



**ANNUAL INFORMATION FORM
FOR THE YEAR ENDED DECEMBER 31, 2012**

March 28, 2013

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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 the future financial and operational effects of LDC's environmental protection requirements, the outcome of outstanding rate applications and other proceedings before the OEB, LDC's CDM programs, the Corporation's plans to borrow funds to repay maturing Debentures and to finance the investment in LDC's infrastructure, the expected results of legal proceedings, market volatility on the Corporation's consolidated results of operations, performance, business prospects and opportunities and the effect of changes in interest rates on future revenue requirements. The statements that make up the forward-looking information are based on assumptions that include, but are not limited to, the future course of the economy and financial markets, the receipt of applicable regulatory approvals and requested rate orders, the receipt of favourable judgments, the level of interest rates and the Corporation's ability to borrow.

The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from historical results or results anticipated by the forward-looking information. The factors which could cause results or events to differ from current expectations include, but are not limited to, market liquidity and the quality of the underlying assets and financial instruments, the timing and extent of changes in prevailing interest rates, inflation levels, legislative, judicial and regulatory developments that could affect revenues and the results of borrowing efforts.

Additional factors which could cause actual results or outcomes to differ materially from the results expressed or implied by forward-looking information include, among other things, the risk factors listed under Part 8 "Risk Factors" in this AIF. Please review this Part 8 – "Risk Factors" in detail. The Corporation cautions that the above list of risk factors is not exhaustive.

All forward-looking information in this AIF is qualified in its entirety by the above cautionary statements and, except as required by law, the Corporation undertakes no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise after the date hereof.

PART 2 - GLOSSARY OF DEFINED TERMS

"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.

"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, 2012.

"Amended and Restated City Note" refers to the Amended and Restated City Note dated May 1, 2006, in the principal amount of \$980,230,955, issued by the Corporation to the City. The Amended and Restated City Note has been cancelled. See section 6.2 under the heading "Indebtedness to the City".

"Board" refers to the board of directors of the Corporation.

"**CAIDI**" refers to the Customer Average Interruption Duration Index and is a measure (in hours) of the average duration of interruptions experienced by customers, not including MED. CAIDI represents the quotient obtained by dividing SAIDI by SAIFI.

"**Canadian Environmental Protection Act**" refers to the *Canadian Environmental Protection Act, 1999* (Canada), as amended.

"**Capital Assets**" refers to the sum of property, plant and equipment and intangible assets, net of accumulated depreciation and amortization. See note 4(g), note 4(h), note 7, and note 8 to the Consolidated Financial Statements.

"**Capital Expenditures**" refers to expenditures relating to property, plant and equipment and intangible assets.

"**CDM**" refers to conservation and demand management.

"**CEA**" refers to the Canadian Electricity Association.

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

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

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

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

"**Conservation and Demand Management Code**" refers to the Conservation and Demand Management Code for Electricity Distributors that was published and became effective on September 16, 2010.

"**Consolidated Financial Statements**" refers to the comparative audited consolidated financial statements of the Corporation together with the auditors' report thereon and the notes thereto as at and for the years ended December 31, 2012 and December 31, 2011, a copy of which is available on the SEDAR website at www.sedar.com.

"**Consumer Price Index**" refers to the index measuring price movements published by Statistics Canada.

"**Consumer Protection Act**" refers to the *Consumer Protection Act, 2002* (Ontario), as amended.

"**Corporation**" refers to Toronto Hydro Corporation.

"**Criminal Code**" refers to the *Criminal Code* (Canada), as amended.

"**Dangerous Goods Transportation Act**" refers to the *Dangerous Goods Transportation Act* (Ontario), as amended.

"**DBRS**" refers to DBRS Limited.

"**Debentures**" refers to the 6.11% Series 1 senior unsecured debentures issued by the Corporation on May 7, 2003, the 5.15% Series 2 senior unsecured debentures issued by the Corporation on November 14, 2007, the 4.49% Series 3 senior unsecured debentures issued by the Corporation on November 12, 2009, the 6.11% Series 4 senior unsecured debentures issued by the Corporation on April 1, 2010, the 6.11% Series 5 senior unsecured debentures issued by the Corporation on April 1, 2010, the 5.54% Series 6 senior unsecured debentures issued by the Corporation on May 20, 2010 and the 3.54% Series 7 senior unsecured debentures issued by the Corporation on November 18, 2011. See note 13 to the Consolidated Financial Statements.

"**Distribution System Code**" refers to the Distribution System Code that was published by the OEB on July 14, 2000, as amended.

"**EHSMS**" refers to the Environment, Health and Safety Management System.

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

"**Electricity Property**" refers to a municipal corporation's or an MEU's interest in real or personal property used in connection with generating, transmitting, distributing or retailing electricity.

"**Electricity Restructuring Act**" refers to the *Electricity Restructuring Act, 2004* (Ontario), as amended.

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

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

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

"**Fire Protection and Prevention Act**" refers to the *Fire Protection and Prevention Act, 1997* (Ontario), as amended.

"**GAAP**" refers to Generally Acceptable Accounting Principles.

"**Green Energy Act**" refers to the *Green Energy Act, 2009* (Ontario), as amended.

"**GWh**" refers to a gigawatt-hour, a standard unit for measuring electrical energy produced or consumed over time. One GWh is the amount of electricity consumed by one million kWh.

"**Hydro One**" refers to Hydro One Inc.

"**IEEE**" refers to the Institute of Electrical and Electronic Engineers Inc.

"**IESO**" refers to the Independent Electricity System Operator.

"**IFRS**" refers to the International Financial Reporting Standards.

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

"**ISO**" refers to the International Organization for Standardization.

"**ITA**" refers to the *Income Tax Act* (Canada), as amended.

"**kW**" refers to a kilowatt, a common measure of electrical power equal to 1,000 Watts.

"**kWh**" refers to a kilowatt-hour, a standard unit for measuring electrical energy produced or consumed over time. One kWh is the amount of electricity consumed by ten 100 Watt light bulbs burning for one hour.

"**LDC**" refers to the Corporation's wholly-owned subsidiary, Toronto Hydro-Electric System Limited.

"**Management's Discussion and Analysis**" refers to Management's Discussion and Analysis of Financial Condition and Results of Operations of the Corporation for the year ended December 31, 2012, a copy of which is available on the SEDAR website at www.sedar.com.

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

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

"**Mercer**" refers to Mercer (Canada) Limited.

"**MEU**" refers to a municipal electricity utility in the Province of Ontario.

"**Ministry of Finance**" refers to the Ministry of Finance of Ontario.

"**MTN Program**" refers to the medium term note program established by the Corporation under which the Corporation issues Debentures. See section 9.2 under the heading "Debentures".

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

"**Named Executive Officer**" or "**NEO**" means, collectively, the Corporation's CEO, the CFO, and the three most highly compensated executive officers of Toronto Hydro who were serving as executive officers as at December 31, 2012, and each individual who would be amongst the three most highly compensated executive officers for the Corporation, but for the fact that such individuals were not executive officers on December 31, 2012, if any.

"**OBCA**" refers to the *Business Corporations Act* (Ontario), as amended.

"**OEB**" refers to the Ontario Energy Board.

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

"**OEFC**" refers to the Ontario Electricity Financial Corporation.

"**OHSAS**" refers to the Occupational Health and Safety Assessment Series.

"**OMERS**" refers to the Ontario Municipal Employees Retirement System, a multi-employer, contributory, defined benefit pension plan established in 1962 by the Province for employees of municipalities, local boards and school boards in Ontario.

"**OPA**" refers to the Ontario Power Authority.

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

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

"**PCBs**" refers to polychlorinated biphenyls, a synthetic chemical compound consisting of chlorine, carbon and hydrogen. PCBs are used primarily as insulating and cooling elements in electrical equipment. Secondary uses include hydraulic and heat transfer fluids, flame proofing adhesives, paints, sealants and cable insulating paper.

"**PILs**" refers to the Payments In Lieu of Corporate Taxes regime contained in the Electricity Act pursuant to which MEUs that are exempt from tax under the ITA and the TA are required to make, for each taxation year, payments in lieu of corporate taxes to the OEFC. See note 4(r) and note 18 to the Consolidated Financial Statements.

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

"**Residential Tenancies Act**" refers to the *Residential Tenancies Act, 2006* (Ontario), as amended.

"**Retail Settlement Code**" refers to the Retail Settlement Code that was published by the OEB on December 13, 2000 and became effective on the commencement of Open Access (except with respect to "Service Agreements", as that term is defined in the Retail Settlement Code, which came into effect on March 1, 2001), as amended.

"**S&P**" refers to Standard & Poor's Financial Services LLC, a subsidiary of the McGraw-Hill Companies Inc.

"SAIDI" means System Average Interruption Duration Index and is a measure (in hours) of the annual system average interruption duration for customers served, not including MED. SAIDI represents the quotient obtained by dividing the total customer hours of interruptions longer than one minute by the number of customers served.

"SAIFI" means System Average Interruption Frequency Index and is a measure of the frequency of service interruptions for customers served, not including MED. SAIFI represents the quotient obtained by dividing the total number of customer interruptions longer than one minute by the number of customers served.

"SEDAR" refers to the Canadian Securities Administrators' System for Electronic Document Analysis and Retrieval. SEDAR's website is www.sedar.com.

"Shareholder Direction" refers to the Shareholder Direction adopted by the Council of the City with respect to the Corporation, as amended and restated from time to time, pursuant to which the City has set out certain corporate governance principles with respect to the Corporation.

"Smart Meter" refers to a metering device capable of recording and transmitting hourly consumption information of a residential or general service customer.

"Standard Supply Customers" refers to persons connected to an electricity distributor's distribution system who are not served by retailers or whose retailer is unable to sell them electricity or who request the distributor to sell electricity to them.

"Standard Supply Service" refers to an electricity distributor's obligation to sell electricity to Standard Supply Customers, or to give effect to such rates as determined by the OEB under section 79.16 of the OEB Act.

"Standard Supply Service Code" refers to the Standard Supply Service Code for Electricity Distributors that was published by the OEB on December 8, 1999 and became effective on the commencement of Open Access, as amended.

"TA" refers to the *Taxation Act, 2007* (Ontario), as amended.

"Technical Standards and Safety Act" refers to the *Technical Standards and Safety Act, 2000* (Ontario), as amended.

"TH Energy" refers to the Corporation's wholly-owned subsidiary, Toronto Hydro Energy Services Inc.

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

"Total Recordable Injury Frequency" refers to the number of recordable injuries multiplied by 200,000 divided by exposure hours, as per CEA standards.

"Transfer By-law" refers to By-law No. 374-1999 of the City made under section 145 of the Electricity Act pursuant to which the Toronto Hydro-Electric Commission and the City transferred their assets and liabilities and employees in respect of the electricity distribution system to LDC and in respect of electricity generation, co-generation and energy services to TH Energy. 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.

"Unit Smart Meter" refers to a unit Smart Meter installed by LDC in a unit of a multi-unit complex where the multi-unit complex is not connected solely to a bulk meter, and includes such other meters as may be prescribed by the Energy Consumer Protection Act.

"US GAAP" refers to United States Generally Accepted Accounting Principles.

"Watt" or "W" refers to a common measure of electrical power. One Watt equals the power used when one ampere of current flows through an electrical circuit with a potential of one volt.

Unless otherwise specified, all references to statutes are to statutes of the Province and all references to dollars are to Canadian dollars.

PART 3 - CORPORATE STRUCTURE

3.1 Name, Address, Incorporation

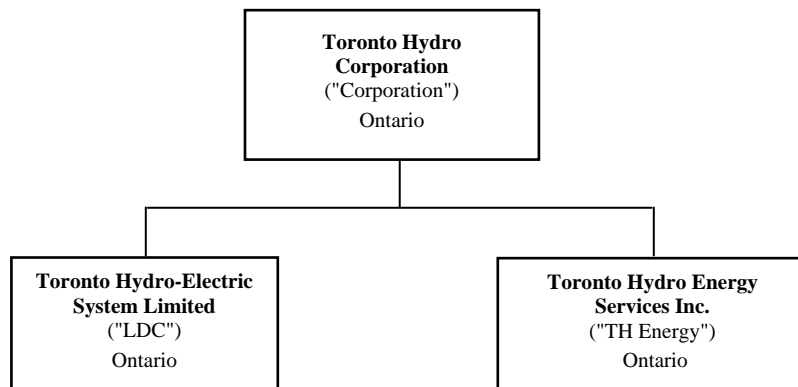
On January 1, 1998, the former municipalities of Metropolitan Toronto, Toronto, East York, Etobicoke, North York, Scarborough and York amalgamated to form the City. At the same time, the electric commissions of Toronto, East York, Etobicoke, North York, Scarborough and York were combined to form the Toronto Hydro-Electric Commission. Toronto Hydro is the successor to the Toronto Hydro-Electric Commission.

The Corporation, LDC and TH Energy were incorporated under the OBCA on June 23, 1999. Pursuant to the Transfer By-law, the Toronto Hydro-Electric Commission and the City transferred their assets and liabilities in respect of the electricity distribution system to LDC and electricity generation, co-generation and energy services to TH Energy. See note 1 to the Consolidated Financial Statements.

The registered and head office of the Corporation is located at 14 Carlton Street, Toronto, Ontario, M5B 1K5.

3.2 Inter-corporate Relationships

The sole shareholder of the Corporation is the City. The Corporation, in turn, owns 100% of the shares of the principal subsidiaries listed below, each of which was incorporated under the OBCA:



PART 4- BUSINESS OF TORONTO HYDRO

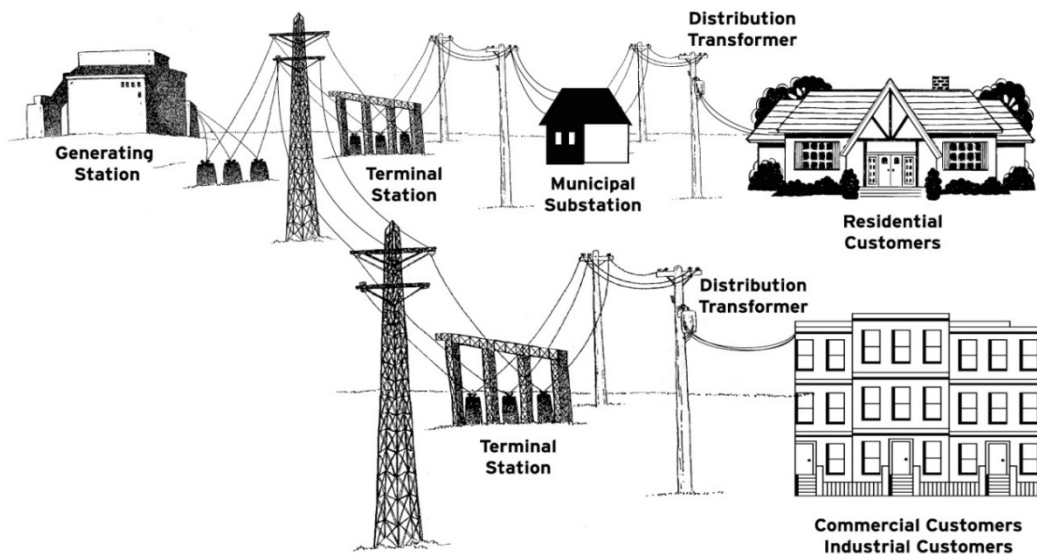
4.1 Industry Structure

The electricity industry in the Province is divided into four principal segments:

- Generation - the production of electricity at generating stations using nuclear, fossil, hydro or other sources of energy;
- Transmission - the transfer of electricity from generating stations to local areas using large, high-voltage power lines;
- Distribution - the delivery of electricity to homes and businesses within local areas using relatively low-voltage power lines; and
- Retailing - the purchase of electricity from generators and its sale to consumers together with a range of related services.

Electricity produced at generating stations is boosted to high voltages by nearby transformers so that the electricity can be transmitted long distances over transmission lines with limited power loss. The voltage is then reduced (stepped down) at terminal stations for supply to electricity distributors or large customers. Electricity distributors carry the electricity to distribution transformers that further reduce the voltage for supply to local customers. Electricity is distributed in the Province through a network of local electricity distributors that includes approximately eighty municipal electricity distributors, a few privately owned electricity distributors, and Hydro One.

