



**ANNUAL INFORMATION FORM  
FOR THE YEAR ENDED DECEMBER 31, 2010**

March 31, 2011

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## **PART 1 - FORWARD-LOOKING INFORMATION**

The Corporation includes forward-looking information in this Annual Information Form (the "AIF") within the meaning of applicable securities laws in Canada ("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. All forward-looking information is given pursuant to the "safe harbour" provisions of applicable Canadian securities legislation. The words "anticipates", "believes", "budgets", "could", "estimates", "expects", "forecasts", "intends", "may", "might", "plans", "projects", "schedule", "should", "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 AIF includes, but is not limited to, statements regarding LDC's distribution revenue, the Corporation's plans to borrow funds to repay maturing Debentures and to finance the investment in LDC's infrastructure, the impact of current economic conditions and financial market volatility on the Corporation's consolidated results of operations, performance, business prospects and opportunities, the potential transfer of street lighting activities from TH Energy, the outcome of outstanding proceedings before the OEB, the effect of changes in interest rates on future revenue requirements and the Corporation's conversion to IFRS. 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, the Corporation's ability to borrow, and the impact of the conversion of IFRS on the Corporation's Consolidated Financial Statements.

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 7 "Risk Factors" in this AIF. Please review this Part 7 – "Risk Factors" in detail. The Corporation cautions that these risk factors are not exclusive.

All forward-looking information in the 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

"**2006 Rate Handbook**" refers to the Electricity Distribution Rate Handbook issued by the OEB in May 2005 and containing filing requirements and guidelines and setting out how the OEB generally intends to address applications for 2006 electricity distribution rates, as amended.

"**AcSB**" refers to Canadian Accounting Standards Board.

"**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 for the year ended December 31, 2010.

"**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. See note 11(b) to the Consolidated Financial Statements.

"**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, in each case, net of accumulated amortization. See note 3(f), note 3(g), note 5, and note 6 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.

"**CEO**" refers to the President and Chief Executive Officer of the Corporation.

"**CFO**" refers to the Chief Financial Officer of the Corporation.

"**City**" or "**City of Toronto**" refers to the city incorporated under the *City of Toronto Act, 1997* (Ontario) and comprised of the former municipalities of Metropolitan Toronto, Toronto, East York, Etobicoke, North York, Scarborough and York.

"**City Note**" refers to the promissory note dated May 7, 2003 in the principal amount of \$980,230,955 issued by the Corporation to the City of Toronto in consideration for the transfer by the City to the Corporation of the Replacement Note. See note 11(b) to the Consolidated Financial Statements.

"**Class Proceedings Act**" refers to the *Class Proceedings Act, 1992* (Ontario), as amended.

"**Consolidated Financial Statements**" refers to the audited consolidated balance sheets of the Corporation as at December 31, 2010 and the audited consolidated statements of retained earnings, income and cash flows of the Corporation for the year ended December 31, 2010, together with the auditors' report thereon and the notes thereto, copies of which are available on the SEDAR website at [www.sedar.com](http://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.

**"CTA"** refers to the *Corporations Tax Act* (Ontario), 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, and the 5.54% Series 6 Senior Unsecured Debentures issued by the Corporation on May 20, 2010. See note 11(a) 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.

**"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 Consumer Protection Act"** refers to the *Energy Consumer Protection Act, 2010* (Ontario), as amended.

**"Energy Competition Act"** refers to the *Energy Competition Act, 1998* (Ontario), as amended.

**"Environmental Protection Act"** refers to the *Environmental Protection Act, 1990* (Ontario), as amended.

**"ERM Program"** refers to the Corporation's Enterprise Risk Management Program.

**"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 and Green Economy 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.

**"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.

**"Initial Note"** refers to the promissory note dated July 1, 1999 in the principal amount of \$947,000,000 issued by LDC to the City 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. See note 11(b) to the Consolidated Financial Statements.

**"Interest Act"** refers to the *Interest Act* (Canada), as amended.

**"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"** refers to Management's Discussion and Analysis of Financial Condition and Results of Operations of the Corporation for the year ended December 31, 2010, a copy of which is available on the SEDAR website at [www.sedar.com](http://www.sedar.com).

**"Market Participants"** refers to persons authorized to participate in the wholesale market for electricity administered by the IESO, including generators, transmitters, distributors, retailers and consumers.

**"MED"** refers to major event days as defined by IEEE specification 1366.

**"MEU"** refers to municipal electricity utility.

**"Minister"** refers to the Province's Minister of Energy.

**"MTN Program"** refers to the medium term note program established by the Corporation in January 2006. See section 8.2 under the heading "Debentures".

**"MW"** refers to megawatt, a common measure of electrical power equal to one million watts.

**"Named Executive Officer"** or **"NEO"** refers to the individuals identified in section 10.2(a) under the heading "Summary Compensation Table".

**"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.

**"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 Ontario's wholesale and retail electricity markets to competition pursuant to the requirement under the Electricity Act that transmitters and distributors of electricity in Ontario provide generators, retailers and consumers with non-discriminatory access to their transmission and distribution systems. Open Access commenced on May 1, 2002.

**"OPG"** refers to Ontario Power Generation Inc.

**"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 Payment 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 taxes to the Ontario Electricity Financial Corporation. See note 3(b) note 3(p) and note 17 to the Consolidated Financial Statements.

**"Province"** refers to the Government of the Province of Ontario.

**"Replacement Note"** refers to the promissory note in the principal amount of \$980,230,955 issued by LDC to the City to replace the Initial Note effective January 1, 2000. The Replacement Note was transferred by the City to the Corporation on May 7, 2003 in consideration for the issuance by the Corporation to the City of the City Note. See note 11(b) to the Consolidated Financial Statements. The Replacement Note was amended and restated effective May 1, 2006 to conform to certain changes made under the Amended and Restated City Note (as the context requires, "Replacement Note" refers to the amended and restated Replacement Note dated May 1, 2006).

**"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.

**"ROE"** refers to return on equity.

**"RPP"** refers to the Regulated Price Plan created as a result of the Electricity Restructuring Act, as amended. The OEB has developed an RPP for residential, small business and certain other customers, which came into effect on April 1, 2005.

**"S&P"** refers to Standard & Poor's.

**"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](http://www.sedar.com).

**"Shareholder Direction"** refers to the Shareholder Direction adopted by the Council of the City of Toronto 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 Service"** refers to a 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 Customers"** refers to persons connected to a distributor's electricity 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 Code"** refers to the Standard Supply Service Code for Electricity Distributors that was published by the OEB in 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..

**"Time-of-Use"** refers to differential electricity rates charged on consumption depending on the time of day.

**"Toronto Hydro"** refers to the Corporation and its subsidiaries.

**"Transfer By-law"** refers to By-law No. 374-1999 of the City of Toronto 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. See note 1 to the Consolidated Financial Statements. 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.

**"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 of Ontario and all references to dollars are to Canadian dollars.**

## **PART 3 - CORPORATE STRUCTURE**

### **3.1 Name, Address, Incorporation**

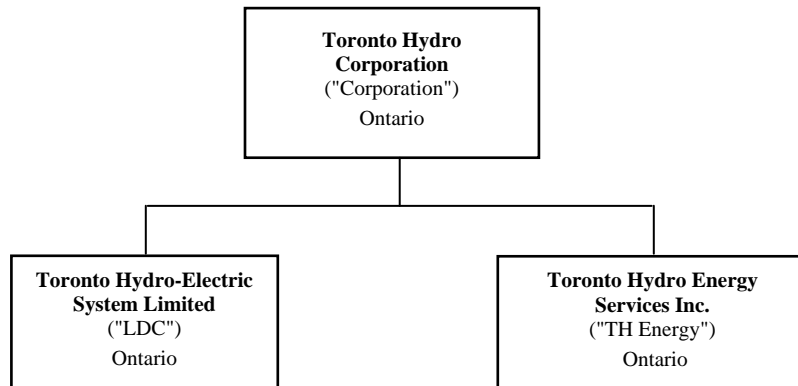
On January 1, 1998, the former municipalities of Metropolitan Toronto, Toronto, East York, Etobicoke, North York, Scarborough and York amalgamated to form the City of Toronto. At the same time, the electric commissions of Toronto, East York, Etobicoke, North York, Scarborough and York were combined to 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 of Toronto 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 of Toronto. The Corporation, in turn, owns 100% of the shares of the principal subsidiaries listed below, each of which was incorporated under the OBCA:



## PART 4- BUSINESS OF TORONTO HYDRO

### 4.1 Toronto Hydro Corporation

The Corporation is a holding company which, through its principal subsidiaries:

- distributes electricity and engages in CDM activities (LDC); and
- provides street lighting services (TH Energy).

The Corporation supervises the operations of, and provides corporate and management services and strategic direction to, its subsidiaries.

### 4.2 Toronto Hydro-Electric System Limited

The principal business of Toronto Hydro is the distribution of electricity by LDC. LDC owns and operates \$2.2 billion of Capital Assets comprised primarily of an electricity distribution system that delivers electricity to approximately 700,000 customers located in the City of Toronto. LDC is the largest municipal electricity distribution company in Canada and distributes approximately 19% of the electricity consumed in Ontario.

#### (a) LDC Distribution System

Electricity produced at generating stations is transmitted along transmission lines owned by Hydro One Inc. to terminal stations at which point the voltage is then reduced (or stepped down) to distribution-level voltages. Distribution voltages are then distributed across LDC's 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 distribution system is serviced from 35 terminal stations and is comprised of approximately 24,400 primary switches, approximately 60,500 distribution transformers, 170 in-service municipal sub-stations, over 15,000 kilometres of overhead wires supported by approximately 139,900 poles and over 10,400 kilometres of underground wires.

(i) *Control Centre*

LDC has one control centre. The control centre co-ordinates and monitors the distribution of electricity throughout its 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 distribution system.

(ii) *Terminal Stations*

LDC receives electricity at 35 transmission system terminal stations at which the voltage is stepped down to distribution voltages. The terminal stations contain power transformers and high-voltage switching equipment that are owned by Hydro One Inc., with the exception of Cavanagh station that is fully owned by LDC. Terminal stations also contain low-voltage equipment such as circuit breakers, switches and station busses that are typically owned by LDC.

(iii) *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 distribution system includes approximately 60,500 distribution transformers. The distribution system also includes 170 in-service municipal sub-stations that are located in various parts of the City of Toronto 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.

(iv) *Wires*

LDC distributes electricity through a network comprised of an overhead circuit of over 15,000 kilometres supported by approximately 139,900 poles and an underground circuit of over 10,400 kilometres.

(v) *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 Province's decision to install Smart Meters throughout Ontario, 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 commercial customers. As at December 31, 2010, LDC had installed approximately 674,000 Smart Meters. LDC intends to make an application before the OEB in 2012 to seek recovery of deferred program costs relating to the Smart Meter project. There can be no assurance that the OEB will approve, in whole or in part, this application.

