duly appointed by an instrument in form and execution satisfactory to the Trustee, and upon compliance with such reasonable requirements as the Trustee or other registrar may prescribe, and such transfer shall be duly noted hereon by the Trustee or other registrar.

This Series 9 Debenture shall not become obligatory for any purpose until it shall have been certified by the manual signature of the Trustee in accordance with the Trust Indenture.

IN WITNESS WHEREOF TORONTO HYDRO CORPORATION has caused this Series 9 Debenture to be signed by its ● and its ●.

TORONTO HYDRO CORPORATION

By: _____
Name: ●
Title: ●

By: _____
Name: ●
Title: ●

(FORM OF TRUSTEE'S CERTIFICATE)

This Debenture is one of the Series 9 Debentures referred to in the Trust Indenture referred to above.

BNY TRUST COMPANY OF CANADA

Trustee

By: _____
Authorized Signatory

(FORM OF REGISTRATION PANEL)

(NO WRITING HEREON EXCEPT BY THE TRUSTEE OR OTHER REGISTRAR)

TORONTO HYDRO CORPORATION
(Incorporated under the laws of Ontario)

●% SENIOR UNSECURED DEBENTURES DUE 20● (SERIES 9)

DATE OF REGISTRATION	IN WHOSE NAME REGISTERED	SIGNATURE OF TRUSTEE OR OTHER REGISTRAR

1 **RATING AGENCY REPORTS**

2

3 In accordance with section 2.4.3 of the OEB's Filing Requirements (July 17, 2013), this
4 schedule includes the following rating agency reports:

- 5 • Appendix A: Standard and Poor's, 8 May 2014; and
6 • Appendix B: DBRS, 13 May 2014.

RatingsDirect®

Summary:

Toronto Hydro Corp.

Primary Credit Analyst:

Stephen R Goltz, Toronto (1) 416-507-2592; stephen.goltz@standardandpoors.com

Secondary Contact:

Andrew Ng, Toronto 416.507.2545; andrew.ng@standardandpoors.com

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Financial Risk

Liquidity

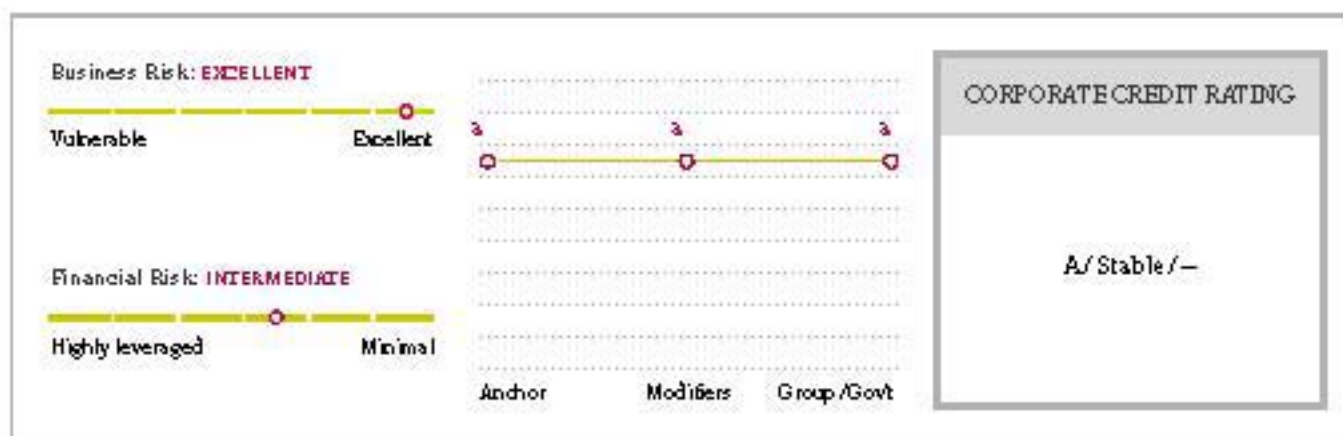
Other Modifiers

Ratings Score Snapshot

Related Criteria And Research

Summary:

Toronto Hydro Corp.



Rationale

Business Risk: Excellent	Financial Risk: Intermediate
<ul style="list-style-type: none"> Transparent, predictable and stable regulatory regime No input cost risks, because tariffs allow the pass-through of major expenses to customers Stable customer base with no meaningful customer concentration risk 	<ul style="list-style-type: none"> Stable regulated cash flow Sizable capital programs related to aging infrastructure High leverage

Outlook: Stable

The stable outlook reflects Standard & Poor's Ratings Services' expectation that Toronto Hydro Corp. will continue to focus on the regulated utility business, which provides a stable and predictable stream of cash flow during our two-year outlook horizon. In addition, we believe the company will manage its capital expenditure cost to be within the approved amount set forth by the Ontario Energy Board (OEB) and maintain the deemed capital structure.