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



4.2 Toronto Hydro Corporation

The Corporation is a holding company which wholly-owns two subsidiaries:

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

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

The Corporation's vision is to maximize customer and stakeholder satisfaction by providing safe and reliable service in an environmentally responsible way. The Corporation's corporate strategy is based on this vision and is focused on the following four pillars:

- *Health & Safety* – To conduct business with a skilled, safe and productive workforce;
- *Asset Modernization* – Improve reliability and strive to meet the objectives of the Green Energy Act by rebuilding the existing aging infrastructure in keeping with leading technology;
- *Customer Service* – Strive to be the best utility in customer service; and
- *Financial Strength* – Achieve consistent financial performance.

4.3 Toronto Hydro-Electric System Limited

The principal business of Toronto Hydro is the distribution of electricity by LDC. LDC owns and operates \$2.6 billion of Capital Assets comprised primarily of an electricity distribution system that delivers electricity to approximately 719,000 customers located in the City. LDC is the largest municipal electricity distribution company in Canada and distributes approximately 19% of the electricity consumed in the Province.

(a) LDC's Electricity Distribution System

Electricity produced at generating stations is transmitted along transmission lines owned by Hydro One to terminal stations at which point the voltage is then reduced (or stepped down) to distribution-level voltages. Distribution-level voltages are then distributed across LDC's electricity distribution system to distribution class transformers at which point the voltage is further reduced (or stepped down) for supply to end use customers. Electricity typically passes through a meter before reaching a distribution board or service panel that directs the electricity to end use circuits.

LDC's electricity distribution system is serviced from a control centre and 35 terminal stations and is comprised of approximately 20,400 primary switches, approximately 60,650 distribution transformers, 169 in-service municipal substations, approximately 15,100 kilometres of overhead wires supported by approximately 174,700 poles and approximately 10,800 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 electricity distribution assets, and provides isolation and work protection for LDC's construction and maintenance crews and external customers. LDC's control centre utilizes supervisory control and data acquisition (SCADA) systems to monitor, operate, sectionalize and restore the electricity distribution system.

(ii) Terminal Stations

LDC receives electricity at 35 transmission system terminal stations at which the voltage is stepped down to distribution-level voltages. The terminal stations contain power transformers and high-voltage switching equipment that are owned by Hydro One, with the exception of Cavanagh station for which the equipment and real property is

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 electricity distribution system includes approximately 60,650 distribution transformers. The electricity distribution system also includes 169 in-service municipal substations that are located in various parts of the City and are used to reduce or step down electricity voltage prior to delivery to distribution transformers. LDC also delivers electricity at distribution voltages directly to certain commercial and industrial customers that own their own substations.

(iv) *Wires*

LDC distributes electricity through a network comprised of an overhead circuit of approximately 15,100 kilometres supported by approximately 174,700 poles and an underground circuit of approximately 10,800 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 decision by the Province's Ministry of Energy to install Smart Meters throughout the Province, LDC launched its Smart Meter project in 2006. The Smart Meter project's objective was to install Smart Meters and supporting infrastructure for all residential and small (less than 50 kW) commercial customers. LDC substantially completed its Smart Meter project in 2010.

As part of its metering services, LDC also installs Unit Smart Meters in multi-unit complexes. As at December 31, 2012, LDC had installed approximately 32,000 Unit Smart Meters in multi-unit complexes.

(vi) *Reliability of Distribution System*

The table below sets forth certain industry recognized measurements of system reliability with respect to LDC's electricity distribution system and the composite measures reported by LDC and the CEA for the twelve month periods ending December 31 in the years indicated below.

	<u>LDC</u> <u>2012</u>	<u>LDC</u> <u>2011</u>	<u>CEA</u> <u>2011 ⁽¹⁾</u>
SAIDI	1.03	1.43	5.11
SAIFI	1.40	1.62	2.53
CAIDI	0.74	0.88	2.02

Note:

(1) CEA 2011 Service Continuity Report on Distribution System Performance in Canadian Electrical Utilities, excluding significant events. At the date of this AIF, the CEA 2012 Service Continuity Report has not been published.

(b) LDC's Service Area and Customers

LDC is the sole provider of electricity distribution services in the City, and serves approximately 719,000 customers. The City is the largest city in Canada with a population of approximately 2.8 million. The City is a financial centre with large and diversified service and industrial sectors.

The table below sets out LDC's customer classes and certain operating data with respect to each class for each of the years in the two-year period ended December 31, 2012:

	Year ended December 31	
	2012	2011
Residential Service ⁽¹⁾		
Number of customers (as at December 31).....	637,910	629,049
kWh	5,173,953,186	5,204,012,541
Revenue	\$709,457,130	\$703,765,567
% of total service revenue	25.3%	25.4%
General Service ⁽²⁾		
Number of customers (as at December 31)	80,699	80,222
kWh	17,205,736,682	17,148,430,298
Revenue	\$1,867,588,336	\$1,824,321,064
% of total service revenue	66.7%	66.0%
Large Users ⁽³⁾		
Number of customers (as at December 31)	52	52
kWh	2,182,029,776	2,355,143,073
Revenue.....	\$222,358,154	\$238,627,556
% of total service revenue	7.9%	8.6%
Total		
Number of customers (as at December 31)	718,661	709,323
kWh.....	24,561,719,644	24,707,585,912
Revenue	\$2,799,403,620	\$2,766,714,187

Notes:

- (1) "Residential Service" means a service that is for domestic or household purposes, including single family or individually metered multi-family units and seasonal occupancy.
- (2) "General Service" means a service supplied to premises other than those receiving "Residential Service" and "Large Users" and typically includes small businesses and bulk-metered multi-unit residential establishments. This service is provided to customers with a monthly peak demand of 5,000 kW or less averaged over a twelve-month period.
- (3) "Large Users" means a service provided to a customer with a monthly peak demand of 5,000 kW or more averaged over a twelve-month period.

(c) LDC's Customer Care and Billing System

On July 6, 2011, LDC implemented a new customer care and billing system for its regulated electricity distribution business. The new system allows for more flexibility for its users and provides an integrated billing platform leveraging the technology of the Smart Meters installed over the past few years.

(d) LDC's Real Property

The following table sets forth summary information with respect to the principal real property owned, leased or otherwise used by LDC:

<u>Property</u>	<u>Total</u>	<u>Owned</u>	<u>Leased</u>	<u>Other⁽¹⁾</u>
Terminal stations	35 sites	8	-	27
Municipal substations	169 sites	157	4	8
Decommissioned municipal substations.....	33 sites	33	-	-

<u>Property</u>	<u>Total</u>	<u>Owned</u>	<u>Leased</u>	<u>Other⁽¹⁾</u>
Control centre ⁽²⁾	1 site	1	-	-
Operations centres ⁽³⁾	7 sites	3	4	-
Other ⁽⁴⁾	2 sites	2	-	-

Notes:

- (1) Certain terminal stations and municipal substations are located on lands owned by the Province, the City and others. Where electricity distribution lines cross over and run parallel with lands owned by railway companies, appropriate access rights, generally referred to as crossing agreements, have been obtained from the railway companies.
- (2) LDC's control centre is located within one of its operations centres.
- (3) LDC's operation centres accommodate office, staff, crews, vehicles, equipment and material necessary to operate and monitor the electricity distribution system.
- (4) Parcels of land for future use.

Under the OEB Act, electricity distributors are entitled to apply to the OEB for authority to expropriate land required in connection with new or expanded electricity distribution lines or interconnections. If, after a hearing, the OEB is of the opinion that the expropriation of land is in the public interest, the OEB may make an order authorizing expropriation upon payment of specified compensation. The Electricity Act grandfathered thousands of existing unregistered easements, principally for distribution over third-party lands. The Electricity Act also authorizes electricity distributors to locate assets on, over or under public streets and highways.

(e) Regulation of LDC

(i) Legislative Framework

The Electricity Act and the OEB Act provide the broad legislative framework for the Province's electricity market.

The Electricity Act restructured the Province's electricity industry. Under the Electricity Act, the former Ontario Hydro was reorganized into five separate corporations (listed below under their current names):

- OPG, the entity responsible for the former Ontario Hydro's generation business;
- Hydro One, the entity responsible for the former Ontario Hydro's electricity transmission, distribution and energy services businesses;
- OEFC, the entity responsible for managing and retiring the former Ontario Hydro's outstanding indebtedness and remaining liabilities;
- IESO, a non-profit corporation responsible for central market operations; and
- Electrical Safety Authority, a non-profit corporation responsible for the electric installation inspection function.

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

The OEB Act expanded the jurisdiction and mandate of the OEB to include regulation of the non-competitive electricity market in addition to the natural gas markets. The business of LDC and other electricity distributors is regulated by the OEB, which has broad powers relating to licensing, standards of conduct and service, the regulation of electricity distribution rates charged by LDC and other electricity distributors and transmission rates charged by Hydro One and other transmitters.

In 2004, the Electricity Restructuring Act established the OPA, as a non-profit, self-financed organization with the mandate to ensure long-term electricity supply adequacy in the Province. The OPA is authorized and has the responsibility to implement an integrated power system supply plan and deliver CDM programs in the Province.

The Energy Consumer Protection Act came into force on January 1, 2011. The Energy Consumer Protection Act amends several statutes, including the OEB Act, the Electricity Act, the Consumer Protection Act and the Residential Tenancies Act. The Energy Consumer Protection Act also enables and sets out the requirements relating to LDC's installation of Unit Smart Meters in multi-unit complexes and provides new rules regarding the manner in which energy consumers are to be billed for their electricity consumption.

(ii) *Licences*

Distribution Licence

The OEB has granted LDC a distribution licence. The term of the current licence is until October 16, 2023. The licence allows LDC to own and operate an electricity distribution system in the City. Among other things, the licence provides that LDC 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.

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, TH Energy does not currently engage in electricity retailing.

Electricity Generation Licence

On December 18, 2002, the OEB issued an electricity generation licence to TH Energy and TREC Windpower Co-operative (No.1) Incorporated (the co-venturers), in connection with a wind turbine located at Exhibition Place in the City. The licence allows the co-venturers to generate electricity or provide ancillary services for sale through the IESO-administered markets, or directly to another person, subject to certain terms and conditions. This licence terminates on December 17, 2022, although the term may be extended by the OEB.

(iii) *Industry Codes*

The OEB has established the Affiliate Relationships Code, the Distribution System Code, the Retail Settlement Code, the Standard Supply Service Code, and the Conservation and Demand Management Code. These codes prescribe minimum standards of conduct, as well as standards of service, for electricity distributors in the non-competitive electricity market, and have been assigned the following ranking in the event there is a conflict between them:

- (1) Affiliate Relationships Code
- (2) Distribution System Code
- (3) Retail Settlement Code
- (4) Standard Supply Service Code
- (5) Conservation and Demand Management Code

These codes are summarized below.

Affiliate Relationships Code

The Affiliate Relationships Code establishes standards and conditions for the interaction between electricity distributors and their affiliated companies. It is intended to minimize the potential for an electricity distributor to cross-subsidize competitive or non-monopoly activities, protect the confidentiality of consumer information collected by an electricity distributor and ensure that there is no preferential access to regulated services. The

Affiliate Relationships Code prescribes standards of conduct for an electricity distributor with respect to the following: the degree of separation from affiliates; sharing of services and resources; transfer pricing; financial transactions with affiliates; equal access to services; and confidentiality of customer information.

Distribution System Code

The Distribution System Code establishes the minimum conditions that an electricity distributor must meet in carrying out its obligations to distribute electricity under its licence and under the Energy Competition Act, and has been amended as the regulatory environment has evolved. Generally, the Distribution System Code prescribes the rights and responsibilities of electricity distributors and electricity distribution customers with respect to the following: connections; connection agreements and conditions of service; expansion projects; alternative bids (available to customers for work otherwise done by an electricity distributor); metering; operations; disconnection and security deposits; and other matters.

Retail Settlement Code

The Retail Settlement Code outlines the obligations of an electricity distributor with respect to its relationship with retail market participants and its role as a retail market settlements administrator. Under the terms of the Retail Settlement Code, an electricity distributor is required to do the following: unbundle the costs of competitive electricity services and non-competitive electricity services; record, in variance accounts, the difference between amounts billed by the IESO to the electricity distributor for competitive and non-competitive electricity services, and the aggregate amounts billed by the electricity distributor to consumers, retailers and others for the same services; and provide electricity billing and settlement services to retailers and customers.

Standard Supply Service Code

The Standard Supply Service Code requires an electricity distributor to act as a default supplier and provide Standard Supply Service to persons connected to the electricity distributor's distribution system. The Standard Supply Service Code also specifies the conditions and manner by which OEB approved Standard Supply Service rates are to be charged to customers. Under the Standard Supply Service Code, an electricity distributor's rates for Standard Supply Service must be approved by the OEB and must consist of the price of electricity and an administrative charge that will allow the electricity distributor to cover its costs of providing the service.

Conservation and Demand Management Code

The Conservation and Demand Management Code sets out the obligations and requirements that licensed electricity distributors must comply with in relation to CDM targets as set out in their licences, as well as the operational framework for electricity distributor-operated CDM activities. The Conservation and Demand Management Code also sets out the conditions and rules that licensed electricity distributors are required to follow if they choose to use OEB approved CDM programs to meet their CDM targets.

(f) Distribution Rates

(i) Rate Setting Mechanism

Pursuant to Section 78 of the OEB Act, the OEB is mandated to regulate the electricity distribution rates charged by electricity distributors. Generally, an electricity distributor's rates are set by way of either a Cost of Service or Incentive Regulation Mechanism framework.

A Cost of Service application requires a detailed examination of evidence and an assessment of the costs incurred by an electricity distributor to provide service, including: capital costs and cost rates for equity and debt; PILs payments; amortization costs; operations, maintenance, and administrative costs; and cost of service offsets in the form of revenues from sources other than electricity distribution rates. The electricity distributor's rates are calculated to recover the total amount of all costs less revenue from other sources, as determined by the OEB, required to provide service to its customers.

The Incentive Regulation Mechanism framework provides for an annual adjustment to an electricity distributor's rates based on a formulaic calculation with no direct examination of evidence regarding the electricity distributor's actual costs and infrastructure needs. The Incentive Regulation Mechanism rate setting plan runs on a four year cycle, with a Cost of Service rate application known as a "rebasement application" serving as the starting point for three subsequent annual rate changes determined through the Incentive Regulation Mechanism adjustment process. The OEB's current Third Generation version of Incentive Regulation Mechanism allows electricity distributors to adjust their rates by the difference between the inflation factor (as determined by Statistics Canada) and the sum of a deemed productivity factor of 0.72% (representing the expected annual electricity distributor productivity gain) and a stretch factor of 0.2%, 0.4% or 0.6% (representing an additional productivity target determined by benchmarked electricity distributor performance).

In certain circumstances, a distributor may also request, under the Incentive Regulation Mechanism, relief by way of the Incremental Capital Module, which is intended to address specific capital expenditure needs that occur during the Incentive Regulation Mechanism term, and are not otherwise funded by the formulaic calculation. In order to determine whether a distributor is eligible for the Incremental Capital Module, the OEB conducts a review of the application by way of a detailed examination of a distributor's evidence and consideration of a number of criteria, such as materiality, need and prudence.

On October 18, 2012, the OEB released its report, *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*, which will guide the OEB in setting rates for electricity distributors. The OEB is currently developing the necessary regulatory instruments and expects such instruments to be largely finalized and implemented in time for setting distribution rates beginning May 2014. The *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* is designed to support the cost-effective planning and operation of the electricity distribution network.

The *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* identifies three rate-setting methods to provide choices for distributors with varying capital requirements: a Fourth Generation Incentive Rate-setting method, which builds on the current Third Generation Incentive Rate-setting method; a Custom Incentive Rate-setting method, through which rates are set based on a five year forecast of a distributor's revenue requirement and sales volumes; and an Annual Incentive Rate-setting Index method, which involves adjustment of rates by a simple price cap index formula. Each distributor may select the rate-setting method that best meets its needs and circumstances. The *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach* also requires distributors to file five-year capital plans to support their rate applications, and to report annually on their key performance outcomes. Within the scope of the information currently available, the Corporation is currently assessing the rate-setting methods available and other implications resulting from the *Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach*.

See section 5.2 under the heading "Rate Applications" for more information on LDC's rate applications.

(ii) *Other Regulated Charges*

The OEB's 2006 Rate Handbook provides standard rates and guidelines to electricity distributors with respect to other regulated charges that are non-competitive in nature, required under OEB codes and guidelines, governed by the market rules or are under the direction of the Province, including transmission charges and retail service charges relating to services provided by electricity distributors to electricity retailers in accordance with the Retail Settlement Code.