As part of its metering services and Smart Meter project, LDC also installs individual suite Smart Meters in multi-residential buildings. As at December 31, 2010, LDC had installed approximately 19,000 individual suite Smart Meters in multi-residential buildings, which are included in the approximately 674,000 Smart Meters installed by LDC.

(vi) *Reliability of Distribution System*

The table below sets forth certain industry recognized measurements of system reliability with respect to LDC's distribution system and the composite measures reported by the Canadian Electricity Association<sup>(1)</sup> for the twelve-month period ended December 31, 2010.

	<u>LDC</u>	<u>Canadian Electricity Association</u>
SAIDI .....	1.29	4.20
SAIFI .....	1.77	2.01
CAIDI .....	0.73	2.09

Note:

- (1) From the Canadian Electricity Association's 2009 Service Continuity Report on Distribution System Performance in Canadian Electrical Utilities, excluding significant events.

**(b) LDC Service Area and Customers**

LDC serves approximately 700,000 customers located in the City of Toronto. The City of Toronto is the largest city in Canada with a population of approximately 2.5 million. The City of Toronto 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, 2010:

	<u>Year ended December 31</u>	
	<u>2010</u>	<u>2009</u>
<b>Residential Service <sup>(1)</sup></b>		
Number of customers (as at December 31).....	620,501	611,357
kWh .....	5,209,204,594	5,037,152,555
Revenue .....	657,418,209	\$605,486,836
% of total service revenue .....	25.7%	25.1%
<b>General Service <sup>(2)</sup></b>		
Number of customers (as at December 31) .....	79,836	78,840
kWh .....	17,317,547,986	16,855,384,268
Revenue .....	1,705,831,766	\$1,597,055,413
% of total service revenue .....	66.6%	66.2%
<b>Large Users <sup>(3)</sup></b>		
Number of customers (as at December 31) .....	50	47
kWh .....	2,219,247,453	2,461,604,984
Revenue .....	198,167,877	\$209,468,491
% of total service revenue .....	7.7%	8.7%
<b>Total</b>		
Number of customers (as at December 31) .....	700,387	690,244
kWh .....	24,746,000,033	24,354,141,807
Revenue .....	2,561,417,852	\$2,412,010,741

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.
- (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 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> <sup>(1)</sup>	<u>Total</u>	<u>Owned</u>	<u>Leased</u>	<u>Other</u> <sup>(2)</sup>
Terminal stations .....	35 sites	8	-	27
Municipal sub-stations .....	170 sites	156	4	10
Decommissioned municipal sub-stations.....	30 sites	30	-	-
Control centre <sup>(3)</sup> .....	1 site	1	-	-
Operations centres <sup>(4)</sup> .....	8 sites	3	5	-

Notes:

- (1) In addition to the properties listed in this table, on December 23, 2010, LDC purchased a parcel of land for future use.
- (2) Certain terminal stations and municipal substations are located on lands owned by the Province, the City of Toronto and others. Where 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.
- (3) LDC's control centre is located within one of its operations centres.
- (4) LCD's operation centres accommodate office, staff, crews, vehicles, equipment and material necessary to operate and monitor the electricity distribution systems.

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.

### (d) Regulation of LDC

The business of LDC is regulated by the 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.

#### (i) *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 of Toronto. Among other things, the licence provides that LDC may not carry on any business activity, other than the distribution of electricity, except through affiliated companies, 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. In addition to the distribution of electricity, under the terms of the Electricity Restructuring Act and the Green Energy Act, electricity distributors are also permitted to provide additional services related to the promotion of CDM activities and alternative, clean and renewable sources of energy.

(ii) *Industry Codes*

The OEB has established the following codes that prescribe minimum standards of conduct and service for LDC and other distributors.

- *Affiliate Relationships Code.* The Affiliate Relationships Code establishes standards and conditions for the interaction between distributors and their affiliated companies.
- *Distribution System Code.* The Distribution System Code establishes the minimum conditions that a distributor must meet in carrying out its obligations to distribute electricity, including standards of service relating to customer connections, expansions and new facilities.
- *Retail Settlement Code.* The Retail Settlement Code outlines the obligations of a distributor with respect to its relationship with retail Market Participants and its role as a retail market settlement administrator.
- *Standard Supply Service Code.* The Standard Supply Service Code requires a distributor to provide Standard Supply Service to its Standard Supply Customers.

The codes and the other regulatory instruments applicable to LDC are described in more detail under Annex A – "Regulation of Ontario's Electricity Industry as it relates to Toronto Hydro".

(iii) *Distribution Rates for LDC*

LDC 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 2010 was based on rates approved for the May 1, 2009 to April 30, 2010 rate year (the "2009 Rate Year"), and the distribution revenue for the remainder of 2010 are based on rates approved for the May 1, 2010 to April 30, 2011 rate year (the "2010 Rate Year").

In its decision on LDC's electricity distribution rates for 2008 and 2009, the OEB ordered that 100% of the net after-tax gains expected on the sale of certain LDC properties should be deducted from the revenue requirement recovered through distribution rates. The OEB deemed this amount to be \$10.3 million (the "Deemed Amount"). On June 16, 2008, LDC filed an appeal with the Divisional Court of Ontario (the "Divisional Court") seeking to overturn the gain on sale aspects of the OEB decision and also sought and obtained a stay order with respect to the deduction of the Deemed Amount from the revenue requirement recovered through rates. On April 30, 2009, the Divisional Court denied the appeal by LDC. LDC filed a motion with the Court of Appeal of Ontario for leave to appeal that decision of the Divisional Court. The requested leave was denied on September 14, 2009. LDC filed a notice of clarification with the OEB with respect to the timing and the quantum of the expected reduction in distribution revenue. On April 9, 2010, the OEB ordered LDC to reduce its revenue requirement for the 2010 Rate Year by \$10.3 million to reflect the expected gains on sale related to some designated surplus properties.

On February 24, 2009, the OEB set LDC's allowed ROE for the 2009 Rate Year at 8.01%. In addition to setting the ROE, the OEB also set LDC's 2009 distribution revenue requirement and rate base at \$482.5 million and \$2,035.0 million, respectively.

On December 11, 2009, the OEB issued revised cost of capital guidelines for implementation in 2010. Under the new guidelines, the ROE formula will be adjusted periodically to reflect the forecasted long Canada bond yield and A-rated Canadian utility bond spreads.

On April 9, 2010, the OEB issued its final decision regarding electricity distribution rates of LDC for the 2010 Rate Year. The decision rendered by the OEB provided for Capital Expenditures of \$350.0 million and operating expenses of \$204.1 million. The OEB also increased the ROE of LDC from 8.01% in 2009 to 9.85% for 2010, as it transitioned to the new ROE formula guidelines issued in December 2009.

On August 23, 2010, LDC filed a rate application with the OEB seeking approval of revenue requirements and corresponding rates for the May 1, 2011 to April 30, 2012 rate year (the "2011 Rate Year"). The requested distribution revenue requirement and rate base for this period are \$578.4 million and \$2,346.3 million, respectively. On February 9, 2011, LDC filed an amendment to its 2011 Rate Year application. The amended distribution revenue requirements and corresponding rate base for the 2011 Rate Year are \$555.4 million and \$2,360 million, respectively.

(iv) *Street Lighting Activities*

On June 15, 2009, the Corporation filed an application with the OEB seeking an electricity distribution license 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 regards to these applications. In its decision, the OEB agreed that, under certain conditions, the treatment of certain types of the 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 operational review and financial valuation of the street lighting assets, which was submitted to the OEB on January 31, 2011. Based on this updated asset valuation and the OEB's decision issued on February 11, 2010, LDC is seeking the OEB's approval to transfer \$29.4 million of street lighting assets from TH Energy to LDC. A final decision from the OEB in regard to such transfer is expected before the end of 2011.

(v) *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 its 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 its final decision, following further review of costs incurred by LDC, in connection with the contact voltage remediation activities. In its decision, the OEB deemed the balance allowable for recovery at \$5.3 million. The variance from the Corporation'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, 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.

(vi) *OEB PILs Proceeding*

The OEB is conducting a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for all MEUs. The current proceeding is expected to provide direction regarding the interpretation of the rules issued by the OEB. The outcome of this proceeding could have a material impact on the financial position of the Corporation.

(vii) *Green Energy Act*

The Green Energy Act came into force on May 14, 2009. The Green Energy Act, among other things: permits electricity distribution companies to own renewable energy generation facilities; obligates electricity distribution companies to provide priority connection access for renewable energy generation facilities; empowers the OEB to set CDM targets for electricity distribution companies as a condition of license; and requires electricity distribution companies to accommodate the development and implementation of a smart grid in relation to their systems.

On November 12, 2010, the OEB amended LDC's distribution license to incorporate the implementation of regulations under the Green Energy Act. The amendments require LDC, as a condition of its license, to achieve approximately 1,300 GWh of energy savings and approximately 280 MW of summer peak demand savings, through CDM activities, over the period beginning January 1, 2011 through December 31, 2014.

(viii) *Energy Consumer Protection Act*

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 enables and sets out the requirements relating to LDC's installation of suite Smart Meters in multi-residential apartment buildings. The Energy Consumer Protection Act also provides for new rules regarding the manner in which energy consumers are to be billed for their electricity consumption.

**(e) Environmental Matters**

(i) *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 that 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.

Finally, municipal by-laws regulate discharges of industrial sewage and storm water run-off to the municipal sewer system.

(ii) *Financial and Operational Effects of Environmental Protection Requirements*

LDC currently spends approximately \$1.0 million per year 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 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, 2010, the Corporation's asset retirement obligations amounted to \$5.0 million. See note 3(n) and note 13 to the Consolidated Financial Statements.

(iii) *Environmental Policy and Oversight*

Toronto Hydro's Environmental Stewardship Policy was approved by the Board on March 5, 2010. This policy establishes specific commitments to continuously monitor and improve Toronto Hydro's management of environmental protection requirements. The Environmental Stewardship Policy is monitored and administered by the Corporation's Vice-President, Organizational Effectiveness, Environment, Health and Safety and its implementation is overseen by the Corporation's Environmental Health and Safety department. The content and compliance with the Environmental Stewardship Policy is reviewed annually by the Board.

LDC has also established various programs designed to identify and manage environmental impacts associated with the distribution of electricity and to aid in the improvement of environmental performance. LDC's environmental programs include: Total Recycled Waste Program (i.e. copper, aluminum, sundry nonferrous, steel); PCB Cable Disposal Program; Spill Response; Waste Management Program (i.e. oils, gas etc.); and Recycling and Conservation at Work Program (i.e. paper, office blue bin). LDC's environmental programs are reviewed and updated periodically by the Board.

(f) **Conservation and Demand Management**

In May 2007, LDC entered into agreements with the OPA to deliver OPA-funded CDM programs in the amount of approximately \$60.0 million during the years from 2007 to 2010. All programs delivered during this time were fully funded by the OPA with any advance payments recorded on the consolidated balance sheet as a deferred liability. LDC also participated in initiatives within the City of Toronto designed to achieve electricity demand reduction up to 300 MW for programs extending from May 7, 2007 to December 31, 2010.