Downside scenario

We could downgrade the rating as a result of a material adverse regulatory decision, severe operational inefficiencies, or other changes that we believe might lead to long-term financial deterioration resulting in adjusted funds from operations [AFFO]-to-debt falling below 13%.

Upside scenario

We could upgrade the rating if we expect Toronto Hydro to demonstrate sustainable long-term financial growth or to improve its financial position that results in AFFO-to-debt of 23%-25%. This could require the utility to deviate from its financial policy, which we believe is highly unlikely. As a result, the prospect of an upgrade is limited during our two-year outlook horizon.

Standard & Poor's Base-Case Scenario

The key drivers in our analysis continue to be the regulatory framework and the performance of the utility operator within the regulatory framework.

Assumptions	Key Metrics			
<ul style="list-style-type: none">• The regulatory system will be stable and Toronto Hydro will not experience any material, adverse regulatory decisions• The utility will earn a standard return on equity of approximately 9.58%, operate within the deemed capital structure with 60% debt, and not spend any unapproved capital• The company will have its rate base reset in 2015 under the new custom incentive rate-making (IR) method	2013A	2014E	2015E	
	AFFO/debt	16.7%	13%-16%	13%-15%
	AFFO/interest	3.68x	3.3x-4.0x	3.3x-4.0x
	AFFO--Adjusted funds from operations. A--Actual. E--Estimate.			

Business Risk: Excellent

In our view, Toronto Hydro's business risk profile is "excellent." The main positive driver continues to be the OEB. The

regulator continues to provide a transparent regulatory framework that supports a stable and predictable cash flow model, which we view as a key credit strength. Historically, electricity rates are established under a cost-of-service framework with rates for subsequent three years under an incentive-rate mechanism. In 2012, the OEB proposed additional alternatives to electricity rate settings. We believe Toronto Hydro will adapt the custom IR method to reflect the revenue requirement based on the large multiyear capital programs the company is committed to in the next few years. Toronto Hydro most recently had its cost-of-service hearing in 2011 and is scheduled for a rate reset in 2015. The regulatory framework also limits the utility's exposure to commodity risk and associated cash flow volatility because price fluctuations in the commodity flow through directly to customers.

Further supporting the excellent business risk profile is Toronto Hydro's large and diverse customer base with no meaningful concentration risk. Residential and small businesses account for more than 90% of the total. In our view this customer profile is less sensitive to macroeconomic stress and business cycles. Nevertheless, the residential customer base has some sensitivity to volume fluctuations, primarily weather-driven, although we do not believe the fluctuations would pressure credit metrics at the rating. We do not expect Toronto Hydro's customer composition to change materially over the next two-year horizon.

We believe the utility carries relatively low operating risk because it has no obligation to ensure an adequate supply of electricity and is not burdened with the procurement process or power purchase agreement, which reduces operating risks. We expect operational efficiency and reliability to remain within provincial industry norms to avoid regulatory risk linked to poor sustained performance.

Financial Risk: Intermediate

When evaluating the "intermediate" financial risk profile for Toronto Hydro, we take into the consideration of the company's lower-risk regulated business model and apply the low-volatility table. We expect the utility will continue generating stable cash flow, a key credit strength. The company has large capital programs in the next few years and relies on the combination of internal FFO and external debt to fund these capital expenditures. As a result, this has a downward pressure on the credit metrics, especially the AFFO-to-debt metric. However we believe the company will be able to maintain the AFFO-to-debt metric above the 13% threshold.

To further support the intermediate financial profile risk is that we expect Toronto Hydro to maintain its deemed capital structure established by the regulator, which includes about 60% debt. Furthermore, the company has a C\$400 million commercial paper (CP) program with C\$150 million outstanding. Supporting the CP program are liquidity facilities available under the utility's C\$600 million revolving credit facility; hence, available borrowing under the credit facility is reduced by the amount of CP outstanding. In our opinion, the credit facility provides sufficient backup liquidity to protect Toronto Hydro in the event the company is unable to roll over the maturing paper with new notes.