4.4 Toronto Hydro Energy Services Inc.

TH Energy is a professional energy services company with \$22.2 million of Capital Assets. Until January 1, 2012, TH Energy owned and operated all of the street lighting assets located in the City and had the sole right to provide maintenance and capital improvements to the street lighting systems throughout the City until 2035, which services were sub-contracted to LDC. Effective January 1, 2012, TH Energy transferred a portion of its street lighting assets to LDC. TH Energy continues to provide street lighting system maintenance and capital improvement services to the City, and such services continue to be sub-contracted to LDC. See section 5.3 under the heading "Street Lighting Activities" for more information on the transfer of street lighting assets from TH Energy to LDC.

TH Energy also provides consolidated billing services to the City, which services are sub-contracted to LDC, and operates a wind turbine located at the Better Living Centre (Exhibition Place) in a joint venture with TREC Windpower Cooperative (No.1) Incorporated.

4.5 Environmental Matters

(a) Environmental Protection Requirements

Toronto Hydro is subject to extensive federal, provincial and local regulation relating to the protection of the environment. The principal federal legislation is the Canadian Environmental Protection Act which regulates the use, import, export and storage of toxic substances, including PCBs and ozone-depleting substances. Toronto Hydro is also subject to the federal Transportation of Dangerous Goods Act which prescribes safety standards and requirements for the handling and transportation of hazardous goods including PCBs and sets reporting, training and inspection requirements relating thereto.

The principal provincial legislation is the Environmental Protection Act which regulates releases and spills of contaminants, including PCBs, ozone-depleting substances and other halocarbons, contaminated sites, waste management, and the monitoring and reporting of airborne contaminant discharge. The provincial Technical Standards and Safety Act also applies to Toronto Hydro's operations with respect to the handling of and training related to compressed gas, propane and liquid fuels. The provincial Fire Protection and Prevention Act requires Toronto Hydro to incorporate procedures and training for dealing with any spills of flammable or combustible liquids. The provincial Dangerous Goods Transportation Act prescribes safety standards and requirements for the transportation of dangerous goods on provincial highways and sets out inspection requirements related thereto.

Municipal by-laws regulate discharges of industrial sewage and storm water run-off to the municipal sewer system and the reporting of the release of certain toxic substances into the atmosphere.

(b) Financial and Operational Effects of Environmental Protection Requirements

In 2012, LDC spent approximately \$0.4 million to meet environmental protection requirements. These costs are not anticipated to significantly increase for future years, and do not currently have a material impact on the Corporation's financial and operational results.

The Corporation recognizes a liability for the future environmental remediation of certain properties and for future removal and handling costs for contamination in electricity distribution equipment in service and in storage. The liability is recognized when the asset retirement obligation is incurred and when the fair value is determined. As at December 31, 2012, the Corporation's asset retirement obligations amounted to \$5.1 million. See note 4 (p) and note 15 to the Consolidated Financial Statements.

(c) Environmental Policy and Oversight

Toronto Hydro has a strong commitment to the environment through the enforcement of a well defined Environmental Policy. Conformance with the Environmental Policy is managed by the Environmental, Health and Safety department led by LDC's Vice-President of Organizational Effectiveness, Environment, Health and Safety. The content of, and conformance with, the Environmental Policy is reviewed annually by the Board.

Toronto Hydro's Environmental Policy identifies several core environmental principles, which include:

- Compliance with all applicable laws, codes and standards;
- Continual improvement of environmental performance through the establishment of annual objectives, targets and programs;
- Employee engagement through education, training and providing general awareness of the Environmental Policy requirements and the environmental management system;
- Community engagement including consultation and engagement of environmental issues within the community and various stakeholders such as suppliers, customers, regulators, industry and the public;

- Pollution prevention through the implementation of policies, programs and procedures; and
- General operations through general awareness, building of an environmental culture and considering the environment in everyday business processes.

LDC manages its environmental aspects in conformance with ISO 14001 and was certified on February 5, 2013 as meeting the requirements of the ISO 14001 standard by a third party auditor.

All legislated environmental reporting requirements for federal, provincial and municipal governments are complied with. Management assurance that these requirements are met is accomplished by commissioning third party environmental compliance audits conducted in conformance with LDC's environmental health and safety audit plan.

Toronto Hydro's environmental policies, programs and procedures are reviewed and approved by management. Quarterly updates are presented to the Board covering current environmental risks, environmental compliance audit findings, mitigation strategies and other material environmental matters.

4.6 Additional Information Regarding Toronto Hydro

(a) Employees

At December 31, 2012, Toronto Hydro had approximately 1,540 employees. Included in Toronto Hydro's employees are 1,025 members of bargaining units represented by the Canadian Union of Public Employees, Local One ("CUPE One"), and 52 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 only become effective if certain prescribed thresholds are exceeded.

On April 12, 2012, the Society of Energy Professionals ratified a new collective agreement for a four-year period expiring December 31, 2015. The collective agreement implemented wage increases of 1.5% retroactive to January 1, 2012, 1.75% effective January 1, 2013 and 2.0% effective on each of January 1, 2014 and January 1, 2015, respectively.

Full time employees of Toronto Hydro participate in the OMERS pension plan. Plan benefits are determined on a formula based on the highest 5-year average contributory earnings and years of service with an offset for Canada Pension Plan benefits and are indexed to increases in the Consumer Price Index, subject to an annual maximum of 6%. Any increase in the Consumer Price Index above 6% per year is carried forward for later years. Both participating employers and participating employees are required to make plan contributions based on participating employees' contributory earnings. All obligations to make payments to retirees under the OMERS pension plan are the responsibility of OMERS.

In addition to OMERS, Toronto Hydro provides other retirement and post-employment benefits to employees, including medical, dental and life insurance benefits. See note 4(o) and note 14 to the Consolidated Financial Statements.

(b) Specialized Skills and Knowledge

Trades and technical jobs play a critical role in the safe and reliable design, construction and maintenance of LDC's electricity distribution system. These jobs include overhead, underground, and stations trades as well as controllers, designers and engineers. LDC hires experienced workers when available, along with apprentices to trades and technical positions. Trade apprentices require between 54 and 78 months to become fully competent and capable of performing all aspects of their job. LDC provides trades, legislative and compliance training through its apprenticeship program.

(c) Health and Safety

Toronto Hydro is committed to a safe and injury free work environment for all employees, contractors, visitors and the public. Through LDC's EHSMS, based on British Standards Institution OHSAS 18001:2007 Standard "*Occupational Health and Safety Management System - Requirements*", LDC maintains and reviews procedures, programs and the Occupational Health and Safety Policy which outlines several core principles including:

- Compliance
- Continual Improvement
- Engagement and Consultation
- Communication
- Accountability
- Risk Management
- Contractor Management
- Incident Investigation
- Performance Monitoring

The content of, and compliance with, the Occupational Health and Safety Policy is reviewed annually by the Board.

Toronto Hydro's health and safety performance is reviewed periodically by the Health and Safety Committee of the Board. In 2012, the Total Recordable Injury Frequency was reduced to 2.15 recordable injuries per 200,000 hours worked compared to 2.49 in 2011.

LDC's legislated occupational health and safety requirements come under provincial jurisdiction exclusively and all legislated occupational health and safety reporting requirements are complied with. Management assurance that these requirements are met is accomplished by commissioning third party environmental compliance audits conducted in conformance with LDC's environmental health and safety audit plan.

Toronto Hydro's occupational health and safety policies, programs and procedures are reviewed and approved by management. Quarterly updates are presented to the Board covering current occupational health and safety risks, performance, compliance audit findings, mitigation strategies and other occupational health and safety matters

(d) Code of Business Conduct

All employees, officers and directors of Toronto Hydro are required to comply with the principles set out in the Code of Business Conduct, which was implemented by Toronto Hydro in 2004, and is reviewed and approved by the Board from time to time. The Code provides for the appointment of an Ethics Officer and establishes a direct hotline to the Ethics Officer by which perceived violations of the principles set out in the Code may be reported, anonymously or otherwise. The Ethics Officer reports quarterly to the Audit Committee of the Board on the nature of complaints received including those related to audit and accounting matters. Where the complaint involves the conduct of a director or officer of the Corporation, the Ethics Officer is required to report it to the Chair of the Audit Committee, who oversees the investigation of that complaint. A copy of Toronto Hydro's Code of Business Conduct is available on the SEDAR website at www.sedar.com.

(e) Insurance

Toronto Hydro's current insurance policies provide coverage for a variety of losses and expenses which might arise from time to time, including comprehensive general liability, all risk property and boiler and machinery insurance, covering loss or damage on certain physical assets, liabilities of directors and officers and automobile liability. Toronto Hydro believes that the coverage, amounts and terms of its insurance arrangements are consistent with prudent Canadian industry practice.

(f) Lending and Investments

Toronto Hydro's lending and investment activities are governed by the terms of the Shareholder Direction and by the terms of the Corporation's Treasury Policy. The Corporation's Treasury Policy was adopted by the Board, is administered by LDC's Treasury Department and overseen by the Corporation's CFO. The primary objective of the Treasury Policy is the implementation of appropriate and effective short-term cash management, investment and borrowing strategies required to manage all corporate funds and related financial risks. The Treasury Policy includes specific operational rules, procedures and benchmarks relating to cash management, liquidity, investments, foreign exchange hedging, borrowing of funds, interest rate risk management, investor relations and corporate debt financing.

(g) Intangible Property

The Corporation owns various intangible assets, such as computer software systems used in the course of business, and intellectual property, including the "Toronto Hydro" brand name and the trademark Toronto Hydro star logo. The Corporation also owns the trademarks peakSAVER[®], POWERSHIFT[®] and PEAKSAVER PLUS[®]. The trademarks peakSAVER[®] and PEAKSAVER PLUS[®] have been licensed by the Corporation to the OPA and sub-licensed to various electricity distributors in the Province for the promotion of a province-wide demand response CDM program.

(h) Seasonal Effects

The Corporation's financial results are impacted by changes in revenues resulting from variations in seasonal weather conditions, the fluctuations in electricity prices, and the timing and recognition of regulatory decisions. The Corporation's revenues tend to be higher in the first and third quarters of a year as a result of higher energy consumption for winter heating in the first quarter and air conditioning and cooling in the third quarter.

PART 5 - GENERAL DEVELOPMENT OF THE BUSINESS

5.1 Business Operations

(a) Three Year History

The following table sets forth selected annual financial information of the Corporation for the three years ended December 31, 2012, 2011 and 2010. This information has been derived from the Consolidated Financial Statements and is presented in millions of dollars.

	Year ended December 31			
	2012	2011 ¹	2010 ¹	% change ²
Net Income	\$86.0	\$95.9	\$66.1	30.1%
Capital Expenditures	\$290.4	\$437.1	\$390.8	(25.7%)
Total assets	\$3,539.4	\$3,527.5	\$3,338.6	6.0%
Shareholder's equity	\$1,140.3	\$1,102.2	\$1,039.4	9.7%

Notes:

- (1) The Corporation's consolidated financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. Selected financial information from comparative consolidated financial statements for 2011 have been adjusted retroactively from the consolidated financial statements previously filed to conform to the presentation of the Corporation's 2012 consolidated financial statements prepared in accordance with US GAAP.
- (2) Percentage change calculated between 2010 and 2012.

(b) Business Operations

Over the past three years, the Corporation continued to streamline its business operations to focus on LDC's core businesses of distributing electricity and engaging in CDM activities.

On January 1, 2011, the Corporation amalgamated with one of its wholly-owned subsidiaries, 1455948 Ontario Inc. ("14 Co."). At the time of the amalgamation, 14 Co. did not have any business operations. 14 Co. had been incorporated by the Corporation to operate an equal partnership with a wholly-owned subsidiary of OPG, OPG EBT Holdco Inc. (the "EBT Express Partnership"). The EBT Express Partnership owned an interest in The SPi Group Inc., an electronic clearing house for wholesale and retail electricity transactions. On April 30, 2009, the EBT Express Partnership sold its interest in The SPi Group Inc. to ERTH Corporation for cash consideration of approximately \$5.2 million. The Corporation's share of the sale proceeds from this transaction as it relates to 14 Co. was approximately \$2.6 million.

On January 1, 2012, the Corporation completed the transfer of a portion of the street lighting assets from TH Energy to the new wholly-owned legal entity (1798594 Ontario Inc.), and the amalgamation of LDC with the new wholly-owned entity. See section 5.3 under the heading "Street Lighting Activities" for more information.

5.2 Rate Applications

LDC's electricity distribution rates are typically effective from May 1 to April 30 of the following year. Accordingly, LDC's distribution revenue for the first four months of 2012 was based on the electricity distribution rates approved for the May 1, 2011 to April 30, 2012 rate year (the "2011 Rate Year"). Rates for May 1, 2012 to April 30, 2013 (the "2012 Rate Year") are currently the subject of a decision in LDC's pending application (see 5.2(c)), and any approved difference relative to current rates would be collected prospectively effective May 1, 2013.

The following is an overview of LDC's rate applications from 2010 to date.

(a) 2010 Rate Year

LDC's electricity distribution rates for the 2010 Rate Year were determined through an application under the Cost of Service framework. The Cost of Service framework sets electricity distribution rates using a detailed examination of evidence and an assessment of the costs incurred by an electricity distributor to provide services to its customers. On April 9, 2010, the OEB issued its decision regarding LDC's electricity distribution rates for the 2010 Rate Year. The decision provided for a distribution revenue requirement and rate base of \$518.7 million and \$2,140.7 million, respectively. In addition, the decision provided for capital program spending levels and operating, maintenance and administration spending levels of \$350.0 million and \$204.1 million, respectively.

(b) 2011 Rate Year

LDC's electricity distribution rates for the 2011 Rate Year were determined through an application filed under the Cost of Service framework. On July 7, 2011, the OEB issued its decision regarding LDC's electricity distribution rates for the 2011 Rate Year. The decision provided for a distribution revenue requirement and rate base of \$522.0 million and \$2,298.2 million, respectively. In addition, the decision provided for capital program spending levels and operating, maintenance and administration spending levels of \$378.8 million and \$238.0 million, respectively.

(c) 2012-2014 Rate Application

On August 26, 2011, LDC filed a rate application, following the Cost of Service framework, with the OEB seeking approval of separate and successive revenue requirements and corresponding electricity distribution rates for 2012, 2013 and 2014. Pursuant to the Incentive Regulation Mechanism framework, the OEB established, as a preliminary issue in this application, that it would consider the question of whether the application filed by LDC under the Cost of Service framework was acceptable or whether it should be dismissed. The Incentive Regulation Mechanism framework provides for a standard adjustment to an electricity distributor's rates based on a formulaic calculation.

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

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

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

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

On May 10, 2012, LDC filed an application for electricity distribution rates for 2012, 2013, and 2014 using the Incentive Regulation Mechanism framework, including the filing of an Incremental Capital Module application (the "IRM/ICM Application"). The formulaic adjustment, requested by LDC, follows the guidelines provided by the OEB and seeks to increase the current revenue requirement by 0.68% to \$525.5 million for 2012, \$529.1 million for 2013 and \$532.7 million for 2014. The 2013 and 2014 formulaic adjustment may be subject to change depending on future inflation and market data.

The IRM/ICM Application proposed by LDC requests rate riders to enable the recovery of capital expenditures. Accordingly, the amount of capital expenditures included in LDC's proposed IRM/ICM Application amounts to \$448.7 million for 2012, \$534.5 million for 2013 and \$439.5 million for 2014.

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

While the IRM/ICM Application proposed by LDC has been under consideration by the OEB, capital spending in 2012 has been maintained at a reduced amount. As it was no longer practical to achieve the previously requested capital spending of \$448.7 million in 2012, an update to the IRM/ICM Application was submitted by LDC on October 31, 2012 modifying the requested capital expenditures for 2012 and 2013 to \$283.0 million and \$579.1 million, respectively, and requesting that consideration for 2014 be deferred to a second phase of the proceeding, once LDC has received a decision from the OEB in respect of phase one. On November 3, 2012, the OEB accepted LDC's request for a two-phase proceeding: phase one comprising LDCs 2012 and 2013 work program proposals and phase two comprising LDCs 2014 work program proposal.

On March 4, 2013, phase one of the proceeding was completed, having been subject to an in-depth review by the OEB. There can be no assurance that the OEB will allow for the total or partial recovery of the capital expenditure balances requested in the current application. The financial effect of the OEB decision will be recorded in the period it becomes known and could be material to the Corporation's financial performance.

5.3 Street Lighting Activities

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

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

The OEB ordered the Corporation to provide a detailed valuation of the street lighting assets and to perform an operational review to determine which street lighting assets could become regulated assets.

The Corporation performed a detailed asset operational review and financial valuation of the street lighting assets, which was submitted to the OEB on January 31, 2011.