On March 31, 2010, the Minister directed the OEB to establish CDM targets to be met by electricity distributors. Accordingly, on November 12, 2010, the OEB directed the LDC to achieve approximately 1,300 GWh of energy savings and approximately 280 MW of summer peak demand savings, over the period beginning January 1, 2011 through December 31, 2014.

On February 2, 2011, LDC entered into an agreement with the OPA to deliver OPA-funded CDM programs in the amount of approximately \$50.0 million from January 1, 2011 to December 31, 2014. All programs to be delivered under this OPA agreement are expected to be fully funded and paid in advance by the OPA.

**4.3 Toronto Hydro Energy Services Inc.**

TH Energy is a professional energy services company with 3 employees (its President, Chief Financial Officer and Vice-President, General Counsel and Corporate Secretary) and \$63.9 million of Capital Assets, as at December 31, 2010.

TH Energy owns and operates street lighting assets located in the City of Toronto and has the sole right to provide maintenance and capital improvements to the street lighting systems throughout the City of Toronto until 2035. A restructuring of TH Energy and its street lighting assets is subject to an application with the OEB (see section 4.2(d)(iv) under the heading "Toronto Hydro-Electric System Limited - Regulation of LDC - Street Lighting Activities"). 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.

Effective January 1, 2010, TH Energy transferred, for no consideration, its energy management services and other generation activities to LDC.

**4.4 Discontinued Operations**

On July 31, 2008, the Corporation sold all of the shares of Toronto Hydro Telecom Inc., a telecommunications subsidiary, to Cogeco Cable Canada Inc. for cash consideration of \$200.0 million.

On April 30, 2009, EBT Express, an equal partnership between the Corporation's wholly owned subsidiary 1455948 Ontario Inc. and OPG EBT Holdco Inc., sold its interest in SPi 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 1455948 Ontario Inc. was approximately \$2.6 million.

#### **4.5 Additional Information Regarding Toronto Hydro**

##### **(a) Employees**

At December 31, 2010, Toronto Hydro had approximately 1,700 employees, all of whom were employed by LDC except for 4 employees who were employed by the Corporation and 3 employees employed by TH Energy. Included in Toronto Hydro's employees are 1,194 members of bargaining units represented by the Canadian Union of Public Employees, Local One ("CUPE One"), and 50 engineers represented by the Society of Energy Professionals.

On December 22, 2008, CUPE One ratified collective agreements governing inside and outside employees for a five-year period expiring January 31, 2014. The collective agreements implemented a wage increase of 3.0% on December 22, 2008 and provide for general wage increases of 3.0%, effective on each of February 1, 2010, 2011, 2012 and 2013, respectively. 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 will not become effective until after 2010 and only if certain prescribed thresholds are exceeded.

On July 1 2007, the Society of Energy Professionals ratified a new collective agreement for a 4.5-year period expiring December 31, 2011. The collective agreement implemented wage increases of 1.75% retroactive to January 1, 2007, 2.50% effective January 1, 2008 and 2.75% effective January 1, 2009, January 1, 2010 and January 1, 2011, 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.

In addition to OMERS, Toronto Hydro provides other retirement and post-employment benefits to employees, including medical, dental and life insurance benefits. See note 3(m) and note 12 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 distribution system. These jobs include overhead and underground trades as well as designers and engineers. LDC hires experienced workers when available, along with apprentices to trades and technical positions. LDC continues to build on its trades training expertise by investing in internal training plans and apprenticeship programs, with the expectation that trades apprentices require up to 54 months to become fully competent and capable of performing all aspects of the job.

##### **(c) Health and Safety**

Toronto Hydro has established various health and safety programs including safe work practices, accident investigation and safety performance management. LDC has reduced lost time accident frequencies from 5.5 per 200,000 hours worked in 1998 to 0.44 per 200,000 hours worked in 2010. Toronto Hydro's safety programs are reviewed and updated periodically by the Health and Safety Committee of the Board.

**(d) 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. The Corporation believes that the coverage, amounts and terms of its insurance arrangements are consistent with prudent Canadian industry practice.

**(e) Lending and Investments**

Toronto Hydro's lending and investment activities are governed by the terms of the Shareholder Direction (see section 5.1 under the heading "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 LDC's Vice-President, Treasurer and Regulatory Affairs. 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.

## **PART 5 - RELATIONSHIP WITH THE CITY OF TORONTO**

### **5.1 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 of the City in connection with its relationship with Toronto Hydro;
- the 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 Toronto Hydro; and
- certain financial and administrative arrangements between the Corporation and the City.

**(a) Objectives**

The City's objectives in connection with its relationship with Toronto Hydro are as follows:

- the value of Toronto Hydro should be maintained or increased;
- the City's income stream from Toronto Hydro should be comparable to the City's estimated financial benefit if Toronto Hydro had been sold as a going concern;
- Toronto Hydro's consumers should not be unduly impacted by the transfer of assets from the City and the Toronto Hydro-Electric Commission to Toronto Hydro; and
- the environmental impacts related to Toronto Hydro should be improved.

**(b) Principles Governing Operations**

The Shareholder Direction states that the business of Toronto Hydro is integral to the well being and the infrastructure of the City of Toronto and provides, among other things, that it is in the best interests of Toronto Hydro and the stakeholders affected by its business that Toronto Hydro conducts its affairs:

- on a commercially prudent basis, while engaging in recruitment practices designed to attract employees from the diverse community it serves and supporting the City's objectives where consistent with Toronto Hydro's business objectives, including procurement practices that encourage participation of equity-seeking groups, in a manner consistent with the energy policies established by the City from time to time, in a socially responsible manner that supports priority objectives of the City that are consistent with Toronto Hydro's business objectives and in accordance with the financial performance objectives of the City;
- to provide a reliable and efficient electricity distribution system that meets changing demand utilizing emerging green technologies as appropriate with an emphasis on customer satisfaction;
- in a safe and environmentally responsible manner while working with the City to achieve its climate change objectives; and
- in a manner that promotes energy conservation and environmental responsibility, works with the City to achieve its climate change objectives, keeps its property and facilities clean and well maintained and free from graffiti and protects and enhances the City's urban forest.

The Shareholder Direction provides that the Board is responsible for determining and implementing the appropriate balance among these principles.

**(c) 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 distribution system, undertaking or securities of a distributor operating outside the City of Toronto 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 up to \$500.0 million in financial support with respect to prudential requirements and as security for obligations under third-party contracts. See note 16 to the Consolidated Financial Statements.

**(d) 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 credit rating and dividends.

**(e) Credit Rating**

The Shareholder Direction provides that the Corporation will obtain and maintain a rating of A minus or higher as defined by S&P on its senior debt securities.

**(f) Dividends**

Subject to applicable law, the Shareholder Direction provides that the Corporation will pay dividends to the City each year equal to the greater of \$25 million or 50% of consolidated net income for the year. The dividends are not cumulative and are payable as follows:

- \$6 million on the last day of each of the first three fiscal quarters during the year;
- \$7 million on the last day of the fiscal year; and
- the amount (if any) by which 50% of Corporation's annual consolidated net income for the year exceeds \$25 million, within ten days after the Board approves the Corporation's consolidated financial statements for the year.

The Corporation declared and paid dividends to the City totalling \$116.4 million in 2008, \$25.2 million in 2009, and \$25.0 million in 2010. See note 18 and note 24(e) to the Consolidated Financial Statements.

On March 11, 2011, the Corporation declared dividends in the amount of \$14.1 million. The dividends are comprised of \$8.1 million with respect to net income for the year ended December 31, 2010, payable to the City on March 18, 2011 and \$6.0 million with respect to the first quarter of 2011, payable to the City on March 31, 2011.

LDC declared and paid dividends to the Corporation amounting to, \$25.0 million in 2008, \$nil in 2009, and \$nil in 2010.

TH Energy declared and paid dividends to the Corporation amounting to \$nil in 2008, \$nil in 2009, and \$19.6 million in 2010.

**5.2 Indebtedness to the City of Toronto**

As part of the consideration for the transfer by the Toronto Hydro-Electric Commission and the City of Toronto of their assets and liabilities in respect of the electricity distribution system to LDC in July 1999, LDC issued the Initial Note to the City.

The Replacement Note was issued to replace the Initial Note effective January 1, 2000. The principal amount of the Replacement Note was increased from \$947,000,000 to \$980,230,955 and the interest rate under the Replacement Note was increased from 6.0% to 6.8% as authorized under the Transfer By-law to reflect certain changes made by the OEB to the permitted cost of debt for purposes of setting distribution rates.

On May 7, 2003, the City transferred to the Corporation the Replacement Note in consideration for the issue by the Corporation to the City of the City Note in the same principal amount.

On September 5, 2006, the Corporation announced that it had agreed to amend and restate the City Note effective May 1, 2006. The Amended and Restated City Note fixed the interest rate at 6.11% and established an agreed repayment schedule: \$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.

The first and second repayments of the Amended and Restated City Note were made, as scheduled, on December 31, 2007 and December 31, 2009, respectively.

During the first quarter of 2010, the City made the determination to monetize its interest in the Amended and Restated City Note under which the Corporation had \$490.1 million of indebtedness outstanding to the City. Concurrent with the closing of the transaction on April 1, 2010, 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") which were sold by a syndicate of underwriters as part of a secondary offering by the City and issued by the Corporation under the terms of an existing trust indenture as supplemented to effect the offering. The aggregate principal amount outstanding under the Series 4 and Series 5 debentures is \$490.1 million. The Series 4 debentures mature on December 30, 2011. The Series 5 debentures mature on May 6, 2013. The Series 4 and Series 5 debentures bear interest at the rate of 6.11% per annum, payable semi-annually in arrears in equal instalments and on the maturity date. The Series 4 and Series 5 debentures 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 did not receive any proceeds from the transaction. Following the completion of the transaction, the Corporation has no further indebtedness outstanding to the City under the terms of the Amended and Restated City Note and the Amended and Restated City Note has been cancelled. See note 11(a) and note 11(b) to the Consolidated Financial Statements.

### **5.3 Services Provided to the City of Toronto**

Toronto Hydro provides certain services to the City at commercial and regulated rates, including consolidated electricity billing services and street lighting services. See section 4.3 under the heading "Toronto Hydro Energy Services Inc." for more information on street lighting services. In addition, the City and its agencies have entered into energy efficiency service contracts with TH Energy and CDM contracts with LDC. See note 19 to the Consolidated Financial Statements.

## **PART 6 - TAXATION**

### **(a) Tax Regime**

The Corporation is generally exempt from tax under the ITA, if not less than 90% of the capital of the Corporation is owned by the City of Toronto 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 of Toronto. In addition, the Corporation's subsidiaries are also generally 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 of Toronto. A corporation exempt from tax under the ITA is also generally exempt from tax under the TA and the CTA.