Liquidity: Adequate

In our view, Toronto Hydro's liquidity "adequate". The company has sufficient liquidity sources to cover more than 1.1x its uses. Moreover, in the event of a 10% EBITDA decline, Toronto Hydro's sources of funds would still exceed its

uses. In our opinion, the company has sound relationships with its banks, generally satisfactory standing in credit markets and generally prudent financial risk management.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> • FFO of approximately C\$290 million • Undrawn committed credit facility of C\$450 million expiring in October 2018, and two smaller facilities with total capacity of C\$95 million, of which C\$26 million is available 	<ul style="list-style-type: none"> • A broad range of capital spending in 2014 that is estimated in the range of C\$280 million to C\$540 million • CP of C\$150 million that matures in 2014 • Cash dividends of approximately C\$61 million

Covenants

We expect Toronto Hydro to maintain sizable headroom below its 75% debt-to-capital covenant.

Other Modifiers

The modifying factors had no impact on the rating.

Ratings Score Snapshot

Corporate Credit Rating

A/Stable/--

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: a

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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Rating Report

Report Date:
May 13, 2014

Previous Report:
October 28, 2013

EB-2014-0166

Toronto Hydro-Electric System Limited
Exhibit 1C
Tab 4
Schedule 7
Appendix B
ORIGINAL
(10 pages)



Insight beyond the rating.

Toronto Hydro Corporation

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The Company
Toronto Hydro Corporation (THC) is a holding company with the following subsidiaries: Toronto Hydro-Electric System Limited, which distributes electricity and engages in Conservation and Demand Management activities; and Toronto Hydro Energy Services Inc., which provides street lighting services. THC's sole shareholder is the City of Toronto (rated AA).

Recent Actions
November 25, 2013
Commercial Paper Rating Assigned; Short-Term Rating Discontinued

Rating

Debt	Rating	Rating Action	Trend
Issuer Rating	A (high)	Confirmed	Stable
Senior Unsecured Debentures & MTNs	A (high)	Confirmed	Stable
Commercial Paper	R-1 (low)	Confirmed	Stable

Rating Update

DBRS has confirmed the ratings of Toronto Hydro Corporation (THC or the Company), as listed above. The rating confirmation reflects THC's low business risk profile and reasonable financial risk profile. However, THC faces financial challenges due to its aging infrastructure replacement program that could pressure its balance sheet. DBRS views leverage rising above the regulatory capital structure as high for the current rating category and could potentially trigger a negative rating action.

THC's business risk profile is supported by a reasonable regulatory environment in Ontario and stable earnings from regulated business accounting for virtually all of the Company's earnings and cash flow. The regulatory framework for distribution utilities in Ontario is shifting from the current third-generation incentive regulatory mechanism (IRM) to the renewed regulatory framework. Under Ontario Energy Board's (OEB) renewed regulatory framework, the Company's electricity distribution business (LDC) is expected to file under custom incentive regulation (CIR) in Q3 2014 for rates effective 2015 to 2019. DBRS views CIR as well-suited to distributors such as THC with large, broad, multi-year capital investments that require certainty of funding in advance, as capex decisions will be driven by pre-approval from the OEB. Given that CIR is new and the forecasting period is five years (compared to three years under the earlier framework), THC's cash flow could be affected if the LDC is unable to recover large unforeseen discrepancies between forecasts and actual capex and operating expenses in a timely manner. The current rating is based on DBRS's expectation that the implementation of the renewed regulatory framework in Ontario will not have a material impact on the credit profile of THC.

THC's financial metrics are currently commensurate with an "A" rating range. However, financial metrics could weaken and may not be commensurate with the current ratings, as significant capital expenditure is needed to replace the Company's aging infrastructure (approximately \$400 million approved by OEB for 2014), resulting in higher free cash flow deficits. In recent years, THC has funded these deficits with a combination of asset sales and debt, maintaining leverage close to the regulatory capital structure (60% debt to 40% equity). DBRS is concerned that the rising leverage could pressure Company's balance sheet as cash balances have been depleted, and going forward it will likely depend entirely on debt due to its limited access to equity markets. DBRS will monitor regulatory developments subsequent to the Company's CIR filings in Q3 2014 and OEB approval expected in Q2 2015, with a view to a potential negative rating action should leverage exceed the regulatory capital structure.