On August 3, 2011, the OEB issued its final decision allowing the transfer of a portion of the street lighting assets to the new wholly-owned legal entity (1798594 Ontario Inc.), and for LDC to amalgamate with the new legal entity. On January 1, 2012, the Corporation completed the asset transfer and amalgamation. The purchase price for such assets, including a post-closing adjustment, was \$42.5 million, subject to transaction costs.

5.4 Conservation and Demand Management

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

Effective January 1, 2011, LDC entered into an agreement with the OPA in the amount of approximately \$50.0 million to deliver CDM programs extending from January 1, 2011 to December 31, 2014. As at December 31, 2012, LDC received approximately \$35.4 million from the OPA for the delivery of CDM programs. All programs to be delivered are fully funded and paid in advance by the OPA. Amounts received but not yet spent are shown under current liabilities as deferred conservation credit. Upon expiration of the agreement, LDC is required to repay to the OPA any excess funding received for program administration less any cost efficiency incentives. These programs are expected to support the achievement of the mandatory CDM targets described above.

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

5.5 Contact Voltage

On June 30, 2009, LDC filed an application with the OEB seeking recovery of costs incurred in 2009 for the remediation of safety issues related to contact voltage. LDC sought recovery of \$14.4 million by way of fixed term rate riders of 3 years for the street lighting and unmetered scattered load rate classes, and one year for all other classes.

On December 10, 2009, the OEB issued an initial decision in this proceeding which provided for the recovery of allowable actual expenditures incurred above the amount deemed as controllable expenses in LDC's 2009 approved electricity distribution rates. At the time of the decision, the Corporation estimated the allowable recovery of costs at \$9.1 million.

On October 29, 2010, the OEB issued a second decision in the matter, following further review of costs incurred by LDC. In this decision, the OEB deemed the balance allowable for recovery at \$5.3 million. The variance from the Corporation's original estimate 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. On March 25, 2011, the OEB issued its decision on the LDC motion, denying the requested additional recovery.

5.6 OEB PILs Proceeding

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

regulatory variance accounts. Subsequent to this decision, the OEB issued interrogatories and decisions for other MEUs.

LDC has reviewed the balances of its PILs regulatory variance accounts and applied the guidelines provided by the OEB. As at December 31, 2012, LDC estimated its liability at approximately \$7.0 million. This balance has been recorded in the Corporation's Consolidated Financial Statements. LDC has applied for disposition of the balance as part of its pending IRM/ICM Application filed on May 10, 2012. The amount to be approved by the OEB will be based on the OEB's interpretation and application of its guidelines and the final balance which is yet to be approved by the OEB could differ materially from LDC's estimation of its liability.

5.7 Accounting Policies

Publicly accountable enterprises in Canada were required to adopt IFRS for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. On September 10, 2010, the Accounting Standards Board granted an optional one-year deferral for IFRS adoption for entities subject to rate regulation. The Corporation elected to take the optional one-year deferral of its adoption of IFRS. In the absence of a definitive plan to consider the issuance of a rate-regulated accounting standard by the International Accounting Standards Board ("IASB"), the Corporation decided to evaluate the option of adopting US GAAP effective January 1, 2012 as an alternative to IFRS. On July 21, 2011, the Ontario Securities Commission granted the Corporation an exemption to allow the Corporation to file financial statements under US GAAP for the years commencing on or after January 1, 2012 but before January 1, 2015. On August 26, 2011, the Board of Directors of the Corporation approved the adoption of US GAAP for financial reporting purposes for the year beginning on January 1, 2012.

The Consolidated Financial Statements are the Corporation's first annual consolidated financial statements prepared in accordance with US GAAP. The Corporation has adjusted amounts reported previously in its interim and annual consolidated financial statements prepared in accordance with Part V of Canadian GAAP. For reporting purposes, the transition date to US GAAP is January 1, 2011, which is the commencement of the 2011 comparative period to the Corporation's 2012 Consolidated Financial Statements. A reconciliation of the transition from Part V of Canadian GAAP to US GAAP from January 1, 2011 and December 31, 2011 is provided in note 25 to the Consolidated Financial Statements. Due to the limited differences between part V of Canadian GAAP and US GAAP, the Corporation's compliance with its debt covenants was not impacted by the conversion to US GAAP.

In the absence of an interim or final rate-regulated accounting standard by the IASB, the Corporation intends to continue to use the Ontario Securities Commission's exemption to report under US GAAP up to December 31, 2014. The Corporation is actively monitoring developments by the IASB on rate regulated accounting should a future IFRS conversion be required. Although the conversion of the Corporation's general purpose financial statements to IFRS was suspended in 2011, the IFRS conversion work is being managed in such a way that if a future transition to IFRS is required, it can be effectively accomplished.

PART 6 - RELATIONSHIP WITH THE CITY

6.1 Shareholder Direction

As sole shareholder of the Corporation, the City has adopted the Shareholder Direction that sets out the following corporate governance principles with respect to Toronto Hydro:

- the objectives 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) Shareholder 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 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 electricity distribution system, undertaking or securities of a distributor operating outside the City unless, among other things, the acquisition does not adversely affect the dividend payable to the City and there is no dilution of the City's shareholding in the Corporation.

The City has authorized the Corporation to provide up to \$500.0 million in financial support with respect to prudential requirements and as security for obligations under third-party contracts. See note 17 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 amounting to the greater of \$25.0 million or 50% of the Corporation's consolidated net income for the year. The dividends are not cumulative and are payable as follows:

- \$6.0 million on the last day of each of the first three fiscal quarters during the year;
- \$7.0 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 \$25.0 million, within ten days after the approval of the Corporation's audited Consolidated Financial Statements for the year by the Board.

The Corporation declared and paid dividends to the City totalling \$25.0 million in 2010, \$33.1 million in 2011 and \$48.0 million in 2012.

On February 28, 2013, the Board of Directors of the Corporation declared dividends in the amount of \$24.0 million. The dividends are comprised of \$18.0 million with respect to net income for the year ended December 31, 2012, payable to the City on March 8, 2013 and \$6.0 million with respect to the first quarter of 2013, payable to the City on March 28, 2013.

LDC declared and paid \$nil dividends to the Corporation in 2010, 2011 and 2012.

TH Energy declared and paid dividends to the Corporation amounting to \$19.6 million in 2010, \$nil in 2011 and \$28.5 million in 2012.

6.2 Indebtedness to the City

On April 1, 2010, the City monetized its interest in the Amended and Restated City Note under which the Corporation had \$490.1 million of indebtedness outstanding to the City. The Amended and Restated City Note represented the Corporation's remaining indebtedness to the City in consideration for the transfer of \$980.2 million of electricity distribution system assets by the Toronto Hydro-Electric Commission and the City to LDC upon initial formation of Toronto Hydro on July 1, 1999.

The Amended and Restated City Note was converted, in accordance with its terms, into two series of debentures of the Corporation ("Series 4" and "Series 5") on April 1, 2010 and sold to the public by a syndicate of investment dealers. The Corporation did not receive any proceeds from the offering of the Series 4 and Series 5 debentures. Following the completion of the offering of the Series 4 and Series 5 debentures, the Amended and Restated City

Note was cancelled and the Corporation has no further indebtedness outstanding to the City under the terms of the Amended and Restated City Note.

As at the date of this AIF, the Corporation has no further indebtedness outstanding to the City.

6.3 Services Provided to the City

Toronto Hydro provides certain services to the City at commercial and regulated rates, including consolidated electricity billing services and street lighting maintenance services provided by TH Energy and sub-contracted to LDC. See section 4.4 under the heading "Toronto Hydro Energy Services Inc." for more information. See note 20 to the Consolidated Financial Statements.

PART 7 – TAXATION

7.1 Tax Regime

The Corporation is exempt from tax under the ITA, if not less than 90% of the capital of the Corporation is owned by the City and not more than 10% of the income of the Corporation is derived from activities carried on outside the municipal geographical boundaries of the City. In addition, the Corporation's subsidiaries are also exempt from tax under the ITA provided that all of their capital is owned by the Corporation and not more than 10% of their respective income is from activities carried on outside the municipal geographical boundaries of the City. A corporation exempt from tax under the ITA is also exempt from tax under the TA.

The Corporation and each of its subsidiaries are MEUs for purposes of the PILs regime contained in the Electricity Act. The Electricity Act provides that a MEU that is exempt from tax under the ITA and the TA is required to make, for each taxation year, a PILs payment to the OEFC in an amount equal to the tax that it would be liable to pay under the ITA and the TA if it were not exempt from tax. The PILs regime came into effect on October 1, 2001, at which time the Corporation and each of its subsidiaries were deemed to have commenced a new taxation year for purposes of determining their respective liabilities for PILs payments.

If the Corporation or a subsidiary ceases to be exempt from tax under the ITA and the TA, it will become subject to tax under those statutes, will no longer be required to make PILs payments to the OEFC, and will be deemed to have disposed of its assets for proceeds of disposition equal to their fair market value at that time and to have reacquired its assets at the same amount with the result that:

- such corporation would become liable to make a PILs payment in respect of any income or gains arising as a result of these deemed dispositions; and
- the amount of annual taxes payable by the corporation under the ITA, and the TA may be different from the PILs payment that would be payable without a loss of tax-exempt status to reflect, among other things, the consequences of these deemed dispositions and acquisitions.

The Electricity Act also provides that a municipal corporation or an MEU is required to pay a transfer tax when it transfers Electricity Property. An interest in Electricity Property includes any interest in a corporation, partnership or other entity that derives its value in whole or in part from Electricity Property. The transfer tax is the prescribed percentage (currently 33%) of the fair market value of the interest transferred. The amount of transfer tax payable where the interest that is transferred is an interest in a corporation, partnership or other entity, is calculated in accordance with a special rule. The amount of transfer tax payable by an MEU on a transfer of Electricity Property may be reduced by:

- any PILs payment made by the MEU in respect of the part of the taxation year up to and including the date that the transfer takes place or a previous taxation year;
- any amount that the MEU has paid as tax under Part III of the TA in respect of the part of the taxation year up to and including the date of the transfer or a previous taxation year; and

- any amount that the MEU would be liable to pay under Part I of the ITA in respect of the taxation year if that tax were calculated on the basis that the MEU had no income during the taxation year other than the capital gain, or income under paragraph 14(1)(b) of the ITA in respect of the disposition of eligible capital property, arising on the transfer of the property subject to the transfer tax.

Transfers of Electricity Property made to a municipal corporation, an MEU, Hydro One or OPG will generally be an excluded transfer and thereby 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.

7.2 PILs Recoveries through Rates

The 2006 Rate Handbook provides for electricity distribution rate adjustments to permit recoveries relating to PILs payments. These recoveries are recalculated and submitted for recovery by LDC in each Cost of Service or rebasing distribution rate application. LDC is also generally at risk for variances between forecasted and actual PILs paid, excluding variances arising from changes in tax rates not assumed in the setting of rates for the period in question, which variances are disposed of through deferral accounts under both a Cost of Service or Incentive Regulation Mechanism. See note 9(f) and 22(b) to the Consolidated Financial Statements.

7.3 Tax Contingencies

The Ministry of Finance had issued assessments in respect of payments in lieu of additional municipal and school taxes under section 92 of the Electricity Act that were in excess of the amounts LDC believes were payable. The dispute arose as a result of inaccurate information incorporated into Ontario Regulation 224/00. The Corporation has worked with the Ministry of Finance to resolve this issue, and as a result the Ministry of Finance issued Ontario Regulation 423/11 on August 31, 2011. The new regulation revoked Ontario Regulation 224/00 and corrected inaccurate information retroactively to 1999.

In May 2012, the Ministry of Finance completed its reassessment as a consequence of the change in regulation. The impact of the reassessment issued was favourable to the Corporation.

PART 8 - RISK FACTORS

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

8.1 Regulatory Developments

Ontario's electricity industry regulatory developments and policy changes may affect the electricity distribution rates charged by LDC and the costs LDC is permitted to recover. This may in turn have a material adverse effect on the financial performance of the Corporation and/or LDC's ability to provide reliable service to its customers. In particular, there can be no assurance that:

- the OEB will approve LDC's electricity distribution rates under the Incentive Regulation Mechanism framework, including the Incremental Capital Module, at levels that will permit LDC to carry out its planned capital work programs required to maintain safe and reliable service to its customers and earn the allowed rate of return on the investment in the business;

- the regulatory instruments that arise from the Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach will be sufficient to address LDC's operations, needs and circumstances in respect of future applications for electricity distribution rates;
- the OEB will not set a lower recovery for LDC's cost of capital;
- the full cost of providing service to distribution customers will be permitted to be recovered through LDC's electricity distribution rates;
- the OEB will not permit competitors to provide distribution services in LDC's licensed area, or permit loads within LDC's service area to become electrically served by a means other than through LDC's electricity distribution system;
- the OEB will allow recovery for revenue lost as a consequence of unanticipated effects of CDM;
- parts of LDC's services will not be separated from LDC and opened to competition; or
- regulatory or other changes will not be made to the PILs regime.

Changes to any of the laws, rules, regulations and policies applicable to the businesses carried on by Toronto Hydro could also have a significant impact on Toronto Hydro. There can be no assurance that Toronto Hydro will be able to comply with applicable future laws, rules, regulations and policies. Failure by Toronto Hydro to comply with applicable laws, rules, regulations and policies may subject Toronto Hydro to civil or regulatory proceedings that may have a material adverse effect on the Corporation.

Any future regulatory decision to disallow or limit the recovery of costs would lead to potential asset impairment and charges to results from operations, which could have a material adverse effect on Toronto Hydro.

8.2 Condition of Distribution Assets

LDC estimates that approximately one-third of its electricity distribution assets are past their expected useful lives. LDC's ability to continue to provide a safe work environment for its employees and a reliable and safe distribution service to its customers and the general public will depend on, among other things, the OEB allowing recovery of costs in respect of LDC's maintenance program and capital expenditure requirements for distribution plant refurbishment and replacement.

LDC is focused on overcoming the above challenges and executing its maintenance program. However, if LDC is unable to carry out these plans in a timely and optimal manner, equipment performance will degrade which may compromise the reliability of distribution assets, the ability to deliver sufficient electricity and/or customer supply security and increase the costs of operating and maintaining these assets.

8.3 Information Technology Infrastructure

Toronto Hydro's ability to operate effectively is in part dependent on the development, maintenance and management of complex information technology systems. Computer systems are employed to operate LDC's electricity distribution system, Toronto Hydro's financial, billing and business systems to capture data and to produce timely and accurate information. Failures of any one of the financial, business and operating systems could have a material adverse effect on the Corporation's business, operating results, financial condition and prospects. Toronto Hydro mitigates this risk through various methods including the use of security event management tools on its distribution and business systems, by separating the electricity distribution system from the business systems and by providing company-wide awareness training to personnel.

LDC's electricity distribution infrastructure and technology systems are also potentially vulnerable to damage or interruption from cyber attacks, which could have an adverse impact on its operations, financial conditions, brand and reputation. While LDC has implemented preventative measures to monitor and protect against cyber attacks and mitigate their effects, there can be no assurance that such measures will be completely effective in protecting LDC's electricity distribution infrastructure or assets from a cyber attack or the effects thereof.

8.4 Labour Relations

Toronto Hydro's ability to operate successfully in the electricity industry in the Province will continue to depend in part on its ability to make changes to existing work processes and conditions to adapt to changing circumstances. Toronto Hydro's ability to make such changes, in turn, will continue to depend in part on its relationship with its labour unions and its ability to develop plans and approaches that are acceptable to its labour unions. There can be no assurance that Toronto Hydro will be able to secure the support of its labour unions.

8.5 Natural and Other Unexpected Occurrences

Toronto Hydro's operations are exposed to the effects of natural and other unexpected occurrences such as severe or unexpected weather conditions, terrorism and pandemics. Although Toronto Hydro's facilities and operations are constructed, operated and maintained to withstand such occurrences, there can be no assurance that they will successfully do so in all circumstances. Any major damage to Toronto Hydro's facilities or interruption of Toronto Hydro's operations arising from these occurrences could result in lost revenues and repair costs that can be substantial. Although Toronto Hydro has insurance, if it sustained a large uninsured loss caused by natural or other unexpected occurrences, LDC would apply to the OEB for the recovery of the loss related to the electricity distribution system. There can be no assurance that the OEB would approve, in whole or in part, such an application.

8.6 Electricity Consumption

LDC's electricity distribution rates are comprised of a fixed charge and a usage-based (consumption) charge. The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control (e.g., principally sustained periods of hot or cold weather could increase the consumption of electricity, sustained periods of mild weather could decrease the consumption of electricity and general economic conditions could affect overall electricity consumption). Accordingly, there can be no assurance that LDC will earn the revenue requirement approved by the OEB.