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, 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. 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 Ontario Electricity Financial Corporation, and will generally 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 generally 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 Parts II, II.1 or III of the CTA 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 that the transfer takes place or a previous taxation year; and
- the tax for which the MEU would be liable under Part I of the ITA if the MEU had no income for the taxation year other than the capital gain, or income 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, an MEU, Hydro One Inc. or Ontario Power Generation Inc. will generally be exempt from the transfer tax.

In addition, a refund of transfer tax will generally 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 electricity activity 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 an MEU.

The 2006 Rate Handbook provides for 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 distribution rate application. See note 3(b) note 3(p) and note 17 to the Consolidated Financial Statements.

## **(b) Tax Contingencies**

The Ministry of Revenue 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 dispute arose as a result of inaccurate information incorporated into Ontario Regulation 224/00 (Tax Matters – Tax Rates on Generating and Transformer Stations, Tax Returns and Payments), correction of which has been requested by LDC.

The balance assessed by the Ministry of Revenue above the balance accrued by the Corporation amounts to \$9.4 million as at December 31, 2010. The Corporation has been working with the Ministry of Revenue and the Ministry of Finance to resolve this issue. However, there can be no assurance that the Corporation will not have to pay the full assessed balance in the future.

## PART 7 - RISK FACTORS

Toronto Hydro's business is subject to a variety of risks including those described below:

### 7.1 Condition of Distribution Assets

LDC estimates that approximately one-third of its distribution assets are past their expected useful life. 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.

### 7.2 Regulatory Developments

Ontario's electricity industry regulatory developments may affect the 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. In particular, there can be no assurance that:

- the OEB may 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 distribution rates;
- the OEB will not permit competitors to provide distribution services in a distributor's licensed area, or loads within LDC's service area to become electrically served by a means other than through LDC's system;
- the OEB will allow recovery for revenue lost as a consequence of the emergence and adoption of new technologies such as distributed generation, or 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 or 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 Toronto Hydro.

On February 13, 2008, the AcSB confirmed that publicly accountable enterprises will be required to adopt IFRS in place of Canadian GAAP for fiscal years beginning on or after January 1, 2011. On September 10, 2010, the AcSB granted an optional one year deferral of IFRS adoption for entities subject to rate regulation. Subsequently, the Canadian Securities Administrators announced that entities subject to rate regulation may defer the adoption of IFRS for up to one year, consistent with the one year deferral granted by the AcSB. Given these recent developments and due to the continued uncertainty around the timing, scope and eventual adoption of a rate-regulated accounting ("RRA") standard under IFRS and the uncertainty regarding the impact of IFRS on the OEB electricity distribution rates application process and the potential material impact of RRA on the Corporation's financial statements, the Corporation has decided to elect the optional one year deferral of its adoption of IFRS. The adoption of IFRS may have an impact on the Corporation's future financial position and results of operations, which impact cannot be reasonably quantified at this time.



### **7.3 Information Technology Infrastructure**

LDC's ability to operate effectively is in part dependent upon the development, maintenance and management of a complex information technology systems infrastructure. Computer systems are employed to operate LDC's distribution system, financial and billing systems and business systems to capture data and to produce timely and accurate information. Failures of LDC's financial, business and operating systems could have a material adverse effect on Toronto Hydro's business, operating results, financial condition or prospects.

### **7.4 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.

### **7.5 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, cyber attacks and pandemics. 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 are substantial in amount. 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. There can be no assurance that the OEB would approve, in whole or in part, such an application.

### **7.6 Electricity Consumption**

LDC's distribution rates typically comprise 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.

### **7.7 Market and Credit Risk**

LDC is subject to credit risk with respect to customer non-payment. 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 attendant bad debt expense incurred by LDC, roughly 80 percent 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 utility's application for recovery of extraordinary bad debt expenses on a case-by-case basis.

LDC is also 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 points) reduction in long-term Government of Canada bond yields used in determining its regulated rate of return would reduce LDC's net income by approximately \$4.6 million.

The Corporation is also exposed to fluctuations in interest rates for the valuation of its post-employment benefit obligations. The Corporation estimates that a 1% (100 basis points) increase in the discount rate used to value these obligations would decrease the accrued benefit obligation, as at December 31, 2010, by \$27.1 million, and a 1% (100 basis points) decrease in the discount rate would increase the accrued benefit obligation, as at December 31, 2010, by \$35.1 million.

## **7.8 Additional Debt Financing**

Cash generated from operations, after the payment of expected dividends, will not be sufficient to repay existing indebtedness, fund Capital Expenditures and meet other obligations. The Corporation relies on debt financing through its MTN Program or existing credit facilities to repay existing indebtedness 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 and its debt securities by credit rating agencies, the current timing of debt maturities and general economic conditions.

## **7.9 Work Force Renewal**

Over the next 9 years, approximately 700 LDC employees will be eligible for retirement. This number represents approximately 40% of LDC's current workforce (with a significant number of 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.

## **7.10 Insurance**

Although Toronto Hydro maintains insurance as described under section 4.5(d) under the heading "Additional Information Regarding Toronto Hydro-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. Further, there can be no assurance that available insurance will cover all losses or liabilities that might arise in the conduct of Toronto Hydro's business. Toronto Hydro self-insures against certain 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 Toronto Hydro.

## **7.11 Credit Rating**

Should the Corporation's credit rating from both credit rating agencies fall below A – (S&P) and A-low (DBRS), the Corporation and its subsidiary companies may be required to post additional collateral with the IESO.

## **7.12 Conflicts of Interest and Change of Ownership**

The City of Toronto owns all of the outstanding shares of the Corporation and has the power to determine the composition of the Board and influence Toronto Hydro'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 and its role as the administrator of the City budget and other matters for the residents of the City. The City may also decide to sell all or part of Toronto Hydro; however the Corporation is not aware of any plan or decision by the City to do so. In this event, depending on the nature of the transaction, the Corporation's credit ratings may be negatively affected.

## **7.13 Real Property Rights**

Certain terminal stations and municipal substations of LDC are located on lands owned by the Province, the City of Toronto 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.

## **7.14 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 a distribution system. LDC has the right to distribute electricity in the City of Toronto. 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 a distribution system, OEB regulation of distribution rates and the level of regulatory compliance required to operate a 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 system.

## **PART 8- CAPITAL STRUCTURE**

### **8.1 Share Capital**

The authorized capital of the Corporation consists of an unlimited number of common shares of which 1,000 common shares are issued and outstanding as at the date of this AIF. The City of Toronto is the sole shareholder of the Corporation. See note 18 to the Consolidated Financial Statements.

### **8.2 Debentures**

On May 7, 2003, the Corporation issued \$225.0 million 6.11% senior unsecured Debentures due May 7, 2013. On November 14, 2007 the Corporation issued \$250.0 million 5.15% senior unsecured Debentures due November 14, 2017. On November 12, 2009, the Corporation issued \$250.0 million 4.49% senior unsecured Debentures due November 12, 2019.

On December 12, 2008, the Corporation filed under its MTN Program a new shelf prospectus providing for the issuance of up to \$1 billion of debentures during the 25 month period following the date of the prospectus. The net proceeds from the sale of Debentures issued under the shelf prospectus were used by the Corporation for general corporate purposes including the repayment of existing indebtedness outstanding to the City under the terms of the Amended and Restated City Note.

During the first quarter of 2010, the City made the determination to monetize its interest in the Amended and Restated City Note under which the Corporation had \$490.1 million of indebtedness outstanding to the City. Concurrent with the closing of the transaction on April 1, 2010, 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") which were sold by a syndicate of underwriters as part of a secondary offering by the City and issued by the Corporation under the terms of an existing trust indenture as supplemented to effect the offering. The aggregate principal amount outstanding under the Series 4 and Series 5 debentures is \$490.1 million. The Series 4 debentures mature on December 30, 2011. The Series 5 debentures mature on May 6, 2013. The Series 4 and Series 5 debentures bear interest at the rate of 6.11% per annum, payable semi-annually in arrears in equal instalments and on the maturity date. The Series 4 and Series 5 debentures 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 did not receive any proceeds from the transaction. Following the completion of the transaction, the Corporation has no further indebtedness outstanding to the City under the terms of the Amended and Restated City Note and the Amended and Restated City Note has been cancelled. See note 11(b) to the Consolidated Financial Statements.

On May 20, 2010, the Corporation issued \$200.0 million in 30-year senior unsecured debentures ("Series 6") which bear interest at the rate of 5.54% per annum and are payable semi-annually in arrears in equal instalments on May 21 and November 21 of each year. The Series 6 debentures mature on May 21, 2040, 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 net proceeds of this issuance will be used principally to finance regulated Capital Expenditures of LDC. See note 11(a) to the Consolidated Financial Statements.

On December 9, 2010, the Corporation filed under its MTN Program a new shelf prospectus providing for the issuance of up to \$1 billion of debentures during the 25 month period following the date of the prospectus. The net proceeds from the sale of Debentures issued under the shelf prospectus will be used by the Corporation for general corporate purposes.

### **8.3 Credit Ratings**

As at the date of this AIF, the Debentures are rated "A" (high) by DBRS and "A" by 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. The "A" category is characterized as "satisfactory credit quality".

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 to indicate relative standing within the major rating categories. The "A" category is characterized as somewhat more susceptible to the adverse changes in circumstances and economic conditions than obligations in higher categories; however, the obligor's capacity to meet the 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 CIBC Mellon Trust Company 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.

## **PART 9 - DIRECTORS AND OFFICERS**

### **9.1 Directors and Officers**

The following table sets forth, for each of the directors and officers of the Corporation, the name, municipality of residence, office, principal occupation and, if a director, the date on which the person became a director.

The City of Toronto is the sole shareholder of the Corporation and has adopted the Shareholder Direction which sets out corporate governance principles with respect to Toronto Hydro. See Part 5 - "Relationship with the City of Toronto". The City elects or appoints all of the directors of the Corporation. There are currently 10 directors. Three of the directors are councillors of the City of Toronto and are not considered independent because of their positions. None of the other directors has a direct or indirect material relationship with the Corporation and are independent.