Rating Considerations

Strengths

- (1) Reasonable regulatory environment
- (2) Strong franchise area
- (3) Reasonable financial profile

Challenges

- (1) Balance sheet pressure due to high capex
- (2) Earnings sensitive to volume
- (3) Limited access to equity markets

Financial Information

Toronto Hydro Corporation (CA\$ millions where applicable)	2013	2012	2011	2010	2009
EBIT gross interest coverage	2.50	2.44	2.16	2.10	1.73
Total debt in capital structure (1)	57.6%	57.2%	59.7%	58.5%	55.4%
Cash flow/Total debt	18.6%	16.3%	19.5%	17.9%	18.3%
(Cash flow-dividends)/Capex (times)	0.62	0.63	0.58	0.58	0.79
Net income before non-recurring items	112	105	93	61	43
Cash flow from operations	301	239	287	253	222

(1) Including operating leases. (2) 2011 to 2013 financials based on USGAAP.

Toronto Hydro Corporation

Report Date:
May 13, 2014

Rating Considerations

Strengths

(1) **Reasonable regulatory environment.** THC is predominantly a regulated electric distribution company that operates in a reasonable regulatory environment. The Company's regulated business model provides a high degree of stability to earnings and cash flow over the long term.

(2) **Strong franchise area.** THC is one of the largest municipally owned local distribution companies (LDCs) in Canada, serving a customer base of approximately 730,000 customers. Almost all of THC's electricity throughput is distributed to residential and general service customers, who account for 90% of the LDC's revenue (approximately 18% of the market in the Province of Ontario (rated AA (low))). Demand from these customers is relatively stable year over year, as they are less sensitive to economic cycles. Toronto is now the fourth-largest metropolitan area, by population, in North America.

(3) **Reasonable financial profile.** The Company's key credit metrics remain reasonable for its rating category. The confirmation incorporates DBRS's expectations that the Company remains committed to maintaining its debt-to-capital ratio in line with the LDC's regulatory 60% debt-to-40% equity structure, and that in the event that debt leverage rises above the regulated capital structure, the Company will take necessary measures to restore its structure to the 60% debt level in a timely manner.

Challenges

(1) **Balance sheet pressure due to high capex.** Significant capital expenditure is needed to replace the Company's aging infrastructure (approximately \$400 million approved by OEB for 2014; \$413 million spent in 2013), resulting in higher free cash flow deficits. In recent years, THC funded free cash flow deficits with a combination of proceeds from asset sales and debt, maintaining leverage close to the regulatory deemed capital structure (60% debt to 40% equity). However, as the Company's cash balances have been depleted, going forward it will need to depend entirely on debt to fund its cash flow deficits. DBRS is concerned that this might affect the Company's financial flexibility and its ability to maintain leverage in line with the LDC's deemed capital structure.

(2) **Earnings sensitive to volume.** Earnings and cash flow for electricity distribution companies are partially dependent on the volume of electricity sold, given that rates typically include a variable charge component. Seasonality, economic cyclicality and weather variability have a direct impact on the volume of electricity sold and, therefore, on revenue earned from electricity sales.

(3) **Limited access to equity markets.** THC's ownership structure (100% owned by the City of Toronto (the City; rated AA)) limits its ability to access the equity markets. As a result, THC's cash flow deficits are being financed largely through debt.

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Earnings and Outlook

(CA\$ millions where applicable)	For the year ended December 31				
	2013	2012	2011	2010	2009
Net Sales	578	577	587	549	504
EBITDA	323	332	325	326	295
EBIT	179	191	174	157	132
Gross interest expense	72	78	81	75	77
Earning before taxes	113	117	98	86	62
Net income before non-recurring items	112	105	93	61	43
Reported net income	121	86	96	66	42
Return on equity	9.5%	9.4%	8.7%	6.0%	4.3%
Rate base	2,298	2,298	2,298	2,141	2,035

(1) 2011 to 2013 financials based on USGAAP.

2013 Summary

- THC's earnings are supported by a reasonable regulatory environment and a strong franchise area with a diversified customer base.
- Net earnings before recurring items were higher due to lower operating costs resulting from cost reductions and staff restructuring in 2012, as well as lower financial charges.
- Reported net income was higher in 2013 due to: (1) OEB's January 2014 disposition of the smart meter deferral account balances, permitting the recovery of return on assets since 2008 and providing for a one-time, non-recurring gain of \$21 million in 2013, offset by higher operating expenses due to storm costs of \$10.2 million; and (2) lower net income in 2012, resulting from a non-recurring restructuring charge of \$27.8 million related to cost-reduction initiatives. DBRS has adjusted net sales and earnings to reflect these non-recurring items.