Economic conditions could also lead to lower overall electricity consumption, particularly in the commercial customer segment, which is estimated to be the most sensitive to economic changes. Lower electricity consumption from customers could negatively impact LDC's revenue. On an annual basis, the Corporation estimates that a decrease of 1% in electricity consumption would reduce net revenue by approximately \$3.6 million.

8.7 Market and Credit Risk

LDC is subject to credit risk with respect to customer non-payment of electricity bills. LDC is permitted to mitigate the risk of customer non-payment using any means permitted by law, including security deposits (including letters of credit, surety bonds, cash deposits or lock-box arrangements, under terms prescribed by the OEB), late payment penalties, pre-payment, pre-authorized payment, load limiters or disconnection. In the event of an actual payment default and a corresponding bad debt expense incurred by LDC, approximately 80% of the expense would be related to commodity and transmission costs and the remainder to LDC's distribution revenue. While LDC would be liable for the full amount of the default, there can be no assurance that the OEB would allow recovery of the bad debt expense from remaining customers. Established practice in such cases is that the OEB would examine any electricity distributor's application for recovery of extraordinary bad debt expenses on a case-by-case basis.

Toronto Hydro is exposed to fluctuations in interest rates for the valuation of its post-employment benefit obligations. Toronto Hydro estimates that a 1% (100 basis point) increase in the discount rate used to value these obligations would decrease the accrued benefit obligation of the Corporation, as at December 31, 2012, by approximately \$39.4 million, and a 1% (100 basis point) decrease in the discount rate would increase the accrued benefit obligation, as at December 31, 2012, by approximately \$48.3 million.

As at December 31, 2012, Toronto Hydro has limited exposure to interest rate risk since its significant obligations are either non-interest bearing or bear fixed interest rates, its financial assets are predominately short term in nature and mostly non-interest bearing, and LDC's revenue is governed by a specified rate of return pricing structure set by the OEB. The Corporation estimates that a 100 basis point increase (decrease) in short term interest rates, with all

other variables held constant, would result in a decrease (increase) of approximately \$0.3 million per annum to net financing charges.

8.8 Additional Debt Financing and Credit Rating

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 the Province, the Corporation's results of operations and financial condition, the ratings assigned to the Corporation or the debentures issued under the Corporation's MTN Program by credit rating agencies, the current timing to maturity of the Corporation's Debentures and general economic conditions. See note 13 to the Consolidated Financial Statements.

Should the Corporation's credit rating from both credit rating agencies fall below "A (minus)" with stable outlook (S&P) and "A (low)" with stable trend (DBRS), the Corporation and its subsidiaries may be required to post additional collateral with the IESO.

8.9 Work Force Renewal

Over the next decade, a significant portion of Toronto Hydro's employees will become eligible for retirement, including potential retirements occurring in supervisory, trades and technical positions. Accordingly, Toronto Hydro will be required to attract, train and retain skilled employees. There can be no assurance that Toronto Hydro will be able to attract and retain the required workforce.

8.10 Insurance

Although Toronto Hydro maintains insurance as described under section 4.6(e) under the heading "Insurance" above, there can be no assurance that Toronto Hydro will be able to obtain or maintain adequate insurance in the future at rates it considers reasonable or that insurance will continue to be available. In addition, there can be no assurance that available insurance will cover all losses or liabilities that might arise in the conduct of the Toronto Hydro's business. Toronto Hydro self-insures against 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 the Corporation's results of operations and financial position.

8.11 Conflicts of Interest

The City owns all of the outstanding shares of the Corporation and has the power to determine the composition of the Board and influence the Corporation's major business and corporate decisions, including its financing programs and dividend payments. A conflict may arise between the City's role as the sole shareholder of the Corporation and its role as the administrator of the City's budget and other matters for the residents of the City.

8.12 Change of Ownership

The City may also decide to sell all or part of the Corporation. In the case of such event, depending on the nature of the transaction, the Corporation's credit ratings could be negatively affected.

8.13 Accounting Policies

Given that the decision granted by the Canadian securities regulatory authorities only allows for the option to prepare consolidated financial statements in accordance with US GAAP for fiscal years beginning before January 1, 2015, and the continued uncertainty around the timing, scope and eventual adoption of a rate-regulated accounting standard under IFRS and the potential material impact of rate regulated accounting on the Corporation's consolidated financial statements, if the Corporation were to adopt the use of IFRS, it may have an impact on the Corporation's future financial position and results of operations, which cannot be reasonably quantified at this time.

8.14 Real Property Rights

Certain terminal stations and municipal substations of LDC are located on lands owned by the Province, the City and others. In some cases, LDC does not have and may not be able to obtain formal access agreements with respect to such facilities. Failure to obtain or maintain access agreements could adversely affect LDC's operations.

8.15 LDC Competition

In the past, there had been one electricity distributor in each region of the Province. Under the current regulatory regime, a person must obtain a licence from the OEB in order to own and operate an electricity distribution system. LDC has the right to distribute electricity in the City. Although the distribution licence specifies the area in which the electricity 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 the Province, including the cost of maintaining an electricity distribution system, OEB regulation of electricity distribution rates and the level of regulatory compliance required to operate an electricity distribution system. However, the Corporation recognizes that more than one distribution licence could be issued for the same area and there is a possibility that in the future some business functions or activities could be separated from LDC and made open to competition from non-regulated business entities, or that defined geographical areas within LDC's service area may be electrically supplied by a means other than through LDC's electricity distribution system.

PART 9 - CAPITAL STRUCTURE

9.1 Share Capital

The authorized capital of the Corporation consists of an unlimited number of common shares of which 1,000 common shares are issued and outstanding as at the date of this AIF. The City is the sole shareholder of the Corporation. See note 19 to the Consolidated Financial Statements.

9.2 Debentures

On May 7, 2003, the Corporation issued \$225.0 million 6.11% senior unsecured debentures due May 7, 2013 ("Series 1"). On November 14, 2007, the Corporation issued \$250.0 million 5.15% senior unsecured debentures due November 14, 2017 ("Series 2").

On November 12, 2009, the Corporation issued \$250.0 million 4.49% senior unsecured debentures, due November 12, 2019 ("Series 3").

The net proceeds from the sale of the Series 1, Series 2 and Series 3 debentures were used by the Corporation for general corporate purposes including the repayment of then-existing indebtedness to the City under the terms of the Amended and Restated City Note.

On April 1, 2010, the Amended and Restated City Note was converted, in accordance with its terms, into \$245.0 million 6.11% senior unsecured debentures due December 30, 2011 ("Series 4") and \$245.0 million 6.11% senior unsecured debentures due May 6, 2013 ("Series 5") and sold to the public by a syndicate of investment dealers. The Corporation did not receive any proceeds from the offering of the Series 4 and Series 5 debentures. See section 6.2 under the heading "Indebtedness to the City" for further information.

On May 20, 2010, the Corporation issued \$200.0 million 5.54% senior unsecured debentures due May 21, 2040 ("Series 6"). The net proceeds from the sale of the Series 6 debentures were used principally to finance regulated Capital Expenditures of LDC.

On November 18, 2011, the Corporation issued \$300.0 million 3.54% senior unsecured debentures, due November 18, 2021 ("Series 7"). The net proceeds from the sale of the Series 7 debentures were used to repay the Corporation's Series 4 debentures which matured on December 30, 2011 for general corporate purposes.

On December 10, 2012, the Corporation filed a base shelf prospectus with the securities commissions or similar regulatory authorities in each of the provinces of Canada. These filings will allow the Corporation to make offerings of unsecured debt securities of up to \$1.5 billion during the 25-month period from the date of the prospectus. See note 13 to the Consolidated Financial Statements.

9.3 Credit Facility

The Corporation is a party to a credit agreement with a syndicate of Canadian chartered banks which establishes a revolving credit facility ("Revolving Credit Facility"). On October 10, 2012, the credit agreement was amended and restated to increase the amount the Corporation may borrow under the Revolving Credit Facility from \$400.0 million to \$600.0 million and to extend the Revolving Credit Facility's maturity date from May 3, 2013 to October 10, 2017. An amount up to \$210.0 million (formerly \$140.0 million) is available in the form of letters of credit. The Revolving Credit Facility may be used for general corporate purposes, letter of credit requirements and financing capital expenditures of LDC.

Additionally, the Corporation is a party to:

- a demand facility with a Canadian chartered bank for \$75.0 million (increased from \$50.0 million on October 10, 2012) for the purpose of issuing letters of credit mainly to support LDC's prudential requirements with the IESO ("Prudential Facility"); and
- a demand facility with a second Canadian chartered bank for \$20.0 million for the purpose of working capital management ("Working Capital Facility").

As at December 31, 2012, no amounts had been drawn under either the Revolving Credit Facility or the Working Capital Facility. As at December 31, 2012, \$49.2 million had been drawn on the Prudential Facility. See note 11 to the Consolidated Financial Statements.

9.4 Credit Ratings

The debentures issued under the Corporation's MTN Program were rated as follows:

	<u>Rating</u>
DBRS.....	A (high)
S&P	A

DBRS rates long-term debt instruments by rating categories ranging from a high of "AAA" to a low of "D". A DBRS rating may be modified by the addition of "high" or "low" to indicate relative standing within the major rating categories. Long-term debt instruments which are rated in the "A" category by DBRS are considered to be of "good credit quality", with substantial capacity for the payment of financial obligations. Entities in the "A" category, however, are considered to be more vulnerable to future events, but qualifying negative factors are considered manageable. An A rating is the second of the three sub-categories within the third of the ten rating categories.

S&P rates long-term debt instruments by rating categories ranging from a high of "AAA" to a low of "D". An S&P rating may be modified by the addition of a plus or minus sign to indicate relative standing within the major rating categories. Long-term debt instruments which are rated in the "A" category by S&P are considered somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories; however, the obligor's capacity to meet its financial commitment on the obligation is still strong. An A rating is the second of the three sub-categories within the third of the ten rating categories.

Credit ratings are intended to provide investors with an independent measure of the credit quality of an issue of securities. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the rating agency.

The Debentures are not listed, posted for trading or quoted on any stock exchange or quotation system.

The Debentures have been issued under the CDSX book entry system administered by CDS Clearing and Depository Services Inc. ("CDS") with BNY Trust Company of Canada as trustee. Accordingly, a nominee of CDS is the registered holder of the Debentures and beneficial ownership of the Debentures is evidenced through book entry credits to securities accounts of CDS participants (e.g., banks, trust companies and securities dealers), who act as agents on behalf of beneficial owners who are their customers, rather than by physical certificates representing the Debentures.

PART 10 - DIRECTORS AND OFFICERS

10.1 Nomination of Directors

The Board consists of eleven directors, all of whom are appointed by the sole shareholder of the Corporation, the City.

Pursuant to the Shareholder Direction, in electing directors to the Board, the City gives due regard to the qualifications of a candidate, including: experience or knowledge; commercial sensitivity and acumen; independence of judgment; and personal integrity. The City seeks candidates with experience and knowledge in: public utility commissions or boards of major corporations or other commercial enterprises; corporate finance; corporate governance; market development; large system operation and management; urban energy industries; and public policy issues and laws relating to Toronto Hydro, the electricity industry, environmental matters, labour relations and occupational health and safety issues.

10.2 Directors and Officers

The following table sets forth, for each of the directors and executive officers of the Corporation, the name, province and country of residence, office, principal occupation and, if a director, the date on which the person became a director. Each director is elected to serve for three years or until his or her successor is elected, except for Councillors of the City of Toronto who are elected to serve for eighteen months or until his or her successor is elected. The Councillors of the City of Toronto began their current term on the dates indicated in the below table under the column "Director Since", while the remaining directors with the exception of Vincent Brescia began their current term on November 30, 2010.

Name ⁽¹⁾ and Residence	Office	Principal Occupation	Director Since
Clare R. Copeland Ontario, Canada	Director and Chair of the Board of Directors	Chief Executive Officer, Falls Management Company ⁽²⁾	June 23, 1999
Patricia Callon Ontario, Canada	Director	Chief Legal Officer, Canadian Securities Transition Office ⁽³⁾	August 1, 2005
Brian Chu Ontario, Canada	Director	Partner, Bogart Robertson & Chu ⁽⁴⁾	August 1, 2005
Derek Cowbourne Ontario, Canada	Director	Corporate Director	December 1, 2008
Paulette Kennedy Ontario, Canada	Director	Commissioner, Ontario Securities Commission ⁽⁵⁾	December 1, 2008

<u>Name ⁽¹⁾ and Residence</u>	<u>Office</u>	<u>Principal Occupation</u>	<u>Director Since</u>
Shoba Khetrapal Ontario, Canada	Director	Corporate Director	December 1, 2008
David Williams Ontario, Canada	Director	Corporate Director	March 31, 2010 ⁽⁶⁾
Vincent Brescia Ontario, Canada	Director	Chief Executive Officer, Federation of Rental-housing Providers of Ontario ⁽⁷⁾	July 12, 2012
Shelley Carroll Ontario, Canada	Director	Councillor, City of Toronto	December 7, 2010
Josh Colle Ontario, Canada	Director	Councillor, City of Toronto	December 7, 2010
Gloria Lindsay Luby Ontario, Canada	Director	Councillor, City of Toronto	January 1, 2013 ⁽⁸⁾
Anthony Haines Ontario, Canada	President and Chief Executive Officer	President and Chief Executive Officer, Toronto Hydro Corporation	N/A
Jean-Sebastien Couillard Ontario, Canada	Chief Financial Officer	Chief Financial Officer, Toronto Hydro Corporation	N/A
Paul Sommerville	Vice President, Regulatory Affairs and General Counsel	Vice President, Regulatory Affairs and General Counsel, Toronto Hydro Corporation	N/A

Notes:

- (1) No director serves as a director or trustee of another reporting issuer except for: (a) Mr. Copeland, who serves as a trustee of RioCan Real Estate Investment Trust, and a director of Danier Leather Inc., Chesswood Group Limited (formerly called Chesswood Income Fund), Entertainment One Ltd., MDC Partners Inc., and Telesat Canada; and (b) Mr. Williams, who serves as a director of Shoppers Drug Mart Corporation, lead director of Aastra Technologies Inc., and a trustee of Canadian Apartment Properties Real Estate Investment Trust.
- (2) Falls Management Company is the developer and operator of Casino Niagara and Niagara Fallsview Casino Resort.
- (3) The Canadian Securities Transition Office was established by the Government of Canada in 2009 to lead the transition to a single Canadian securities regulator.
- (4) Bogart, Robertson & Chu is a law firm.
- (5) The Ontario Securities Commission is a regulatory agency which administers and enforces securities legislation in the Province.
- (6) Mr. Williams also served as a director of the Corporation from June 23, 1999 to August 1, 2005.
- (7) The Federation of Rental-housing Providers of Ontario is the largest association in Ontario representing those who own, manage, build and finance residential rental properties.
- (8) Ms. Lindsay Luby replaced Mr. Ron. Moeser as a City councillor director effective as of January 1, 2013. Mr. Moeser served as a director of the Corporation from December 7, 2010 to December 31, 2012.

10.3 Principal Occupations

All of the directors and executive officers of the Corporation have held the principal occupations identified in section 10.2 above with the same or associated companies or organizations for 5 years or more, except for:

- (a) Ms. Callon, who was a Consultant with the Ontario Securities Commission between September 2005 and August 2009;
- (b) Mr. Cowbourne, who held various executive positions with the IESO prior to April 1, 2008;
- (c) Ms. Kennedy, who was the Chief Auditor and subsequently Chief Financial Officer of AEGON Canada Inc. prior to January 2008;
- (d) 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;
- (e) Mr. Haines who was the President of LDC from September 2006 until his appointment as CEO effective October 1, 2009;
- (f) Mr. Williams, who was interim President and CEO of Shoppers Drug Mart Corporation from February, 2011 to October, 2011.

10.4 Cease Trade Orders, Bankruptcies, Penalties or Sanctions

Mr. Copeland was a director of White Rose Crafts and Nursery Sales Limited when it filed a voluntary assignment into bankruptcy in June 2002. Mr Copeland resigned from this position in June 2002. Mr. Copeland also sat on the board of directors of Playdium Entertainment Corporation, which filed an application under the Companies' Creditors Arrangement Act (Canada) in February 2001. Mr. Copeland resigned from this position in May 2001. In each instance, Mr Copeland had been asked to join the board when the company was already in difficulty due to his corporate restructuring experience.