<b><u>Name <sup>(1)</sup> and Municipality of Residence</u></b>	<b><u>Office</u></b>	<b><u>Principal Occupation</u></b>	<b><u>Director Since</u></b>	<b><u>Expiry of Current Term</u></b>
Clare R. Copeland <sup>(2)</sup> Toronto, Ontario	Director and Chair of the Board of Directors	Chief Executive Officer, Falls Management Company <sup>(3)</sup>	June 23, 1999	November 30, 2012
Patricia Callon Toronto, Ontario	Director and Chair-designate	Director, Stakeholder Outreach & Communications, Canadian Securities Transition Office	August 1, 2005	November 30, 2012
Brian Chu Toronto, Ontario	Director	Partner, Bogart Robertson & Chu	August 1, 2005	November 30, 2012
Derek Cowbourne Toronto, Ontario	Director	Corporate Director	December 1, 2008	November 30, 2012
Paulette Kennedy Toronto, Ontario	Director	Commissioner, Ontario Securities Commission	December 1, 2008	November 30, 2012
Shoba Khetrupal Toronto, Ontario	Director	Corporate Director	December 1, 2008	November 30, 2012
David Williams Toronto, Ontario	Director	Interim President and Chief Executive Officer, Shoppers Drug Mart Corporation <sup>(4)</sup>	March 31, 2010	November 30, 2012
Shelley Carroll Toronto, Ontario	Director	Councillor, City of Toronto	December 7, 2010	November 30, 2012
Josh Colle Toronto, Ontario	Director	Councillor, City of Toronto	December 7, 2010	November 30, 2012
Ron Moeser Toronto, Ontario	Director	Councillor, City of Toronto	December 7, 2010	November 30, 2012
Anthony Haines Toronto, Ontario	President and Chief Executive Officer	President and Chief Executive Officer, Toronto Hydro Corporation	N/A	N/A
Jean-Sebastien Couillard Toronto, Ontario	Chief Financial Officer	Chief Financial Officer, Toronto Hydro Corporation	N/A	N/A

<b><u>Name <sup>(1)</sup> and Municipality of Residence</u></b>	<b><u>Office</u></b>	<b><u>Principal Occupation</u></b>	<b><u>Director Since</u></b>	<b><u>Expiry of Current Term</u></b>
Lawrence D. Wilde Mississauga, Ontario	Vice-President, General Counsel and Corporate Secretary	Vice-President, General Counsel and Corporate Secretary, Toronto Hydro Corporation	N/A	N/A

Notes:

- (1) No director serves as a director of another reporting issuer except for: (a) Mr. Copeland, who serves as a director of RioCan Real Estate Investment Trust, Danier Leather Inc., Chesswood Income Trust (formerly called Cars4U), Entertainment One Ltd., M.D.C. Holdings, Inc., and Telesat Canada; and (b) Mr. Williams, who serves as a chair of the board of directors for Shoppers Drug Mart Corporation, lead director of Aastra Technologies Inc., and director of Canadian Apartment Properties Real Estate Income Trust.
- (2) Mr. Copeland was a director of White Rose Crafts and Nursery Sales Inc. that 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 had been asked to join the board when the company was already in difficulty due to his corporate restructuring experience.
- (3) Falls Management Company is the developer and operator of Casino Niagara and Niagara Fallsview Casino Resort.
- (4) Shoppers Drug Mart Corporation is a licensor of retail drug stores.

Except as noted above, no director or executive officer of the Corporation is, as at the date of this AIF, or has within 10 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.

## 9.2 Principal Occupations

All of the directors and senior officers of the Corporation have held the principal occupations identified in section 9.1 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) Mr. Cowbourne, who held various executive positions with the IESO prior to April 1, 2008;
- (c) Ms. Kennedy, who was the Chief Financial Officer and Chief Auditor of AEGON Canada Inc. prior to January 2008;
- (d) Ms. Khetrapal, who was the Vice President and Chief Financial Officer of Weekenders International prior to December 2006;
- (e) Mr. Colle, who was Manager, Government Relations of Greater Toronto Airports Authority from March 2004 to August 2008, and Associate Vice-President of Bridgepoint Group Ltd. From August 2008 to November 2010; and
- (f) Mr. Haines was the Chief Administrative Officer of the Corporation from May 2005 to August 2006 and the President of the LDC from September 2006 until his appointment as CEO effective October 1, 2009.

## 9.3 Committees of the Board of Directors

The Board has established four committees:

- (a) The Audit Committee is responsible for overseeing the adequacy and effectiveness of financial reporting, accounting systems and internal controls. 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 officers' personal expenses on an annual basis and recommends the external auditor for appointment by the Corporation's sole shareholder. Members of the Audit Committee are Mr. Chu, Ms. Kennedy and Ms. Khetrapal. Mr. Chu is the Chair of the Audit Committee. See section 9.4 "Audit Committee" below for further information on the Audit Committee.
- (b) 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. Management undertakes orientation and education programs for new directors. Members of the Corporate Governance Committee are Mr. Cowbourne, Mr. Chu and Ms. Kennedy. Mr. Cowbourne is the Chair of the Corporate Governance Committee.
- (c) The Compensation Committee is responsible for reviewing the performance and remuneration of senior executives and succession planning for senior management positions. Members of the Compensation Committee are: Ms. Callon, Mr. Bastable and Mr. Copeland. Ms. Callon is the Chair of the Compensation Committee. Mr. Bastable is a member of the Board of Directors of the LDC.
- (d) The Health and Safety Committee is responsible for considering and making recommendations to the Board with respect to matters of health and safety. Members of the Health and Safety Committee are Mr. Williams, Ms. Callon and Ms. Khetrapal. Mr. Williams is the Chair of the Health and Safety Committee.

## **9.4 Audit Committee**

### **(a) Composition of the Audit Committee**

The Board has established the Audit 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 and external audit functions. The Audit Committee is comprised of Mr. Chu (Chair), Ms. Kennedy and Ms. Khetrupal, each of whom is independent and financially literate within the meaning of applicable Canadian securities laws.

### **(b) 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 (from 1996 to 2000) and as a member of the Finance Committee of the Ontario College of Art and Design (from 1999 to 2005). Mr. Chu served as the Chair of the Finance and Audit Committee of the Laidlaw Foundation (from November 2006 to June 2008) and continues as a member of that Committee. 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.

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 and accounting positions including Chief Financial Officer and Chief Auditor, AEGON Canada Inc. (2003-2008), Senior Vice-President and Chief Internal Auditor, Sobeys Inc. (2002-2003), Chief Auditor, Sun Life Financial Inc. (1997-2000) and Vice-President Finance and Actuarial (2001-2002) Sun Life Financial Inc. Ms. Kennedy is currently a Commissioner of the Ontario Securities Commission, a member of the Financial Consumer Agency of Canada External Stakeholder Advisory Committee, a member of the Business Board of the University of Toronto and Vice-Chair of the University of Toronto Audit Committee.

Ms. Khetrupal 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 St. Joseph's Health Centre and Chair of its Audit Committee. She is also a member of the Board of Directors of Cancer Care Ontario and Vice Chair of its Audit Committee. She is also a member of the Board of Directors of The Public Accountants Council, and a member for its Audit Committee. In addition, she is a member of the Canada Pension Plan Review Tribunal. Previous positions held include Vice President and Treasurer, Moore Corporation Limited, Director, Economics & Planning Canadian Pacific Enterprises Limited and member of the Board of Directors of Moore Group Services BVBA-Belgium, Peak Technologies Canada Ltd., Moore Holdings Ltd. - Australia and the Ontario Casino Corporation.

### **(c) Charter**

Under the terms of its charter, the Audit Committee is responsible for:

- managing the relationship between the Corporation and its external auditors, including: appointing and replacing the external auditors, subject to shareholder approval; setting the compensation of the external auditors subject to the approval of the Board or the shareholder, as applicable; overseeing the work of the external auditors (including resolving disagreements between management and the external auditors with respect to financial reporting); pre-approving all audit services and permitted non-audit services to be provided to the Corporation and its subsidiary entities by the external auditors; ensuring that the external auditors report to the Audit Committee



in a timely manner with respect to all required matters; reviewing and approving the hiring policies of the Corporation with respect to present and former partners and employees of the external auditors; ensuring the rotation of the audit partner having primary responsibility for the audit of the Corporation, the audit partner responsible for reviewing the audit and the external auditors at such intervals as may be required; reviewing and assessing the performance, independence and objectivity of the external auditors;

- overseeing the external audit of the Corporation, including: reviewing and approving the engagement letter and the audit plan (including financial risk areas identified by the external auditors and management); reviewing and assessing the accounting and reporting practices and principles used by the Corporation in preparing its financial statements; reviewing and assessing the results of the external audit and the external auditors' opinion on the financial statements including all significant accounting policies and practices used, including changes from preceding years and any proposed changes for future years, all significant financial reporting issues, estimates and judgments made, 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, 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, the effect of regulatory and accounting initiatives and off-balance sheet transactions or structures on the financial statements, any errors or omissions in, and any required restatement of, the financial statements for preceding years, all significant tax issues, the reporting of all material contingent liabilities, and any material written communications between the external auditors and management; 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; 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; and 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;
- overseeing the internal audit of the Corporation, including: reviewing and approving the audit plan, including significant risk exposures identified by the internal auditor and management; reviewing and discussing with the internal auditors and management the results of any internal audits; 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); appointing and replacing the internal auditor; reviewing and assessing the performance of the internal auditor; and ensuring the Committee is kept informed of emerging trends and successful practices in internal auditing; confirming there is effective and efficient coordination of activities between internal and external auditors;
- reviewing, approving and, where required, recommending to the Board for approval, the financial statements, management's discussion and analysis of financial condition and results of operations and interim financial reports of the Corporation, annual information form and other public disclosure of financial information extracted from the financial statements of the Corporation with particular focus on the quality and appropriateness of accounting and reporting practices and principles and any changes thereto, 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, material financial risks, material transactions, material adjustments, compliance with loan agreements, material off-balance sheet transactions and structures, compliance with accounting standards, compliance with legal and regulatory requirements and disagreements with management;

- overseeing the internal financial control structure and financial risk management systems of the Corporation, including: reviewing and discussing with management and the external auditors and the quality and adequacy of internal control over the financial reporting structures of the Corporation (including any major deficiencies or weakness and the steps taken by management to rectify these deficiencies or weaknesses); reviewing and discussing with management 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; and 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
- establishing adequate policies and procedures, or requiring that adequate policies and procedures are established, with respect to the following (and annually assessing the adequacy of these procedures): the review of the public disclosure of financial information extracted from the financial statements of the Corporation; the receipt, retention and treatment of complaints received by the Corporation with respect to accounting, internal accounting controls or auditing matters; and the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.

**(d) 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.

**(e) External Auditors Service Fees**

The Corporation's auditors are Ernst & Young LLP, Chartered Accountants.

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.

	<b>Year ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
Audit fees <sup>(1)</sup> .....	\$800,385	\$530,582
Audit-related fees <sup>(2)</sup> .....	\$159,557	\$192,784
Tax fees <sup>(3)</sup> .....	\$-	\$-
All other fees <sup>(4)</sup> .....	\$583,035	\$308,020

Notes:

- (1) Includes fees for audit services.
- (2) Includes fees for interim reviews, 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) Includes fees for professional services rendered in respect of tax compliance, tax advice and tax planning.
- (4) Includes fees for products and services other than those referred to in notes (1), (2) and (3) above. Amount shown relates to professional fees in respect of the MTN Program, consultations relating to the transition to IFRS, the annual Canadian Public Accountability Board levy, and other miscellaneous fees.