Electricity Throughputs (million kWh)	%	2013	2012	2011	2010	2009	2008	2007	2006
Residential	21%	5,073	5,174	5,204	5,209	5,037	5,216	5,332	5,352
General service	70%	17,027	17,206	17,148	17,318	16,855	17,415	17,837	17,583
Large users	10%	2,326	2,182	2,355	2,219	2,462	2,508	2,591	2,592
Total (million kWh)	100%	24,426	24,562	24,708	24,746	24,354	25,139	25,760	25,527
Growth in electricity throughputs		(0.6%)	(0.6%)	(0.2%)	1.6%	(3.1%)	(2.4%)	0.9%	(3.2%)

Customers	%	2013	2012	2011	2010	2009	2008	2007	2006
Residential	89%	648,380	637,910	629,049	620,501	611,357	605,509	601,515	599,080
General service	11%	81,137	80,699	80,222	79,836	78,840	78,589	78,349	78,978
Large users	0%	51	52	52	50	47	47	49	49
Total	100%	729,568	718,661	709,323	700,387	690,244	684,145	679,913	678,107
Growth in customer base		1.5%	1.3%	1.3%	1.5%	0.9%	0.6%	0.3%	0.2%

As of December 31, 2013

2014 Outlook

- 2014 is the final year the LDC will use a third-generation IRM (2012-2014). Under the IRM, the Company's earnings and ROE could be negatively affected if it is unable to meet the efficiency targets.

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Financial Profile and Outlook

(CA\$ millions where applicable)	For the year ended December 31				
	2013	2012	2011	2010	2009
Net income before non-recurring items	112	105	93	61	43
Depreciation & amortization	173	142	151	169	163
Deferred income taxes and other	16	(7)	43	22	16
Cash flow from operations	301	239	287	253	222
Dividends paid	(43)	(48)	(33)	(25)	(25)
Capital expenditures	(413)	(302)	(437)	(391)	(249)
Free cash flow (bef. working cap. changes)	(156)	(111)	(183)	(163)	(53)
Changes in non-cash work. cap. items	(45)	(4)	59	27	(31)
Changes in regulatory assets & liabilities	(20)	11	(66)	(16)	(59)
Net Free Cash Flow	(220)	(103)	(191)	(151)	(142)
Acquisitions & long-term investments	0	0	0	0	0
Short-term investments	0	34	(34)	50	0
Proceeds on asset sales	2	3	5	9	1
Net equity change	0	0	0	0	0
Net debt change	147	(2)	54	198	3
Other	(5)	(9)	(10)	13	9
Change in cash	(77)	(78)	(176)	119	(129)
Total debt	1,618	1,470	1,470	1,410	1,211
Cash and cash equivalents	0	77	154	330	211
Total debt in capital structure (1)	57.6%	57.2%	59.7%	58.5%	55.4%
Cash flow/Total debt	18.6%	16.3%	19.5%	17.9%	18.3%
EBIT gross interest coverage (times)	2.50	2.44	2.16	2.10	1.73
Dividend payout ratio	38.4%	45.6%	35.5%	40.8%	59.2%

(1) Including operating leases. (2) 2011 to 2013 financials based on USGAAP.

2013 Summary

- THC's financial profile and key credit metrics remained reasonable for the assigned rating category.
- Capex has been steadily rising due to the replacement of aging electricity infrastructure, resulting in free cash flow deficits. Capital expenditures for the Copeland project were \$43.5 million for 2013 (Total of \$60.5 million spent on the project). The deficit in 2013 was financed with debt and cash on hand.
- Dividends are paid as per policy adopted by the City, that THC will pay the greater of \$25 million per year (in segments throughout the year) or, if applicable, 50% of its consolidated net income for the year.

2014 Outlook

- In December 2013, the OEB approved a settlement agreement which correlates to the approval of capital expenditures amounting to \$398.8 million for 2014.
- In February 2014, THC commenced tunneling for the Copeland Station project. The total capital expenditure required for the project is expected to be approximately \$195 million.
- DBRS expects the Company to manage its balance sheet prudently, so that it continues to maintain its leverage in line with the LDC's deemed capital structure. Should leverage rise above the deemed capital structure (over 60%) or if key credit metrics weaken significantly, THC's financial profile could deteriorate to a level that is no longer commensurate with the current A (high) rating.
- It remains to be seen whether THC's dividend policy will be flexible should capex increase significantly, potentially weakening its financial profile.