Except as noted above, no director or executive officer of the Corporation is, as at the date of this AIF, or has within ten years prior to the date of this AIF:

- (a) been a director, chief executive officer or chief financial officer of any company (including the Corporation) that was the subject of a cease trade or similar order or an order that denied the company access to any exemption under securities legislation for a period of more than 30 consecutive days, where such order was issued while the director or executive officer was acting in the capacity as director, chief executive officer or chief financial officer;
- (b) been a director, chief executive officer or chief financial officer of any company (including the Corporation) that was the subject of a cease trade or similar order or an order that denied the company access to any exemption under securities legislation for a period of more than 30 consecutive days, where such order was issued after the director or executive officer ceased to be a director, chief executive officer or chief financial officer and which resulted from an event that occurred while that person was acting in the capacity as director, chief executive officer or chief financial officer;
- (c) been a director, chief executive officer or chief financial officer of any company (including the Corporation) that, while that person was acting in that capacity or within a year of that person ceasing to act in that capacity, became bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold its assets; or
- (d) become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold the assets of such director or executive officer.

10.5 Independence

The Board consists of eleven directors, all of whom are appointed by the City in its capacity as sole shareholder of the Corporation. Three of the directors are Councillors of the City of Toronto and are not considered independent because of their positions. None of the other directors have a direct or indirect material relationship with the Corporation and are independent within the meaning of applicable Canadian securities law.

No members of management sit on the Board. The Board meets regularly in the absence of management to discuss the management of the Corporation. Under its mandate, the Board is authorized to retain independent legal counsel and other advisors if it considers this appropriate. The mandate also provides that the Board shall have unrestricted access to the officers of the Corporation and is authorized to invite officers and employees of the Corporation and others to attend or participate in its meetings and proceedings if it considers this appropriate.

10.6 Committees of the Board of Directors

The Board has established four standing committees:

(a) Audit Committee

The Audit Committee is responsible for overseeing the adequacy and effectiveness of financial reporting, accounting systems, internal financial control structures and financial risk management systems. The Audit Committee reviews the Corporation's quarterly and annual financial statements as well as financial statements prepared in connection with securities offerings or required by applicable regulatory authorities, reviews the audit plans of the external auditors, oversees the internal audit of the Corporation, reviews 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 Part 11 under the heading "Audit Committee" below for further information on the Audit Committee.

(b) Corporate Governance Committee

The Corporate Governance Committee is responsible for considering and making recommendations to the Board with respect to matters relating to the corporate governance of Toronto Hydro, including board and committee composition and mandates, and guidelines for assessing the effectiveness of the Board and its committees and procedures to ensure that the Board functions independently from management. 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) Compensation Committee

The Compensation Committee is responsible for reviewing and assisting the Board in overseeing Toronto Hydro's compensation program. Members of the Compensation Committee are: Ms. Callon, Mr. Copeland, Mr. Bastable and Ms. Beed. Ms. Callon is the Chair of the Compensation Committee. Mr. Bastable and Ms. Beed are members of the Board of Directors of LDC. See section 12.1(a) under the heading "Compensation Committee" for further information on the Compensation Committee.

(d) Health and Safety Committee

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.

10.7 Board Orientation and Continuing Education

Each new director, upon joining the Board, is given a comprehensive set of materials designed to provide him/her with a summary of the key organizational, financial, regulatory, and operational aspects of Toronto Hydro. These materials also contain information on the various Toronto Hydro boards and their committees.

On an on-going basis, as part of regular and special board meetings, directors receive presentations and reports on topics related to Toronto Hydro's businesses and the obligations and responsibilities of directors. Topics covered are either suggested by management or requested by the directors. As well, directors receive information from management in response to any actions arising at a board meeting or otherwise.

10.8 Board, Committee and Director Assessments

The Corporate Governance Committee oversees a process used to evaluate the effectiveness of the Board 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.

10.9 Board Oversight and Management of Risks

In 2010, the Corporation adopted an Enterprise Risk Management Program to provide a consistent and disciplined methodology for the identification, assessment, mitigation, monitoring and reporting of risks applicable to Toronto Hydro. The Enterprise Risk Management Program follows industry best practices and adopts a rigorous top-down and bottom-up approach to integrate risk management into the Corporation's strategic plan and to manage strategic, operational, financial, employee, health and safety, environmental, and external risks.

To ensure strong oversight over the risk management process, a formal risk governance structure is in place. The Corporation's Enterprise Risk Management Program is administered under the supervision of LDC's Vice-President, Strategic Management and Information Technology, who reports and makes recommendations to an executive Risk Oversight Committee consisting of all executive officers of the Corporation and LDC. The executive Risk Oversight Committee provides quarterly reports to the Board regarding material risks. The Board is ultimately responsible for the oversight and management of the Corporation's risks.

10.10 Indebtedness of Directors and Executive Officers

No director, executive officer, employee, former director, former executive officer or former employee or associate of any director or executive officer of the Corporation or any of its subsidiaries had any outstanding indebtedness to the Corporation or any of its subsidiaries except routine indebtedness or had any indebtedness that was the subject of a guarantee, support agreement, letter of credit or other similar arrangement or understanding provided by the Corporation or any of its subsidiaries.

PART 11- AUDIT COMMITTEE

11.1 Composition, Independence and Financial Literacy

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.

11.2 Relevant Education and Experience

In addition to each member's general business experience, the education and experience of each Audit Committee member that is relevant to the performance of his or her responsibilities as an Audit Committee member is described below.

Mr. Chu holds a Juris Doctor from the University of Toronto and is a member of the Law Society of Upper Canada. Mr. Chu is a founding partner of the law firm of Bogart Robertson and Chu, practicing corporate and commercial real estate law. Mr. Chu served as Chair of the Audit Committee of Centennial College and as a member of the Finance Committee of the Ontario College of Art and Design. Mr. Chu served as the Chair of the Finance and Audit Committee of the Laidlaw Foundation. Mr. Chu serves on the Finance and Operations Committee of the Centennial Centre of Science and Technology (Ontario Science Centre). Mr. Chu has been a member of the Canadian Tax Foundation since 1986.

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 Auditor and subsequently Chief Financial Officer, AEGON Canada Inc., Senior Vice-President and Chief Internal Auditor, Sobeys Inc., Chief Auditor, Sun Life Financial Inc. and Vice-President Finance and Actuarial 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 Governing Council of the University of Toronto, Chair of the University of Toronto Audit Committee and a member of the University of Toronto's Business Board and Pension Committee.

Ms. Khetrpal holds a Masters degree in Economics, is a certified director of the Institute of Corporate Directors and a member of the Toronto Chartered Financial Analysts Society. She is a member of the Board of Directors of Cancer Care Ontario and Vice Chair of its Audit Committee. She is also Vice Chair of the Board of Directors of The Public Accountants Council and a member of its governance committee. In addition, she is a member of the Canada Pension Plan Review Tribunal. Previous positions held include Vice President and Chief Financial Officer of Weekenders International, Vice President and Treasurer, Moore Corporation Limited, Director, Economics & Planning Canadian Pacific Enterprises Limited and member of the Boards of Directors of Moore Group Services BVBA-Belgium, Peak Technologies Canada Ltd., Moore Holdings Ltd. - Australia and the Ontario Casino Corporation.

11.3 Audit Committee Charter

Under the terms of its charter, the Audit Committee is responsible for: managing the relationship between the Corporation and its external auditors; overseeing the external audit; overseeing the internal audit; reviewing, approving and recommending to the Board for approval the financial statements, management's discussion and analysis and interim reports of the Corporation, the annual information form and other public disclosure of financial information extracted from the Financial Statements of the Corporation; overseeing internal financial control structure and financial risk management systems; and establishing and reviewing certain procedures.

The full text of Corporation's Audit Committee Charter is attached as Annex A.

11.4 Policy on the Provision of Services by the External Auditors

The Audit Committee has developed a Policy on the Provision of Services by the External Auditors. Under the terms of the Policy:

- the external auditors may not provide services to Toronto Hydro that impair or have the potential to impair the independence and objectivity of the external auditors in relation to the external audit function (generally, prohibited services include services where the external auditors participate in activities that are normally undertaken by management of Toronto Hydro, are remunerated through a "success fee" structure, act in an advocacy role for Toronto Hydro or may be required to audit their own work);

- the Audit Committee has pre-approved certain audit and permitted non-audit services as services that the auditors may provide to Toronto Hydro, including: services that constitute the agreed scope of the external audit or interim reviews of Toronto Hydro; services that are outside the agreed scope of, but are consistent with, the external audit or interim reviews of Toronto Hydro; tax services that do not compromise the independence and objectivity of the external auditors in relation to the external audit; and other services of an advisory nature that do not compromise the independence and objectivity of the external auditors in relation to the external audit work; and
- an authorization process has been established which provides, among other things: the Chief Financial Officer may authorize in advance all engagements of the external auditors to provide pre-approved services (other than audit services) to Toronto Hydro up to a maximum of \$25,000 for any engagement and up to a maximum of \$100,000 for all engagements in any fiscal quarter (the Chief Financial Officer must report all such authorized engagements to the Audit Committee at its next meeting); the Chair of the Audit Committee may authorize in advance all engagements of the external auditors to provide pre-approved services (other than audit services) to Toronto Hydro up to a maximum of \$50,000 for any engagement and up to a maximum of \$100,000 for all engagements in any fiscal quarter (the Chair must report all such authorized engagements to the Audit Committee at its next meeting); and the Audit Committee must authorize in advance all engagements of the external auditors to provide pre-approved services to Toronto Hydro above the prescribed thresholds and all engagements to provide services that are not pre-approved services regardless of the dollar value of the services.

Exceptions can be made to this Policy where the exceptions are in the interests of Toronto Hydro and appropriate arrangements are established to ensure the independence and objectivity of the external auditors in relation to the external audit. Any exception must be authorized by the Audit Committee and must be reported to the Board.

11.5 External Auditors Service Fees

On April 12, 2011, KPMG LLP was appointed as the external auditor of the Corporation, replacing the former external audit firm of Ernst & Young LLP.

The table below sets out the fees billed by the Corporation's auditors for each of last two fiscal years in respect of the services noted below.

	Year ended December 31,			
	2012		2011	
	KPMG	E&Y	KPMG	E&Y
Audit fees ⁽¹⁾	\$557,981	\$-	\$392,423	\$474,848
Audit-related fees ⁽²⁾	\$-	\$-	\$-	\$-
Tax fees ⁽³⁾	\$-	\$-	\$-	\$-
All other fees ⁽⁴⁾	\$125,398	\$53,947	\$648,144	\$179,335

Notes:

- (1) Fees for audit services and interim reviews, including CPAB levy.
- (2) Fees for assurance and related services that are reasonably related to the performance of the audit or review of the Corporation's financial statements and are not reported under (1) above.
- (3) Fees for professional services rendered for tax compliance.
- (4) Fees related to consultations in respect of the transition to US GAAP and IFRS, the MTN Program, the implementation of a new billing system, and other miscellaneous fees.

PART 12- EXECUTIVE COMPENSATION

12.1 Compensation Governance

(a) Compensation Committee

(i) *Composition and Independence*

The Corporation's executive compensation program is supervised by the Compensation Committee under the direction of the Board. The Compensation Committee is comprised of Ms. Callon (Chair), Mr. Copeland, Mr. Bastable and Ms. Beed, each of whom is independent within the meaning of applicable Canadian securities laws. Mr. Bastable and Ms. Beed are members of the Board of Directors of LDC.

(ii) *Relevant Education and Experience*

The general business experience, education, skills and expertise of each Compensation Committee member, together with the education, experience, skills and expertise of the other members of the Compensation Committee, enable the Compensation Committee to make decisions on the suitability of Toronto Hydro's compensation policies and practices. The relevant experience, education, skills and expertise of each Compensation Committee member is described below.

Ms. Callon holds a law degree from the University of Western Ontario and is a member of the Law Society of Upper Canada. She is currently Chief Legal Officer of the Canadian Securities Transition Office, the organization established by the federal government to implement a national securities regulator. Ms. Callon has held a variety of senior positions, including Vice-President & Associate General Counsel, Canadian Imperial Bank of Commerce and advisor to the Ontario Securities Commission. In 2012, she obtained the Human Resources and Compensation Committee Certified (H.R.C.C.C.) designation from The Directors College (a joint venture of McMaster University and The Conference Board of Canada). In 2005, she graduated from the Directors Education Program sponsored by the Institute of Corporate Directors Corporate Governance College and the Rotman School of Management which included specific training on the board's role in enhancing human performance, including the appointment, evaluation, compensation and renewal of an organization's executive team. She is a member of the Board of Directors of Community MicroSkills Development Centre and Chair of its corporate governance committee which is responsible for, among other things, succession planning and performance evaluation of the Community MicroSkills Development Centre's executive director.

Mr. Copeland has a wide range of experience in Executive Compensation. He has held the position of Chairman of the Compensation Committee on several companies including Toronto Hydro Corporation, RioCan Real Estate Investment Trust, Danier Leather Inc., Chesswood Group Limited, The Pioneer Group Inc., MDC Partners Inc. and Entertainment One Ltd. Mr. Copeland is well versed and up-to-date with compensation systems and benefit programs at all levels. Mr. Copeland has also been the Chief Executive Officer of several organizations and in that role has the business experience of being the ultimate decision maker, together with the organizations' boards of directors and compensation committees, as applicable, regarding compensation issues.

Mr. Bastable has considerable experience in executive compensation matters from his years as the Chief Executive Officer of a publicly traded company, and as a member of the compensation committees of several boards on which he serves or has served as a director. Mr. Bastable is a Fellow of the Institute of Chartered Accountants in Ireland. He is currently Chairman of Cushman & Wakefield Ltd. His past business experience includes positions as Chief Financial Officer, and Chief Executive Officer of Royal LePage Ltd. He currently serves as a Trustee of Brookfield Office Properties Canada Real Estate Investment Trust and is a member of its Audit Committee, and Chair of its Governance and Nominating Committee. He is also a member of the Independent Review Committee of Brandes Investment Partners & Co. He has significant board and committee experience with not-for-profit organizations including as Chair of the Board of Governors and member of the compensation committee of McMaster University in Hamilton, Ontario. He is familiar with the structure of compensation systems and related benefit programs, and is experienced in executive performance evaluation.

Ms. Beed holds a Master's of Science degree in Nursing from the University of Toronto and has held many senior positions in the health care field including at the Hospital for Sick Children, the Princess Margaret Hospital /

Ontario Cancer Institute (Vice-President, Organizational Development), the University Health Network (Chief Operating Officer) and Markham Stouffville Hospital (Chief Executive Officer). Ms. Beed has also been a Global Partner with Deloitte Consulting Inc., where her focus was Change Management and Strategic Business Development in both the Energy and Consumer industry groups. Ms. Beed currently sits on several not-for-profit boards including, ventureLAB Inc., Character Community Foundation of York Region, and the Dean's Advisory Council of the Faculty of Health at York University.

(iii) *Compensation Committee Charter*

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 Toronto Hydro's compensation program and assessing the performance and compensation of the CEO and the other officers of the Corporation. Specifically, under the terms of its charter, the Compensation Committee is responsible for assisting the Board in fulfilling its responsibilities with respect to: the recruitment and assessment of the performance of the CEO; the review and approval of the compensation of the CEO and the other executive officers of Toronto Hydro; the review and approval of executive compensation disclosure; and the general oversight of the compensation structure and benefit plans and programs for Toronto Hydro.

(b) Compensation Risk Oversight

Toronto Hydro has a rigorous risk management and governance structure in place to assist the Board with its oversight and management of all of the Corporation's risks, including risks related to Toronto Hydro's compensation policies and practices. While the Board and Compensation Committee have not conducted a formal assessment of the implications of risks specifically associated with the Corporation's compensation policies and practices, the Compensation Committee has and continues to consider the Corporation's strategic objectives, plans and risk strategy in its review and recommendations regarding Toronto Hydro's compensation program. In addition to the Corporation's Enterprise Risk Management Program, the practices, processes and systems in place to identify and mitigate compensation policies and practices that could encourage an executive officer to take inappropriate or excessive risks include: the periodic review and audit of the Corporation's executive compensation program by the Corporation's internal auditor; the development and application of a management control reporting system providing transparency and control to compensation measures; the use of a balanced scorecard of corporate, divisional and individual performance objectives; the periodic benchmarking of the Corporation's compensation program; the review of the Corporation's compensation program by an independent compensation consultant and, from time to time, the OEB; and the application of maximum payout amounts for achievement of individual performance goals. See section 10.9 under the heading "Board Oversight and Management of Risks" for more information on the Corporation's Enterprise Risk Management Program, section 12.2(c)(ii) under the heading "Benchmarking" for more information on the Corporation's benchmarking of its compensation program, section 12.2(c)(iii) under the heading "Compensation Consultants and Advisors" for more information on the Corporation's compensation consultant and section 12.2(d)(ii) under the heading "Performance-Based Incentive Compensation" for more information on the Corporation's performance-based incentive compensation program.