**9.5 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. The Code provides for the appointment of an Ethics and Compliance Officer and establishes a direct hotline to the Ethics and Compliance Officer by which perceived violations of the principles set out in the Code may be reported, anonymously or otherwise. The Ethics and Compliance Officer reports quarterly to the Audit Committee 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 and Compliance Officer is required to report it to the Chair of the Audit Committee, who oversees the investigation of that complaint.

**9.6 Board Assessments**

**(a) Independence**

The Board consists of 10 directors, all of whom are appointed by the sole shareholder of the Corporation, the City of Toronto. Three of the directors are Councillors of the City of Toronto but none of the other directors has a direct or indirect material relationship with the Corporation and are independent. 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.

## **(b) 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. Directors are also periodically provided with orientation sessions with senior management and facility tours to assist them in understanding Toronto Hydro's businesses.

## **(c) Board, Committee and Director Assessments**

The Corporate Governance Committee oversees a process used to evaluate the effectiveness of the Board and its committees. The process 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 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. The directors' responses related to the individual directors are provided directly to the Chair of the Board for review, consideration and application.

## **(d) Risk Management**

In 2010, the Corporation adopted an Enterprise Risk Management Program (the "ERM Program") to provide a consistent and disciplined methodology for the identification, assessment, monitoring and reporting of risks applicable to Toronto Hydro. The ERM Program follows industry best practices and emphasizes a top-down approach to integrate risk management with strategic planning. To ensure strong oversight over the risk management process and alignment with the Shareholder Direction, a risk governance structure is in place, consisting of regular reporting to the Board, and regular meetings of an executive Risk Oversight Committee. The Corporation's ERM Program plays an important role in managing and maintaining Toronto Hydro's brand and reputation and in assuring overall risk identification and management.

# **PART 10- EXECUTIVE COMPENSATION**

## **10.1 Compensation Discussion and Analysis**

### **(a) General Objectives of Compensation Program**

The Corporation's executive compensation program is designed to attract and retain key executives, motivate them to achieve corporate goals and reward them for superior performance.

### **(b) Process for Establishing Compensation**

The Corporation's executive compensation program is supervised by the Compensation Committee under the direction of the Board. The Compensation Committee operates under a written charter adopted by the Board. The primary function of the Compensation Committee is to advise and assist the Board in overseeing the compensation structure and benefit plans and programs of the Corporation and its subsidiaries and assessing the performance and compensation of the CEO. The Compensation Committee reviews and approves individual objectives for the CEO, assesses the CEO's performance against those objectives on a periodic basis and recommends the CEO's compensation including performance-based incentive compensation to the Board based on the achievement of those objectives. While the CEO sets the compensation for the other NEOs, the Compensation Committee reviews the compensation of the other NEOs.

The Corporation periodically reviews the levels of compensation provided to the NEOs to ensure competitiveness. An external consultant is retained to recommend compensation levels for the NEOs to the Compensation Committee and CEO. These recommendations are based on a review of the appropriate comparative markets. Periodically, NEO positions are benchmarked to comparable roles using the Mercer Benchmark Database, which allows comparisons to be made to different segments of the market to ensure reasonableness including GTA industrials, national industrials, and executives in companies with comparable revenues (excluding flow through revenues, crown corporations and public sector). The recommendations are designed to establish, over a reasonable period of time, total compensation in the range of the 50<sup>th</sup> percentile of those companies within the data base.

**(c) Elements of Compensation**

The principal components of compensation for NEOs are:

- base salary;
- performance-based incentive compensation;
- bonuses or special payments;
- personal benefits and perquisites;
- pension plan;
- retirement benefits;
- retirement allowances; and
- termination benefits.

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 their individual performance rating. The performance rating is determined, in the case of the CEO, by the Compensation Committee and, in the case of the other NEOs, by the CEO, based on the achievement of performance objectives, knowledge, skills, and competencies related to day-to-day performance, as well as demonstration of desired corporate behaviours.

**(ii) Performance-Based Incentive Compensation**

All NEOs receive a portion of their annual compensation in the form of performance-based cash payments. The NEOs' performance-based incentive compensation is closely aligned with the Corporation's performance and is designed to retain, motivate and reward NEOs for reaching individual and corporate objectives established at the beginning of each calendar year.

Each NEO's annual performance-based incentive compensation is expressed as a target amount and calculated as a percentage of the NEO's base salary for the year. In the case of the CEO, the Compensation Committee, and, in the case of the other NEOs, the CEO, may determine to increase the performance-based incentive compensation by up to 50% of the target amount for each NEO in the event that the Corporation has exceeded the corporate objectives and that NEO has exceeded his individual objectives for a given year.

Each NEO's performance compensation is based on a pre-determined "weighting" of corporate and individual performance objectives. Position weightings vary by role to reflect the performance focus of the role and may change from year to year.

Corporate performance objectives are based on yearly corporate objectives, which are based on financial and other measures.

Each NEO's individual objectives are established at the start of the year based on areas of strategic and operational emphasis related to their respective responsibilities and portfolios, employee engagement and communication, customer service and stakeholder relations. The CEO's individual objectives are reviewed and approved by the Compensation Committee. The objectives of the other NEOs are reviewed and approved by the CEO.

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 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 Compensation 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 Compensation 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 determines the amount of performance-based incentive compensation to be paid to each other NEO.

Each NEO's annual performance-based incentive compensation for a fiscal year is determined and paid in one lump sum in the next fiscal year.

(iii) *Bonuses or Special Payments*

From time to time under special circumstances, the Corporation may provide special cash incentives or bonuses to compensate NEOs for exceptional performance. Any cash incentive or special bonuses paid to the CEO is approved by the Board after review of the recommendation of the Compensation Committee. In the case of each of the other NEOs, any cash incentive or bonus is approved by the CEO.

(iv) *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 health, dental, group life insurance, short-term and long-term disability, accidental death & dismemberment, a fitness subsidy and educational reimbursements.

(v) *Pension Plan*

The NEOs participate in the OMERS pension plan. All full-time employees of the Corporation are required to participate in OMERS and it is generally available to all employees. All obligations to make payments to retirees under this pension plan are the responsibility of OMERS. Toronto Hydro does not have any obligation to make payment to any NEO in respect of the OMERS pension plan. See 4.5(a) under the heading "Employees" for more information on the OMERS pension plan.

(vi) *Retirement Benefits*

The Corporation pays certain medical, dental, and life insurance benefits on behalf of its retired employees if they have met the years of service requirement. NEOs are eligible to receive post-retirement health, dental and life insurance if, after at least 5 years of service with the Corporation, they retire from the Corporation and begin collecting under the OMERS pension plan upon retirement. Post-retirement benefits aid in attracting and retaining key executives to ensure the long-term success of the Corporation.

(vii) *Retirement Allowances*

From time to time, 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. Retirement allowance payments are typically paid in one or two lump sum instalments following termination or retirement of the NEO.

(viii) *Termination Benefits*

From time to time, the Corporation enters into termination agreements with certain key executives, including NEOs. These agreements are made on a case-by-case basis based on the NEO's age, years of service and position. Typically, termination benefits are paid either as a lump sum or as salary continuation for an agreed period following termination.

## 10.2 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, 2008, 2009 and 2010, by the CEO, the CFO, the 3 most highly compensated executive officers of Toronto Hydro who were serving as executive officers at December 31, 2010, and each individual who would be amongst the 3 most highly compensated executive officers of the Corporation, but for the fact that such individuals were not executive officers on December 31, 2010, if any (collectively, the "Named Executive Officers" or "NEOs"):

Summary Compensation Table<sup>(1)</sup>

NEO Name and Principal Position	Year	Salary (\$)	Non-Equity Incentive Plan Compensation <sup>(2)</sup> (\$)	All Other Compensation <sup>(3)</sup> (\$)	Total Compensation (\$)
Anthony Haines <sup>(4)</sup>	2010	\$372,807	\$340,018	\$44,905 <sup>(5)</sup>	\$757,730
President and Chief Executive Officer, Toronto Hydro Corporation	2009	\$325,744	\$224,166	\$129,161 <sup>(6)</sup>	\$679,071
	2008	\$309,383	\$217,372	\$38,792 <sup>(7)</sup>	\$565,547
Jean-Sebastien Couillard	2010	\$238,462	\$129,860	\$24,220 <sup>(8)</sup>	\$392,542
Chief Financial Officer, Toronto Hydro Corporation	2009	\$231,542	\$111,796	\$57,913 <sup>(9)</sup>	\$401,251
	2008	\$224,443	\$133,751	\$29,551 <sup>(10)</sup>	\$387,745
Dino Priore	2010	\$219,583	\$126,763	\$19,272 <sup>(11)</sup>	\$365,618
Vice-President, Distribution Services Toronto Hydro –Electric System Limited	2009	\$184,275	\$82,776	\$25,362 <sup>(12)</sup>	\$292,413
	2008	\$164,780	\$63,965	\$20,011 <sup>(13)</sup>	\$248,756
Ivano Labricciosa	2010	\$212,780	\$112,574	\$31,975 <sup>(14)</sup>	\$357,329
Vice-President, Asset Management Toronto Hydro –Electric System Limited	2009	\$179,337	\$74,391	\$48,413 <sup>(15)</sup>	\$302,141
	2008	\$162,532	\$60,277	\$25,661 <sup>(16)</sup>	\$248,470
Ben La Pianta	2010	\$216,813	\$116,472	\$19,066 <sup>(17)</sup>	\$352,351
Vice-President, Grid Response Toronto Hydro –Electric System Limited	2009	\$181,374	\$81,732	\$24,916 <sup>(18)</sup>	\$288,022
	2008	\$151,492	\$62,065	\$22,171 <sup>(19)</sup>	\$235,728

Notes:

- (1) Amounts shown in this table are in Canadian dollars and have been rounded to the nearest dollar.
- (2) 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., 2010) represent the annual performance-based incentive compensation earned by the NEO for the achievement of performance goals in respect of that fiscal year (i.e. 2010) but which amounts are paid in the following fiscal year (i.e. 2011).

- (3) Amounts shown in this column reflect all other compensation earned by the NEO during the year. Unless otherwise noted in footnotes to follow, 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 are worth \$50,000 or more, or are worth 10% or more of the NEO's total salary for the year. Perquisites or other personal benefits that exceed 25% of the total value of perquisites and other personal benefits reported for an NEO for the year have been identified in footnotes to follow. Perquisites and other personal benefits have been calculated by using the actual cost.
- (4) Mr. Haines was appointed as CEO on October 1, 2009. Prior to that, Mr. Haines was President of the LDC.
- (5) Amount shown includes \$32,306 for vehicle lease costs.
- (6) Amount shown includes \$65,288 for payout of unused vacation and \$19,227 for vehicle lease costs.
- (7) Amount shown includes \$18,187 for vehicle lease costs.
- (8) Amount shown includes \$15,148 for vehicle lease costs.
- (9) Amount shown includes \$7,194 for pay out of unused vacation and \$15,476 for vehicle lease costs.
- (10) Amount shown includes \$14,635 for vehicle lease costs.
- (11) In this instance, the aggregate value of perquisites and other personal benefits represent approximately 9% of the NEO's total salary for the year. Amount shown includes \$11,209 for vehicle lease costs.
- (12) Amount shown includes \$11,451 for vehicle lease costs.
- (13) Amount shown includes \$8,441 for vehicle lease costs.
- (14) Amount shown includes \$14,059 for vehicle lease costs and \$8,292 for vehicle repairs.
- (15) Amount shown includes \$21,678 for pay out of unused vacation.
- (16) Amount shown includes \$12,349 for vehicle lease costs.
- (17) In this instance, the aggregate value of perquisites and other personal benefits represent approximately 9% of the NEO's total salary for the year. Amount shown includes \$14,252 for vehicle lease costs.
- (18) Amount shown includes \$10,500 for vehicle lease costs.
- (19) Amount shown includes \$11,655 for vehicle lease costs.