Toronto Hydro Corporation

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Long-Term Debt Maturities and Bank Lines

(CA\$ millions)	Amount	Drawn/CPs/LOCs	Available	Expiry
Cash & Cash Equivalents	-	-	-	-
Revolving Credit Facility	600.0	150.0	450.0	Oct 10, 2018
Prudential Facility	75.0	50.1	24.9	Demand
Working Capital Facility	20.0	19.1	0.9	Demand
		Total	475.9	

As at December 31, 2013

- On September 6, 2013, Toronto Hydro extended its \$600 million committed credit facility by an additional year, to now mature in October 2018. As at December 31, 2013, \$150 million was drawn under this facility.
- On December 17, 2013, Toronto Hydro launched a Commercial Paper program (DBRS rated R-1 (low)) for \$400 million backstopped by its credit facility.
- The Company's liquidity profile remained strong and sufficient to cover all near- to medium-term obligations, with approximately \$477 million of available funds.
- THC also has a \$75 million Prudential Facility and \$20 million Working Capital Facility.

Debentures		
(CA\$ millions)	Maturity	Outstanding
Series 2 - 5.15%	Nov 14, 2017	250.0
Series 3 - 4.49%	Nov 12, 2019	250.0
Series 6 - 5.54%	May 21, 2040	200.0
Series 7 - 3.54%	Nov 18, 2021	300.0
Series 8 - 2.91%	Apr 10, 2023	250.0
Series 9 - 3.96%	Apr 9, 2063	200.0
Total debentures		1,450.0
Less: Current portion of debentures		(0.7)
Long-term portion of debentures		1,449.3

As at December 31, 2013

Debentures Maturities						
(CA\$ millions)	2014	2015	2016	2017	2018+	Total
Amount	-	-	-	250.0	1200.0	1450.0
% of Total	0.0%	0.0%	0.0%	17.2%	82.8%	100.0%

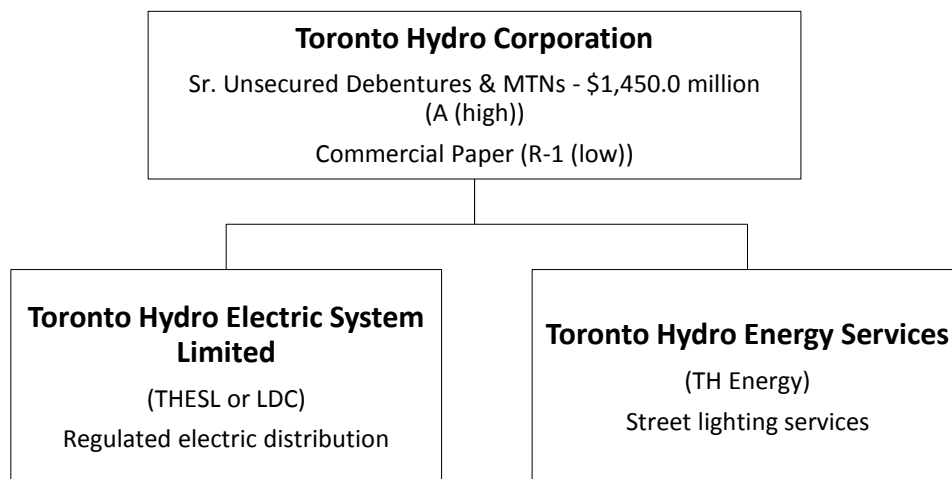
As at December 31, 2013

- Debt maturities are reasonably staggered and THC continues to have good access to debt capital markets. The Company has access to a base shelf prospectus filed on December 10, 2012, for the issuance of up to \$1.5 billion (approximately, \$1.05 billion available as at December 31, 2013), active for 25 months following this prospectus date.
- On April 9, 2013, THC issued \$250 million of 2.91% senior unsecured debentures due April 10, 2023 (Series 8), and \$200 million of 3.96% senior unsecured debentures due April 9, 2063 (Series 9). Net proceeds from the issuances were used to repay THC's Series 1 and Series 5 debentures, which matured on May 7, 2013, and May 6, 2013, respectively.

Toronto Hydro Corporation

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Corporate Structure



- THC is a holding company with the following two subsidiaries operating exclusively in the Toronto area:
 - Toronto Hydro Electric System Limited, one of the largest municipal distribution utilities in Canada, is responsible for regulated electricity distribution (99% of revenue).
 - Toronto Hydro Energy Services Inc., which has a contractual relationship with the City, owns and operates street lighting services (1% of revenue).
- Most of the energy produced in Ontario is generated by Ontario Power Generation Inc. (rated A (low)), then transmitted to THC's networks by Hydro One Inc. (rated A (high)). From there, THC distributes the power to its customers via overhead and underground lines.
- The Company currently employs approximately 1,540 people, has a peak load of approximately 5,000 megawatts and distributes electricity to approximately 730,000 customers (approximately 18% of the market in the Province of Ontario (rated AA (low))).