12.2 Compensation Discussion and Analysis

(a) Named Executive Officers

This Compensation Discussion and Analysis describes and explains all significant elements of compensation awarded to, earned by, paid to, or payable to the NEOs for the financial year ended December 31, 2012. The NEOs are:

- (i) **Anthony Haines**
President and CEO, Toronto Hydro Corporation
- (ii) **Jean-Sebastien Couillard**
CFO, Toronto Hydro Corporation
- (iii) **Dino Priore**
Vice-President, Distribution Services, Toronto Hydro-Electric System Limited

- (iv) **Ben La Pianta**
Vice-President, Distribution Grid Management, Toronto Hydro-Electric System Limited
- (v) **Ivano Labricciosa**
Vice-President, Asset Management, Toronto Hydro-Electric System Limited

(b) General Objectives of Compensation Program

The Corporation's executive compensation program is designed to attract and retain executives who have the skills and experience to help the Corporation achieve its strategic goals, to motivate executives to achieve such corporate goals and to reward executives for superior performance and achievement of corporate, divisional and individual objectives.

(c) Process for Establishing Compensation

(i) *Policies and Practices*

The Corporation's overall executive compensation structure and program is developed and supervised by the Compensation Committee with the assistance of a compensation consultant, and approved by the Board. See section 12.2(c)(iii) under the heading "Compensation Consultants and Advisors" for more information on the compensation consultant.

Pursuant to the terms of its charter, the Compensation Committee has the responsibility to annually, and more frequently if appropriate, review and approve the individual performance-based incentive compensation goals and objectives related to the compensation of the CEO and to assess the CEO's performance against those goals and objectives. The Compensation Committee also makes recommendations to the Board with respect to the overall compensation and benefits of the CEO. The Board ultimately sets and approves the CEO's compensation.

The CEO has the responsibility to annually, and more frequently if appropriate, review and approve the individual performance-based incentive compensation goals and objectives related to the compensation of the other executive officers, including the NEOs, and assess the other executive officers' performance against those goals and objectives. The CEO proposes the other executive officers' performance-based incentive compensation and overall compensation, subject to the Compensation Committee's review and approval.

(ii) *Benchmarking*

The Corporation periodically benchmarks the compensation it provides to the NEOs to ensure reasonableness, competitiveness and effectiveness of the Corporation's compensation program, including the level and type of compensation provided. The Compensation Committee engages Mercer to provide executive compensation benchmarking consulting services. See section 12.2(c)(iii) under the heading "Compensation Consultants and Advisors" for more information on services provided by Mercer.

NEO compensation is generally benchmarked against the executive compensation provided by other electricity distributors and other organizations that are selected and deemed relevant due to the fact that they are similar to the Corporation in scope, complexity and revenue. In particular, when benchmarking the NEOs' compensation with respect to the Corporation's revenue as compared to the revenue of other non-LDC companies in the benchmarking group, Mercer has taken a conservative approach and excluded the Corporation's flow through revenue for electricity transmission and generation. The benchmark group's compensation data is derived from the Mercer Benchmark Database, which includes data from industrial organizations located in the Greater Toronto Area, industrial organizations located across Canada, and organizations from the national public sector. Publicly-disclosed compensation information for executive officers is also considered. For the purposes of benchmarking the CFO's compensation, in addition to the above criteria, Mercer has included the cost of power in order to recognize accountability for total cash flow managed by the Corporation.

In addition, for the purposes of benchmarking the CEO's compensation, the Compensation Committee has examined the executive compensation provided by the following companies: AltaGas Ltd., ATCO Ltd., British Columbia Hydro and Power Authority (operates as BC Hydro), Capital Power Corporation, Emera Inc., Enbridge Inc.,

ENMAX Corporation, Epcor Utilities Inc., Hydro One, IESO, OEB, Ontario Power Authority, OPG, SaskPower, TransAlta Corporation and Union Gas Limited.

The executive compensation information derived from the benchmarking analysis is designed to assist the Compensation Committee in establishing, over a reasonable period of time, total compensation for NEOs in the range of the median total compensation of those companies within the benchmark group. Total compensation to NEOs may exceed the median of the marketplace when corporate, divisional and individual performance significantly exceeds objectives.

(iii) *Compensation Consultants and Advisors*

The Corporation began engaging the services of Mercer for executive compensation consulting services in 2005. In 2007, Mercer was retained directly by the Compensation Committee for executive compensation consulting services. The services provided to the Compensation Committee by Mercer include providing advice on the competitiveness and appropriateness of the Corporation's executive compensation program, compensation benchmarking services, and other compensation related matters that may arise from time to time.

The table below sets out the fees billed by Mercer for each of last two fiscal years in respect of the services noted below.

	Year ended December 31,	
	2012	2011
Executive Compensation – Related Fees ⁽¹⁾	\$207,096	\$148,405
All Other Fees ⁽²⁾	Nil	\$19,414

Notes:

- (1) Aggregate fees billed by Mercer, or any of its affiliates, for services related to determining compensation for any of the Corporation's directors and executive officers.
- (2) In the current year, there were no services provided by Mercer, or any of its affiliates, that are not reported under (1) above. In 2011, these fees related to workforce diversity consultation services performed at the request of management, and pursuant to a Board request. Other than certain approved services which are specified in the Corporation's policy on provision of services by compensation advisors, the Compensation Committee must pre-approve other services Mercer or its affiliates provide to the Corporation at the request of management.

(d) Elements of Compensation

The principal components of compensation for NEOs are:

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

As the Corporation has a single shareholder that is the registered and beneficial owner of all of its issued and outstanding shares, the Corporation is not able to offer an equity incentive plan or other stock-based compensation to its NEOs. The lack of an equity incentive is an underlying consideration of the Corporation in determining the NEOs overall compensation package from the above-noted components.

(i) *Base Salary*

In accordance with the general objectives and process for establishing compensation noted above, the Corporation provides NEOs with a base salary to compensate them for services rendered during the fiscal year. The Corporation provides reasonably competitive market-based base salaries to help attract, motivate, and retain NEOs who are critical to the Corporation's success.

Annually, adjustments to base salaries for NEOs are driven by market benchmarking data and the NEO's individual performance rating. The performance rating is determined, in the case of the CEO, by the Compensation Committee and, in the case of the other NEOs, by the CEO, based on the achievement of performance-based incentive compensation objectives, knowledge, skills, and competencies related to day-to-day performance, as well as demonstration of desired corporate behaviours, subject to the Compensation Committee's review.

(ii) *Performance-Based Incentive Compensation*

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

The annual performance-based incentive compensation is calculated as a percentage of the NEO's base salary for the year and, if earned, paid in one lump sum in the next fiscal year.

In order for an NEO to earn and receive the performance-based incentive compensation, the Corporation and the NEO must each achieve certain pre-determined performance objectives. Each NEO's performance-based incentive compensation is based on a weighting of corporate, divisional and individual performance objectives, which weightings and objectives are determined at the start of each year and vary by role to reflect the performance focus of the role. The weighting and objectives are reviewed and set each year in order to reflect the Corporation's overall strategy and objectives.

Corporate and divisional performance objectives are based on financial and other industry specific measures. Each NEO's individual objectives are based on areas of strategic and operational emphasis related to their respective responsibilities and portfolios.

The CEO's individual objectives are reviewed and approved by the Compensation Committee. The individual 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 strategy or priorities.

In the case of the CEO, an annual performance evaluation in respect of his individual performance goals is conducted by the Chair of the Board who provides a recommendation to the 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 proposes the amount of performance-based incentive compensation to be paid to each other NEO. The Compensation Committee reviews and approves the amounts of performance-based incentive compensation to be paid to each of the other NEOs.

The Compensation Committee may exercise its discretion to increase or reduce the performance-based incentive compensation paid to the CEO or NEOs, as applicable, including in certain circumstances absent attainment of a relevant performance goal or similar condition.

(iii) *Personal Benefits and Perquisites*

The Corporation provides NEOs with other personal benefits and perquisites that the Corporation believes are reasonable and consistent with its overall compensation program to better enable the Corporation to attract and retain superior employees for key positions. Benefits include group health, dental, group life insurance, short-term and long-term disability, accidental death & dismemberment, a fitness subsidy, and educational reimbursements, all of which are generally available to all salaried employees and do not discriminate in scope, terms or operation

between employees of the same classification. The Corporation also previously provided NEOs with vehicles as part of the NEOs' personal benefits and perquisites, which benefit was eliminated effective February 28, 2012.

(iv) *Pension Plan*

All full-time employees of the Corporation, including the NEOs, are required to participate in the OMERS pension plan. Pursuant to the terms of the OMERS pension plan, NEOs are required to make plan contributions based on their pensionable earnings. In 2012, each NEO was required to contribute 8.3% of the first \$50,100 of pensionable earnings and thereafter 12.8% on all earnings over \$50,100 and up to \$149,242. Beyond the \$149,242 maximum, contributions of 12.8% continue towards a Retirement Compensation Arrangement (RCA), which is governed separately under the Canadian Income Tax Act. The OMERS pension plan is generally available to all other salaried employees and does not discriminate in scope, terms or operation between employees of the same classification. See section 4.6(a) under the heading "Employees" for more information on the OMERS pension plan.

(v) *Retirement Benefits*

NEOs are eligible to receive post-retirement health, dental and life insurance after a minimum of five years of service with the Corporation if they retire from the Corporation and begin collecting under the OMERS pension plan upon retirement. The post-retirement benefits provided to eligible NEOs are the same as are generally available to all other salaried employees and do not discriminate in scope, terms or operation between employees of the same classification. Post-retirement benefits aid in attracting and retaining key executives to ensure the long-term success of the Corporation.

(vi) *Retirement Allowances*

From time to time, in certain circumstances, the Corporation enters into retirement allowance agreements with its NEOs. The retirement allowance agreements are designed in recognition of service and to promote retention, stability and continuity of the NEOs. These agreements are made on a case-by-case basis based on an NEO's years of service and position. Any retirement allowance provided to the CEO is approved by the Board after review of the recommendation of the Compensation Committee. In the case of each of the other NEOs, any retirement allowance agreement is proposed by the CEO and reviewed and approved by the Compensation Committee. Retirement allowance payments are typically paid in one or two lump sum instalments following termination or retirement of the NEO.

(vii) *Termination Payments*

From time to time, the Corporation enters into agreements with NEOs which provide for payments upon termination. These agreements are made on a case-by-case basis based on the NEO's age, years of service and position. Any such agreement for the CEO is approved by the Board after review of the recommendation of the Compensation Committee. In the case of each of the other NEOs, any such agreement is proposed by the CEO and reviewed and approved by the Compensation Committee. Typically, termination payments are paid either as a lump sum or as salary continuation for an agreed period following termination.

12.3 Compensation of Named Executive Officers

(a) Summary Compensation Table

The following table provides a summary of the compensation earned during the years ended December 31, 2010, 2011 and 2012, by the NEOs:

Summary Compensation Table⁽¹⁾

NEO Name and Principal Position	Year	Salary ⁽²⁾	Non-Equity Incentive Plan Compensation ⁽³⁾	All Other Compensation ⁽⁴⁾	Total Compensation
		(\$)	(\$)	(\$)	(\$)
Anthony Haines	2012	\$471,702	\$445,899	\$17,900	\$935,501
President and Chief Executive Officer, Toronto Hydro Corporation	2011	\$421,702	\$371,378	\$58,903	\$851,983
	2010	\$372,807	\$340,018	\$44,905	\$757,730
Jean-Sebastien Couillard	2012	\$267,357	\$155,253	\$7,972	\$430,582
Chief Financial Officer, Toronto Hydro Corporation	2011	\$257,934	\$141,152	\$30,337	\$429,423
	2010	\$238,462	\$129,860	\$24,220	\$392,542
Dino Priore	2012	\$252,757	\$149,572	\$7,980	\$410,309
Vice-President, Distribution Services Toronto Hydro –Electric System Limited	2011	\$244,104	\$134,121	\$20,140	\$398,365
	2010	\$219,583	\$126,763	\$19,272	\$365,618
Ben La Pianta	2012	\$239,981	\$140,921	\$5,100	\$386,002
Vice-President, Distribution Grid Management Toronto Hydro –Electric System Limited	2011	\$231,712	\$118,421	\$31,440	\$381,573
	2010	\$216,813	\$116,472	\$19,066	\$352,351
Ivano Labricciosa	2012	\$230,890	\$133,947	\$6,384	\$371,221
Vice-President, Asset Management Toronto Hydro –Electric System Limited	2011	\$222,813	\$118,482	\$31,356	\$372,652
	2010	\$212,780	\$112,574	\$31,975	\$357,329

Notes:

- (1) Amounts shown in this table are in Canadian dollars and have been rounded to the nearest dollar.
- (2) Amounts shown reflect actual amounts paid during the year.
- (3) Each NEO's annual performance-based incentive compensation for a fiscal year is determined and paid in the next fiscal year. Accordingly, amounts reflected in respect of a particular year (i.e. 2012) represent the annual performance-based incentive compensation earned by the NEO for the achievement of performance objectives in respect of that fiscal year (i.e. 2012) but which amounts are paid in the following fiscal year (i.e. 2013).
- (4) Amounts shown in this column reflect all other compensation earned by the NEO during the year. The amounts shown include the aggregate value of perquisites and other personal benefits provided to the NEO, where such perquisites and personal benefits are not generally available to all employees and have been calculated by using the actual cost. In 2012, perquisites and personal benefits were not worth \$50,000 or more for any NEO, nor were they worth 10% or more of any NEO's total salary for the year. In 2011 and 2010 there were perquisites and personal benefits not generally available to all employees reported for NEOs that were worth \$50,000 or more, or were worth 10% or more of the NEO's total salary.

(b) Compensation of NEOs in 2012 – Narrative Discussion

(i) Base Salaries

The NEOs' annual base salaries for 2012 were: \$473,625 in the case of Mr. Haines, \$267,703 in the case of Mr. Couillard, \$253,065 in the case of Mr. Priore, \$240,289 in the case of Mr. La Pianta, and \$231,198 in the case of Mr. Labricciosa.

(ii) Performance-Based Incentive Compensation

The respective target performance-based incentive compensation amounts for each NEO for 2012 were as follows: 65% of the base salary, in the case of Mr. Haines, 40% of the base salary in the case of Mr. Couillard, 40% of the

base salary in the case of Mr. Priore, 40% of the base salary in the case of Mr. La Pianta, and 40% of the base salary in the case of Mr. Labricciosa. The performance-based incentive compensation amount payable to each NEO may exceed the respective target % of base salary indicated previously when results exceed corporate and divisional objectives and may be below the respective target % of base salary indicated previously when the corporate and divisional objectives are not achieved.

The weightings attributed to Mr. Haines' 2012 performance-based incentive compensation were as follows: 80% based on the performance of the Corporation and 20% based on the achievement of individual performance objectives. For all other NEOs, the performance-based incentive compensation weightings were as follows: 60% based on the performance of the Corporation, 20% based on the Corporation's achievement of divisional objectives, and 20% based on the NEO's achievement of individual performance objectives.