**(b) Compensation of NEOs – Narrative Discussion**

*(i) Base Salaries*

The NEOs received the following annual base salaries for 2010: \$373,625 in the case of Mr. Haines, \$238,703 in the case of Mr. Couillard, \$220,065 in the case of Mr. Priore, \$213,198 in the case of Mr. Labricciosa, and \$217,289 in the case of Mr. La Pianta.

*(ii) Performance-Based Incentive Compensation*

The target amounts of each NEO's 2010 annual performance-based incentive compensation 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. Labricciosa, and 40% of the base salary in the case of Mr. La Pianta.

The weightings attributed to each NEO's 2010 annual performance-based incentive compensation were as follows:

- a) Mr. Haines: 20% based on his individual performance and 80% based on the performance of the Corporation;
- b) Mr. Couillard: 40% based on his individual performance and 60% based on the performance of the Corporation;
- c) Mr. Priore: 40% based on his individual performance and 60% based on the performance of the Corporation;
- d) Mr. Labricciosa: 40% based on his individual performance and 60% based on the performance of the Corporation; and



- e) Mr. La Pianta: 40% based on his individual performance and 60% based on the performance of the Corporation.

Each of the NEOs achieved his individual objectives for 2010.

The performance objectives of the Corporation for 2010 were as follows:

<b>Objective</b>	<b>Target</b>	<b>Weight (%)</b>
Call Centre Service	70%	10
SAIDI (minutes)	80	5
Feeder Performance (FESI-7)	41	5
Distribution Plant Capital per unit	1.150	30
SAIFI	1.62	5
Safety (% with no injury)	95%	5
Safety Leadership	90%	5
Attendance (# of days absent)	9.0	5
Consolidated Operating Expense	\$231.5m	15
Consolidated Net Income	\$50.6m	15

The Corporation achieved all of its 2010 performance objectives, except for the objective related to SAIFI.

(iii) *Bonuses or Special Payments*

The Corporation did not issue any bonuses or special payments to NEOs in 2010.

(iv) *Other Personal Benefits and Perquisites*

In 2010, the NEOs received personal benefits and perquisites as described in section 10.1(c)(iv) under the heading "Compensation Discussion and Analysis – Elements of Compensation – Personal Benefits and Perquisites", and as detailed in the Summary Compensation Table above.

(v) *Pension Plan*

In 2010, each of the NEOs participated in the OMERS pension plan. See section 4.5(a) under the heading "Employees" and section 10.1(c)(v) under the heading "Compensation Discussion and Analysis – Elements of Compensation – Pension Plan" for further information on the OMERS pension plan.

(vi) *Retirement Benefits*

As of December 31, 2010, Mr. Haines, Mr. Couillard, Mr. Priore, Mr. Labricciosa, and Mr. La Pianta have each provided Toronto Hydro with more than 5 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.

(vii) *Retirement Allowance*

Mr. Haines is entitled to a retirement allowance which is calculated based on completed years of service and is payable in the form of a lump-sum cash payment following Mr. Haines' termination or retirement from the Corporation. In order to receive this retirement allowance, Mr. Haines must remain in active service for the Corporation until at least December 31, 2011. If Mr. Haines is terminated or retires from the Corporation during 2012, he will receive a \$50,000 retirement allowance. The amount of the retirement allowance payable to Mr. Haines will thereafter be increased by an additional \$90,000 per year (until 2016) and \$125,000 per year (from 2017 to 2020) for each full calendar year of service completed. The maximum retirement 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 retirement allowance of \$1,000,000. In the event of the death of Mr. Haines while in active service for the Corporation, the retirement 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.

(viii) *Termination Benefits*

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 \$1,268,285), 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 \$545,758), 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.

### 10.3 Compensation of Directors

(a) **Director Compensation Table**

Director Name	Fees Earned (\$)	All other compensation (\$)	Total (\$)
Clare Copeland	\$75,000	\$6,595 <sup>(1)</sup>	\$81,595
Patricia Callon	\$26,500	Nil	\$26,500
Brian Chu	\$29,500	Nil	\$29,500
Derek Cowbourne	\$24,500	Nil	\$24,500
Paulette Kennedy	\$29,500	Nil	\$29,500
Shoba Khetrpal	\$28,500	Nil	\$28,500
Bill Rupert <sup>(2)</sup>	\$26,500	Nil	\$26,500
David Williams <sup>(3)</sup>	\$17,375	Nil	\$17,375
Deputy Mayor Joe Pantalone <sup>(4)</sup>	Nil	Nil	Nil

<b>Director Name</b>	<b>Fees Earned (\$)</b>	<b>All other compensation (\$)</b>	<b>Total (\$)</b>
Councillor Gordon Perks <sup>(5)</sup>	Nil	Nil	Nil
Councillor Bill Saundercook <sup>(6)</sup>	Nil	Nil	Nil
Councillor Shelly Carroll <sup>(7)</sup>	Nil	Nil	Nil
Councillor Josh Colle <sup>(8)</sup>	Nil	Nil	Nil
Councillor Ron Moeser <sup>(9)</sup>	Nil	Nil	Nil

Notes:

- (1) An amount in respect of health and dental plan benefits.
- (2) Mr. Rupert resigned as a director of the Corporation effective December 2, 2010.
- (3) David Williams became a director of the Corporation on March 31, 2010.
- (4) Councillor Joe Pantalone ceased to be a director of the Corporation effective December 7, 2010.
- (5) Councillor Gordon Perks ceased to be a director of the Corporation effective December 7, 2010.
- (6) Councillor Bill Saundercook ceased to be a director of the Corporation effective December 7, 2010.
- (7) Councillor Shelly Carroll became a director of the Corporation effective December 7, 2010.
- (8) Councillor Josh Colle became a director of the Corporation effective December 7, 2010.
- (9) Councillor Ron Moeser became a director of the Corporation effective December 7, 2010.

#### **(b) Compensation of Directors – Narrative Discussion**

Directors of the Corporation, other than Councillors of the City of Toronto, 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 of Toronto. 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, Compensation Committee and Health and Safety Committee attended — \$1,000, subject to annual maximum fees per committee member of \$5,000 for the Audit Committee, Corporate Governance Committee, and the Health and Safety Committee and \$4,000 for the Compensation Committee. The Chair receives no meeting attendance fees. Councillors of the City of Toronto receive no remuneration for their services as directors of the Corporation.

Mr. Copeland also receives health and dental benefits through participation in the same health and dental plan offered to all Toronto Hydro employees.

### **PART 11- LEGAL PROCEEDINGS**

LDC is a party to various legal proceedings relating to the period before July 1999 when Toronto Hydro acquired the assets and liabilities of the Toronto Hydro-Electric Commission. In addition, LDC is a party to various legal proceedings arising since that time in the normal course of business. The pending legal proceedings containing material claims affecting LDC are described below.

#### **11.1 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 Ontario MEUs, in 1998. The actions sought \$500,000,000 and \$64,000,000, 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 \$17,000,000 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*. LDC's share of the settlement amount was expected to be \$7,750,000, payable on June 30, 2011. Under the settlement, all the MEUs involved in the settlement, including LDC, have requested an order from the OEB allowing for the future recovery from customers of all costs related to the settlement. LDC has accrued a liability and a corresponding regulatory asset in the amount of \$7,750,000.

On February 22, 2011, the OEB issued its final decision allowing for LDC to recover the settlement amount of \$7,526,000 from customers over the period commencing May 1, 2011 and ending April 30, 2013.

### **11.2 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 also added LDC as a defendant. The main action seeks damages in the amount of \$10,000,000 from LDC. Both actions are at a preliminary stage. A third party claim and now the Statement of Claim in the main action have been served on LDC and statements of defence to the main action and 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 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 also added LDC as a defendant. The main action seeks damages in the amount of \$400,000 from LDC. Both actions are at a preliminary stage. Although a third party claim and the Statement of Claim in the main action have been served on LDC, statements of defence to the main action and 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.

### **11.3 2 Secord Avenue**

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the Class Proceedings Act 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 has been filed, and a certification order 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 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.

Another action was commenced against LDC in February 2009 in the Ontario Superior Court of Justice seeking damages in the amount of \$20.0 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 has been filed, and a certification order 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 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, these two actions, together with a third smaller non-class action commenced in April 2009 involving the same incident, will be tried at the same time or consecutively. Consequently, documentary discovery and examinations for discovery will be joined for all three actions.

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. 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.

#### **11.4 Adamopoulos v. LDC**

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. This action is at an intermediate state. The plaintiff's motion increasing its claim for damages to \$23,790,000 was granted on July 7, 2010. The trial in this action is scheduled for May 2011. 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.

#### **11.5 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 million or 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. A statement of defence has been filed. Prior to any certification of the action as a class proceeding, cross summary judgment motions are scheduled to be heard on June 16 and 17, 2011 to determine whether the Interest Act has been breached. 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 the Corporation's Consolidated Financial Statements and results of operations.

### **PART 12- 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](http://www.sedar.com).

### **PART 13 - NAMED AND INTERESTS OF EXPERTS**

The external auditor of the Corporation is Ernst & Young LLP. Ernst & Young LLP is independent within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario.

### **PART 14 - 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](http://www.sedar.com).

**ANNEX A**  
**REGULATION OF ONTARIO'S ELECTRICITY INDUSTRY**  
**AS IT RELATES TO TORONTO HYDRO**

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# REGULATION OF ONTARIO'S ELECTRICITY INDUSTRY AS IT RELATES TO TORONTO HYDRO

Capitalized and technical terms used but not defined in this Annex A are defined in Part 2 - "Glossary of Defined Terms" of the AIF.