Regulation

- THC operates under a reasonable regulatory environment regulated by the OEB (refer to Page 8), whose mandate is to approve and set rates for the distribution and transmission of electricity, as set out by the *Electricity Act, 1998*.
- The LDC operates with a deemed capital structure of 60% debt (divided into 56% long-term and 4% short-term) and 40% equity, and an allowed ROE of 9.58%.
- For rate setting, the Company currently operates under the third-generation IRM framework for the 2012-2014 rate years.
- For 2015 and onward, THC is expected to operate under a CIR, which is a hybrid between cost of service (COS) and IRM (minimum five-year term). The rate setting for the term is based on distributor's forecasts and OEB's IR analysis, using productivity benchmarking.
- CIR is suited to distributors with large, broad, multi-year investment needs over a five-year period or more and distributors who require certainty of funding several years in advance.
- CIR requires THC to provide five-year histories and five-year forecasts, with emphasis on how the plan will vary from one application type to another. Benchmarking will likely include a combination of service quality, financial performance, asset management and Conservation and Demand Management (CDM) inflation factors. "Off-ramps" of +/- 300 basis points will be allowed and additional funding is available to compensate for unforeseen events costing over \$1 million.
- In January 2014, the OEB approved the disposition of balances in its smart meter deferral account related to installations in 2008, 2009 and 2010. The two new rate riders approved are effective May 1, 2014.
- In 2015, the LDC will be allowed to seek recovery for capital spent in 2012 and 2013 that has not yet been approved by the OEB in the current ICM decision, due to the standard operation of the regulatory model.

**Toronto Hydro
Corporation**

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Assessment of Regulatory Environment

Criteria	Score	Analysis
(1) Deemed Equity	Excellent Good Satisfactory Below Average Poor	The OEB allows LDC to have a deemed equity of 40%, which has been consistent historically.
(2) Allowed ROE	Excellent Good Satisfactory Below Average Poor	The OEB's allowed return on equity (ROE) for the LDC has been 9.58% in the past few years.
(3) Energy Cost Recovery	Excellent Good Satisfactory Below Average Poor	No power price risk, as the Company is allowed to pass through the entire cost of purchased power used by its customers.
(4) Capital Cost Recovery	Excellent Good Satisfactory Below Average Poor	Major capital costs are pre-approved by the OEB and added to rate base after project completion.
(5) COS vs. IRM	Excellent Good Satisfactory Below Average Poor	LDC is regulated under an incentive rate mechanism (IRM), with three years in between the COS rebasing year.

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Criteria	Score	Analysis
(6) Political Interference	Excellent Good Satisfactory Below Average Poor	After years of a relatively stable political and regulatory environment, the utility sector in Ontario could face growing challenges. As generation costs potentially rise above and ultimately test the political ceiling (10% increase of the total bill annually), it may be difficult for the utilities to pass costs onto the ratepayers.
(7) Retail Rate	Excellent Good Satisfactory Below Average Poor	Retail rates in Ontario are at the mid-range of rates in other Canadian provinces. Toronto Hydro's rates range between 11.2 cents/kWh to 13.5 cent/kWh on peak rates from May 2014. The economic environment in Ontario is stable (real GDP grew by 2.3% in 2013).
(8) Stranded Cost Recovery	Excellent Good Satisfactory Below Average Poor	Toronto Hydro has a limited history of stranded costs. Most prudently incurred or budgeted capital expenditures are approved by the OEB. DBRS notes that there can be some regulatory lag in the approval of capital expenditures under the renewed regulatory framework.
(9) Rate Freeze	Excellent Good Satisfactory Below Average Poor	From 2002 to 2005, due to rising rates during Ontario's experimental utility deregulation phase, a distribution rate freeze was imposed province-wide. There have been no subsequent province-wide rate freezes.
(10) Market Structure (Deregulation)	Excellent Good Satisfactory Below Average Poor	Electricity distribution in Ontario is largely regulated and the structure provides for stability and low risk associated with purchased energy costs and counterparty risk.