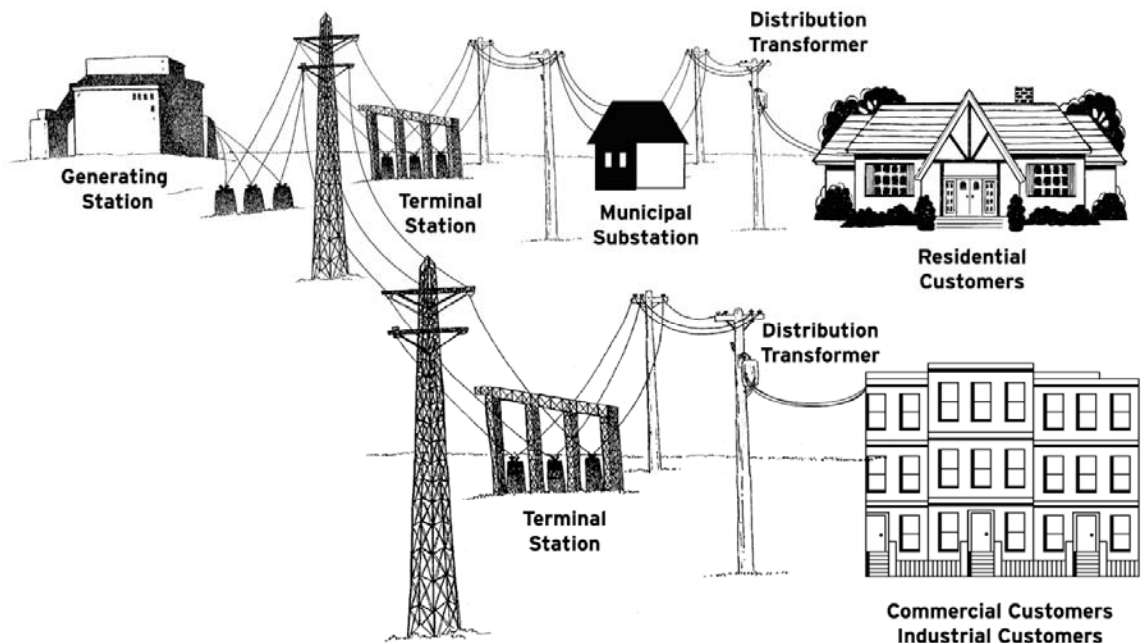
## 1. Introduction

The electricity industry in Ontario is divided into 4 principal segments:

- Generation - the production of electricity at generating stations using nuclear, fossil, hydro 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 such as energy profiling and energy management.

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 distributors or large customers. Distributors carry the electricity to distribution transformers that further reduce the voltage for supply to local customers. Electricity is distributed in Ontario through a network of local distributors that includes approximately eighty municipal distributors, a few privately owned distributors, and Hydro One Networks Inc.

The following diagram illustrates the basic structure of an electricity infrastructure system:



## **2. Industry Structure**

The Electricity Act and the OEB Act establish the broad legislative framework for Ontario's competitive electricity market. The Electricity Act permitted the restructuring of Ontario's electricity industry, and enabled the implementation of Open Access to transmission and distribution systems. The OEB Act expanded the jurisdiction and mandate of the OEB to include regulation of the electricity and natural gas markets.

Under the Electricity Act, the former Ontario Hydro was reorganized into 5 separate corporations (listed below under their current names):

- Ontario Power Generation Inc. (OPG), the entity responsible for the former Ontario Hydro's generation business;
- Hydro One Inc., the entity responsible for the former Ontario Hydro's electricity transmission, distribution and energy services businesses;
- Ontario Electricity Financial Corporation (OEFC), the entity responsible for managing and retiring Ontario Hydro's outstanding indebtedness and remaining liabilities;
- Independent Electricity System Operator (IESO), a non-profit corporation responsible for central market operations; and
- Electrical Safety Authority (ESA), a non-profit corporation responsible for the electric installation inspection function.

Additionally, the Electricity Act requires electricity utilities in Ontario to keep their distribution businesses separate from their other businesses.

The Electricity Restructuring Act established the OPA, as a non-profit, self-financed corporation with the mandate to ensure long-term electricity supply adequacy in Ontario. The OPA is authorized to enter into contracts for the supply, as well as the conservation, of electricity, and is responsible for developing an integrated power system supply plan in furtherance of its mandate.

The Electricity Restructuring Act also created a hybrid wholesale electricity market under which the output from generators owned and operated by OPG are to be provided at prices to be determined by the OEB on regulated heritage assets. These prices and quantities are combined with prices and quantities resulting from contracts with non-utility generators and with residual prices and quantities, determined in the spot market, to form a blended wholesale price for electricity. The OEB is also responsible for determining commodity prices charged to consumers, by setting RPP and Time-of-Use thresholds and rates.

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, and the regulation of distribution rates charged by LDC and other electricity distributors, and transmission rates charged by Hydro One Networks Inc. and other transmitters.

Under the current regulations, LDC continues to have an obligation to connect and supply customers in accordance with the Electricity Act, and the conditions of its distribution licence and rate orders. The OEB provides a framework for the review of electricity distribution utilities' revenue requirements so that rates may be periodically re-established.

## **3. Regulation of Distributors**

### **3.1 Industry Codes**

The OEB has established the Affiliate Relationships Code, the Distribution System Code, the Retail Settlement Code, and the Standard Supply Service Code. These codes prescribe minimum standards of conduct, as well as



standards of service, for distributors in the 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; and
- (4) Standard Supply Service 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 a utility to cross-subsidize competitive or non-monopoly activities, protect the confidentiality of consumer information collected by a distributor, and ensure that there is no preferential access to regulated services. In the Affiliate Relationships Code, an electricity distributor is referred to as a "utility". LDC is a utility that is subject to the Affiliate Relationships Code.

The Affiliate Relationships Code prescribes standards of conduct for a utility 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 a distributor must meet in carrying out its obligations to distribute electricity under its licence and under the *Energy Competition Act, 1998* (Ontario), and has been amended as the regulatory environment has evolved. Generally, the Distribution Service Code prescribes the rights and responsibilities of distributors and 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 the distributor); metering; operations; disconnection and security deposits; and other matters.

### *Retail Settlement Code*

The Retail Settlement Code outlines the obligations of a 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, a distributor is required to do the following: unbundle the costs of competitive electricity services (i.e., cost of electricity based on prices determined in the wholesale market administered by the IESO) and non-competitive electricity services (i.e., administrative charges, transmission services and other costs) required to support the wholesale market; and record, in variance accounts, the difference between amounts billed by the IESO to the distributor for competitive and non-competitive electricity services, and the aggregate amounts billed by the distributor to consumers, retailers and others for the same services.

Pursuant to the Retail Settlement Code, a distributor is also required to provide electricity billing and settlement services to retailers and customers, which includes preparing electricity bills which unbundle, among other things, competitive and non-competitive electricity services and distribution charges, and providing billing options.

Distributors may require retailers to maintain security arrangements (including letters of credit, surety bonds, cash deposits or lock-box arrangements), under terms prescribed by the OEB, to protect against the risk of payment default by retailers. In addition, distributors are permitted to mitigate the risk of customer non-payment using any means allowed by law, including security deposits (under terms prescribed by the OEB), late payment penalties, prepayment, pre-authorized payment, load limiters and/or disconnection.

The Retail Settlement Code also provides for the following: service transaction requests; maintenance of customer records and access to information; service agreements; and special provisions for RPP customers.

### *Standard Supply Service Code*

The Standard Supply Service Code requires a distributor to act as a default supplier and provide Standard Supply Service to persons connected to the distributor's distribution system under specified conditions.

Under the Standard Supply Service Code, a 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 distributor to cover its costs of providing the service.

A distributor may mitigate the risk of non-payment from Standard Supply Service customers by using any means permitted by law, including security deposits (under terms prescribed by the OEB), late payment penalties, prepayment, pre-authorized payment, load limiters or disconnection.

## **3.2 Distribution Rates**

### *Cost of Service Regulation*

The OEB considers it necessary to periodically examine the cost basis of distributor rates through a detailed assessment of the costs incurred to provide service, including: capital costs based on approved capital structures and cost rates for equity and debt; PILs payments; depreciation and amortization costs; operations, maintenance, and administrative costs; and cost of service offsets in the form of revenues from sources other than distribution rates. The process of undertaking such an assessment requires the distributor to produce extensive evidence documenting the levels of its costs. A cost of service assessment, known as a "rebasings", can serve as the starting point for subsequent rate changes determined through a mechanistic incentive regulation mechanism ("IRM") adjustment process.

### *Other Regulated Charges*

The 2006 Rate Handbook provides standard rates and guidelines to distributors with respect to other regulated charges that are non-competitive in nature and are regulated by the OEB, 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 distributors to retailers in accordance with the Retail Settlement Code.

### *Settlement Variances*

The OEB has allowed LDC to defer settlement variances from May 1, 2002 to December 31, 2010. This balance represents 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 after May 1, 2002. The settlement variances relate primarily to service charges, non-competitive electricity charges, imported power charges, and charges related to the manner in which the output of specific generation assets are priced in Ontario.

### *PILs*

OEB regulatory practice provides for the recovery of forecast PILs payment liabilities through distribution rates. LDC is generally at risk for variances between forecast 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 are disposed of through deferral accounts. As at December 31, 2010, LDC has accumulated a PILs variance amount representing differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in the rate adjustment model.

## **4. Additional Licences**

### **4.1 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. Apart from certain bill consolidation and settlement services provided under contract to the City of Toronto, TH Energy does not currently engage in electricity retailing.

### **4.2 Wholesaler Licence**

On March 16, 2001, the OEB issued an electricity wholesaler licence to TH Energy. This licence was renewed on January 19, 2006 and extends to January 18, 2011. TH Energy has applied for an extension to its electricity wholesaler licence. The licence allows TH Energy to purchase electricity from the markets administered by the IESO or directly from an electricity generator and to sell electricity through the markets administered by the IESO or directly to third parties other than consumers subject to the terms and conditions contained in the licence. TH Energy does not currently engage in any wholesale marketing activities.

### **4.3 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 the terms and conditions contained in the licence which can be summarized as follows:

- *Term, Amendments* – The licence was effective as of December 18, 2002 and terminates on December 17, 2022, although the term may be extended by the OEB. The licence may be amended by the OEB on the application of any person, if it considers the amendment to be necessary in order to implement a directive issued under the OEB Act, or in the public interest, having regard to the objectives of the OEB and the purposes of the Electricity Act.
- *Information Disclosure* –The co-venturers are required to provide the OEB with information regarding any material change in circumstances that adversely affects or is likely to adversely affect its ability to comply with the conditions of the licence, as soon as practicable, but in any event within fifteen days of the date upon which the change occurs.
- *Obligation to Comply with Market Rules* – The co-venturers are obligated to comply with all applicable market rules under the Electricity Act.

### **4.4 Smart Sub Metering Licence**

On July 7, 2010 LDC applied to the OEB for a Smart Sub Metering Licence, which would allow LDC to conduct smart sub metering activities as defined under the OEB's Smart Sub Metering Code. LDC's requirement for such a licence stems from various OEB code requirements that it may be subject to should it ever acquire the metering business of another licensed smart sub metering provider. The application is currently being reviewed by the OEB.