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Toronto Hydro Corporation
Balance Sheet

(CA\$ millions)

	<u>Dec. 31</u>	<u>Dec. 31</u>	<u>Dec. 31</u>		<u>Dec. 31</u>	<u>Dec. 31</u>	<u>Dec. 31</u>
Assets	2013	2012	2011	Liabilities & Equity	2013	2012	2011
Cash & equivalents	0	77	154	Bank indebtedness	169	0	0
Accounts receivable	203	175	183	Accounts payable	457	383	412
Inventories	9	8	7	Current portion L.T.D.	0	470	0
Unbilled revenue	327	278	262	Customer advanced deposits	37	40	40
Prepaid expenses & other	17	15	51	Deferred revenue	21	20	13
				Other current liab.	13	24	17
Total Current Assets	555	552	657	Total Current Liab.	696	938	483
Net fixed assets	2,664	2,527	2,399	Long-term debt	1,449	1,000	1,470
Future income tax assets	158	194	202	Deferred income taxes	175	193	200
Goodwill & intangibles	171	134	113	Provisions	237	249	241
Regulatory assets	234	120	143	Regulatory liabilities	5	4	3
Investments & others	14	12	12	Other L.T. liab.	16	16	27
				Shareholders' equity	1,219	1,140	1,102
Total Assets	3,798	3,539	3,528	Total Liab. & SE	3,798	3,539	3,528

For the year ended December 31
Liquidity & Capital Ratios

	2013	2012	2011	2010	2009
Current ratio	0.80	0.59	1.36	1.26	2.02
Total debt in capital structure	57.0%	56.3%	57.1%	57.6%	54.8%
Total debt in capital structure (1)	57.6%	57.2%	59.7%	58.5%	55.4%
Cash flow/Total debt	18.6%	16.3%	19.5%	17.9%	18.3%
Cash flow/Total debt (1)	18.2%	15.7%	17.6%	17.3%	17.9%
(Cash flow-dividends)/Capex (times)	0.62	0.63	0.58	0.58	0.79
Dividend payout ratio	38.4%	45.6%	35.5%	40.8%	59.2%

Coverage Ratios (times)

EBIT gross interest coverage	2.50	2.44	2.16	2.10	1.73
EBITDA gross interest coverage	4.50	4.25	4.03	4.37	3.86
Fixed-charges coverage	2.53	2.46	2.16	2.10	1.77
EBIT gross interest coverage (1)	2.51	2.46	2.24	2.13	1.76

Profitability Ratios

EBITDA margin	55.9%	57.5%	55.3%	59.4%	58.6%
EBIT margin	31.0%	33.0%	29.6%	28.5%	26.3%
Profit margin	19.4%	18.2%	15.9%	11.1%	8.4%
Return on equity	9.5%	9.4%	8.7%	6.0%	4.3%
Return on capital	5.9%	6.0%	5.6%	4.5%	4.1%

(1) Including operating leases. (2) 2011 to 2013 financials based on USGAAP.

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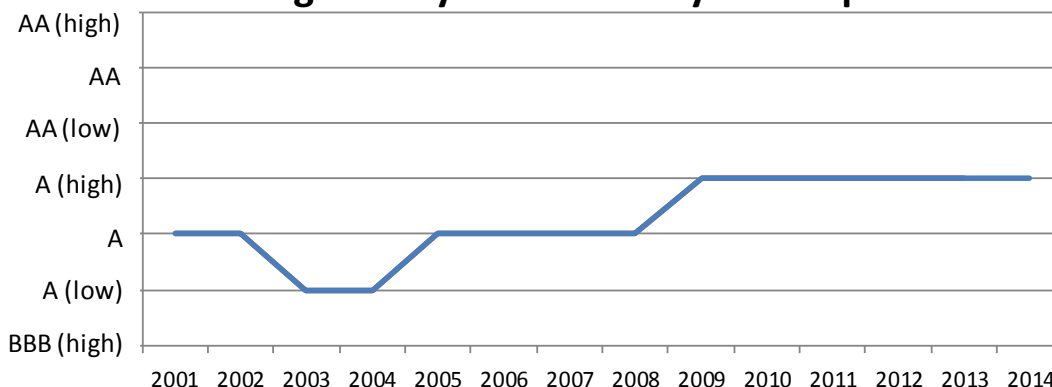
Rating

Debt	Rating	Rating Action	Trend
Issuer Rating	A (high)	Confirmed	Stable
Senior Unsecured Debentures & MTNs	A (high)	Confirmed	Stable
Commercial Paper	R-1 (low)	Confirmed	Stable

Rating History

	Current	2013	2012	2011	2009-2010
Issuer Rating	A (high)	A (high)	NR	NR	NR
Senior Unsecured Debentures & MTNs	A (high)	A (high)	A (high)	A (high)	A (high)
Commercial Paper	R-1 (low)	R-1 (low)	NR	NR	NR

Rating History of Toronto Hydro Corporation



Note:

All figures are in Canadian dollars unless otherwise noted.

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