The performance objectives of the Corporation for 2012 were as follows:

Corporate Objective	Measure	Target	Weight (%)
Net Income before restructuring charges (\$ millions)	Net Income per the Corporation's Consolidated Financial Statements before restructuring charges.	89.1	30
THESL Regulated Capital (\$ millions)	THESL capital work to be completed for regulated operations in 2012, including planned and demand work, reactive capital, IT, fleet & facilities, customer connections and infrastructure renewal. Excludes work on transmission stations, and related contributions to Hydro One.	240.0	10
Worst Performing Feeders	Total number of feeders experiencing more than seven sustained outages in a year, with outages defined as interruptions greater than one minute.	40	5
System Average Interruption Duration Index (SAIDI) (in minutes)	Measure of the annual system average interruption duration for customer served, not including MED.	93.7	10
System Average Interruption Frequency Index (SAIFI) (in minutes)	Measure of the frequency of service interruptions for customers served, not including MED.	1.76	10
Conservation Demand Management	Annual summer peak demand savings through year over year MW reduction.	49.0	5
Enhanced Customer Engagement	Increase in customer self-serve transactions / engagements using various self-serve options and media channels, including the call centre, Toronto Hydro website, social media sites and web portals.	110%	5
Call Centre Service Response	Average of call centre responses within thirty seconds.	70%	5
Safety	Number of recordable injuries x 200,000 / exposure hours.	3.40	10
Employee Engagement	Average number of employee engagement sessions per employee per year, including company-wide, divisional and departmental.	8	10

The divisional performance objectives for 2012 were as follows:

Divisional Objective	FINANCE		DISTRIBUTION SERVICES		DISTRIBUTION GRID MANAGEMENT		ASSET MANAGEMENT	
	Target	Weight (%)	Target	Weight (%)	Target	Weight (%)	Target	Weight (%)
	Jean-Sebastien Couillard		Dino Priore		Ben La Pianta		Ivano Labricciosa	
Net Income before restructuring charges (\$ millions)	89.1	40	N/A	N/A	N/A	N/A	N/A	N/A
Operating Expense per the Divisional & Corporate budgets (\$ millions)	251.96	30	38.92	5	55.79	5	19.24	5
THESL Regulated Capital (\$ millions)	240.0	5	240.0	10	240.0	15	240.0	10

Divisional Objective	FINANCE		DISTRIBUTION SERVICES		DISTRIBUTION GRID MANAGEMENT		ASSET MANAGEMENT	
	Jean-Sebastien Couillard		Dino Priore		Ben La Pianta		Ivano Labricciosa	
	Target	Weight (%)	Target	Weight (%)	Target	Weight (%)	Target	Weight (%)
Worst Performing Feeders	N/A	N/A	40	15	40	15	40	15
System Average Interruption Duration Index (SAIDI) (in minutes)	N/A	N/A	93.7	15	93.7	15	93.7	15
System Average Interruption Frequency Index (SAIFI) (in minutes)	N/A	N/A	1.76	15	1.76	15	1.76	15
Conservation Demand Management	49.0	5	N/A	N/A	N/A	N/A	N/A	N/A
Safety	3.4	5	3.4	15	3.4	10	3.4	15
Safety Leadership (safety inspections completed as a percentage of plan) per division	N/A	N/A	95%	10	95%	10	95%	10
Employee Engagement	8	10	8	5	8	5	8	5
Attendance (average days absent per employee per division)	3.2	5	7.6	10	9.6	10	6.6	10

The Corporation exceeded all of its 2012 corporate and divisional objectives. Each of the NEOs exceeded his individual performance objectives for 2012. Each of the corporate, divisional and individual performance objectives were reasonably difficult to attain and served to encourage success in the NEO performance and in the Corporation's financial and operational results.

The percentage of total compensation that relates to the achievement of each NEO's individual performance objectives were as follows: 9% for Mr. Haines, 6% for Mr. Couillard, 7% for Mr. Priore, 7% for Mr. La Pianta and 6% for Mr. Labricciosa.

(iii) *Personal Benefits and Perquisites*

In 2012, the NEOs received personal benefits and perquisites as described in section 12.2(d)(iii) under the heading "Personal Benefits and Perquisites", and as quantified in the Summary Compensation Table in section 12.3(a) above.

(iv) *Pension Plan*

In 2012, each of the NEOs participated in the OMERS pension plan. The OMERS pension plan is a group pension plan that is generally available to all salaried employees and does not discriminate in scope, terms or operation between employees of the same classification. See section 4.6(a) under the heading "Employees" and section 12.2(d)(iv) under the heading "Pension Plan" for further information on the OMERS pension plan.

(v) *Retirement Benefits*

As of December 31, 2012, Mr. Haines, Mr. Couillard, Mr. Priore, Mr. La Pianta and Mr. Labricciosa have each provided Toronto Hydro with more than five years of service and are therefore eligible for post-retirement medical, dental, and life insurance benefits if they retire from the Corporation and begin collecting under the OMERS pension plan upon retirement.

(vi) *Retirement Allowance*

Mr. Haines is the only NEO entitled to retirement allowances, which allowances are calculated based on completed years of service and are payable in the form of lump-sum cash payments following Mr. Haines' termination (without cause) or retirement from the Corporation.

Under the terms of Mr. Haines' existing retirement allowance (the "Existing Allowance"), if Mr. Haines is terminated (without cause) or retires from the Corporation during 2013, he will receive a \$140,000 retirement allowance. The amount of the Existing Allowance payable to Mr. Haines will thereafter be increased by an additional \$90,000 per year (from 2013 to 2016) and \$125,000 per year (from 2017 to 2020) for each full calendar year of service completed. The maximum Existing Allowance payable to Mr. Haines is \$1,000,000, which Mr. Haines will earn if he remains in active service for the Corporation until December 31, 2020. In the event that Mr. Haines becomes permanently disabled while in active service for the Corporation, he will be deemed to remain in active service for the Corporation until December 31, 2020, at which point he will be considered to have retired and earned the maximum Existing Allowance of \$1,000,000. In the event of the death of Mr. Haines while in active service for the Corporation, the Existing Allowance which Mr. Haines would have earned as of the date of his death will be paid to his designated beneficiary or to the legal representative of Mr. Haines' estate.

As part of his compensation package, Mr. Haines also participates in the OMERS defined benefit pension plan. See "Pension Plan" above in section 12.3(b)(iv). OMERS has recently made significant unilateral changes to its defined benefit pension plan that significantly reduce the value of Mr. Haines' pension benefit under the OMERS pension plan. The changes made by OMERS do not significantly impact the other NEOs. In order to mitigate the impact of these changes in a manner consistent with the terms of his existing employment relationship with the Corporation, the Corporation has awarded Mr. Haines a second retirement allowance (the "Second Allowance"). Under the terms of the Second Allowance, if Mr. Haines is terminated (without cause) or retires from the Corporation during 2014, he will receive a \$100,000 retirement allowance. The amount of the Second Allowance payable to Mr. Haines will thereafter be increased by an additional \$100,000 per year (from 2014 to 2015) and \$225,000 per year (from 2016 to 2021) for each full calendar year of service completed. The maximum Second Allowance payable to Mr. Haines is \$1,650,000, which Mr. Haines will earn if he remains in active service for the Corporation until December 31, 2021. In the event that Mr. Haines becomes permanently disabled while in active service for the Corporation, he will be deemed to remain in active service for the Corporation until December 31, 2021, at which point he will be considered to have retired and earned the maximum Second Allowance of \$1,650,000. The provisions relating to entitlement on death are identical to those established for the Existing Allowance.

(vii) *Termination Payments*

Both Mr. Haines and Mr. Couillard have entered into agreements with the Corporation which provide for certain payments upon termination.

If the employment of Mr. Haines is terminated without cause by the Corporation, then Mr. Haines is entitled to a payment equal to 24 months of base salary and performance pay that would have been paid had he continued to work for 24 months (approximately \$1,718,780 as at December 31, 2012), 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 \$614,687 as at December 31, 2012), with the performance pay calculated based on the average annual performance pay earned by Mr. Couillard during the 3 years preceding the date of termination. Mr. Couillard would also be entitled to continued group health and dental benefit coverage for a period of 18 months from the date of termination.

12.4 Compensation of Directors

(a) Director Compensation Table

Director Name	Fees Earned (\$)	All other compensation (\$)	Total (\$)
Clare Copeland	75,000	Nil	75,000
Patricia Callon	30,500	4,700 ⁽¹⁾	35,200
Brian Chu	28,500	Nil	28,500
Derek Cowbourne	26,500	Nil	26,500
Paulette Kennedy	29,500	Nil	29,500
Shoba Khetrapal	30,500	Nil	30,500
David Williams	25,500	2,352 ⁽²⁾	27,852
Vincent Brescia	8,250	Nil	8,250
Councillor Shelly Carroll	Nil	Nil	Nil
Councillor Josh Colle	Nil	Nil	Nil
Councillor Ron Moeser	Nil	Nil	Nil

Notes:

- (1) Includes amounts in respect of Director's College expenses.
- (2) Includes amounts in respect of travel reimbursements for board meeting attendance.

(b) Compensation of Directors – Narrative Discussion

Directors of the Corporation, other than Councillors of the City, are compensated for their services as directors through a combination of retainer fees and meeting attendance fees. These fees are set by the sole shareholder of the Corporation, the City. The annual retainer fees are as follows: chair of the Board – \$75,000 and each of the other directors – \$12,500. The meeting attendance fees are as follows: each meeting of the Board and the subsidiaries attended – \$1,000 and each meeting of the Audit Committee, Corporate Governance Committee, 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 receive no remuneration for their services as directors of the Corporation.

PART 13- 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. Legal proceedings containing material claims affecting LDC are described below.

13.1 Christian Helm Class Action

On December 6, 2010, a statement of claim in a proposed class action was issued against LDC. The claim sought general and special damages in the amount of \$100.0 million for disgorgement of unjust gains allegedly resulting from the receipt of interest on overdue accounts in contravention of the Interest Act. On April 30, 2012, a

settlement reached by the parties was approved by Order of the Ontario Superior Court of Justice. Pursuant to the terms of the Order, LDC was required to pay the amount of \$5.8 million plus costs in settlement of all claims, substantially all of which had been paid as at December 31, 2012. The Corporation accrued a liability to cover the expected settlement in 2010. The action has been dismissed, and the claims by all class members have been released.

13.2 2 Secord Avenue

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the Class Proceedings Act seeking damages in the amount of \$30.0 million as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence and third party claim have been served by LDC and a third party defence and counterclaim against LDC seeking damages in the amount of \$51.0 million have been filed. A certification order has been issued. Affidavits of documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. 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.

On December 20, 2010, LDC was served with a statement of claim by the City seeking damages in the amount of \$2.0 million as a result of the fire at 2 Secord Avenue. A statement of defence and a third party claim have been served. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

By order of the court dated January 24, 2012, the above actions and a smaller non-class action commenced in April 2009 involving the same incident will be tried at the same time or consecutively.

13.3 2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the Class Proceedings Act seeking damages in the amount of \$30.0 million as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action seeks damages in the amount of \$10.0 million from LDC. Both actions are at a preliminary stage and the certification hearing has yet to occur. Statements of defence to the main action and to the third party claim have not been filed. Accordingly, given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with these actions.

Another third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice seeking damages in the amount of \$30.0 million as compensation for damages allegedly suffered as a result of the fire at 2369 Lakeshore Boulevard West. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action sought damages in the amount of \$0.4 million from LDC. LDC has filed a statement of defence, crossclaim and counterclaim. Examinations for discovery have not taken place, notwithstanding a court ordered timetable to have them completed by February 29, 2012. By order dated December 5, 2012, these actions were dismissed by the court for delay.

On August 29, 2011, LDC was served with a statement of claim by the owner of the building and the property management company for the building seeking damages in the amount of \$2.0 million as a result of the fire at 2369 Lakeshore Boulevard West. LDC has filed a statement of defence and counterclaim. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance

of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

13.4 Adamopoulos

An action was commenced against LDC in November 2004 in the Ontario Superior Court of Justice seeking damages in the amount of \$7.8 million as compensation for damages allegedly suffered as a result of a motor vehicle accident involving an LDC vehicle on January 9, 2001. The plaintiff's motion increasing its claim for damages to \$23.8 million was granted on July 7, 2010. This matter has been settled and a court order has been issued dismissing the action and all related claims by payment of a total amount of approximately \$4.6 million. LDC's liability insurance covered the settlement amount.

13.5 Late Payment Charges Class Action

By Order dated July 22, 2010, the Ontario Superior Court of Justice consolidated and approved the settlement of two class actions against LDC, one commenced in 1994 and the other, against all MEUs, in 1998. The actions sought \$500.0 million and \$64.0 million, respectively, in restitution for late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. The claims made against LDC and the definition of the plaintiff classes were identical in both actions such that any damages payable by LDC in the first action would reduce the damages payable by LDC in the second action, and vice versa.

The July 22, 2010 court order formalized a settlement pursuant to which the defendant MEUs will pay the amount of \$17.0 million plus costs and taxes in settlement of all claims. The amount allocated for payment by each MEU is its proportionate share of the settlement amount based on its percentage of distribution service revenue over the period for which it has exposure for repayment of late payment penalties exceeding the interest rate limit in the Criminal Code. Under the settlement, all of the MEUs involved in the settlement, including LDC, requested an order from the OEB allowing for the future recovery from customers of all costs related to the settlement. On February 22, 2011, the OEB issued its final decision allowing LDC to recover its share of the settlement in the amount of \$7.5 million from customers. The payment to settle LDC's portion of the class action suit was made on June 30, 2011. On July 7, 2011, the OEB authorized LDC to begin the recovery of the balance on August 1, 2011. The full recovery of the balance will be done over a 21-month period ending April 30, 2013.

PART 14 - MATERIAL CONTRACTS

Except for the indenture and the supplemental indentures under which the Debentures were issued, Toronto Hydro has not entered into any material contract (other than contracts entered into in the ordinary course of business) in the most recently completed financial year, or before the most recently completed financial year, if such contract is still in effect.

Copies of these material contracts are available on the SEDAR website at www.sedar.com.

PART 15 - NAMED AND INTERESTS OF EXPERTS

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

PART 16 - TRANSFER AGENTS AND REGISTRARS

The trustee and registrar for the Corporation is BNY Trust Company of Canada, located in Toronto, Ontario.

PART 17 - ADDITIONAL INFORMATION

Additional information relating to the Corporation, including copies of the Consolidated Financial Statements and Management's Discussion and Analysis, are available on the SEDAR website at www.sedar.com.

ANNEX A - AUDIT COMMITTEE CHARTER

1. General

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

2. Composition

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

3. Responsibilities

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

The Committee shall have the responsibilities set out below.

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

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

- (i) appointing and replacing the external auditors, subject to shareholder approval;
- (ii) setting the compensation of the external auditors subject to the approval of the board of directors or shareholder, as applicable;

- (iii) overseeing the work of the external auditors, including resolving disagreements between management and the external auditors with respect to financial reporting;
 - (iv) pre-approving all audit services and permitted non-audit services to be provided to the Corporation and its subsidiary entities by the external auditors in accordance with the "Policy on the Provision of services by the External Auditors";
 - (v) having the external auditors report to the Committee in a timely manner with respect to all required matters, including those set out in paragraph 3(2);
 - (vi) reviewing and approving the hiring policies of the Corporation with respect to present and former partners and employees of the external auditors;
 - (vii) ensuring the rotation of the audit partner having primary responsibility for the external audit of the Corporation, the audit partner responsible for reviewing the external audit and the external auditors at such intervals as may be required; and
 - (viii) reviewing and assessing the performance, independence and objectivity of the external auditors.
- (b) ***Overseeing the External Audit***

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

- (i) reviewing and approving the engagement letter and the audit plan, including financial risk areas identified by the external auditors and management;
- (ii) reviewing and assessing the accounting and reporting practices and principles used by the Corporation in preparing its financial statements, including:
 - (1) all significant accounting policies and practices used, including changes from preceding years and any proposed changes for future years;
 - (2) all significant financial reporting issues, estimates and judgments made;
 - (3) all alternative treatments of financial information discussed by the external auditors and management, the results of such discussions and the treatments preferred by the external auditors;
 - (4) any major issues identified by the external auditors with respect to the adequacy of internal control systems and procedures and any special audit steps adopted in light of material deficiencies and weaknesses;
 - (5) the effect of regulatory and accounting initiatives and off-balance sheet transactions or structures on the financial statements;
 - (6) any errors or omissions in, and any required restatement of, the financial statements for preceding years;
 - (7) all significant tax issues;
 - (8) the reporting of all material contingent liabilities; and
 - (9) any material written communications between the external auditors and management;

- (iii) reviewing and assessing the results of the external audit and the external auditors' opinion on the financial statements;
- (iv) reviewing and discussing with the external auditors and management any management or internal control letters issued or proposed to be issued by the external auditors;
- (v) reviewing and discussing with the external auditors any problems or difficulties encountered by them in the course of their audit work and management's response (including any restrictions on the scope of activities or access to requested information and any significant disagreements with management); and
- (vi) reviewing and discussing with legal counsel any legal matters that may have a material impact on the financial statements, operations, assets or compliance policies of the Corporation and any material reports or enquiries received by the Corporation and its subsidiary entities from regulators or government agencies.

(c) ***Overseeing the Internal Audit***

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

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

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

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

- (i) the quality and appropriateness of accounting and reporting practices and principles and any changes thereto;

- (ii) major estimates or judgments, including alternative treatments of financial information discussed by management and the external auditors, the results of such discussions and the treatment preferred by the external auditors;
- (iii) material financial risks;
- (iv) material transactions;
- (v) material adjustments;
- (vi) compliance with loan agreements;
- (vii) material off-balance sheet transactions and structures;
- (viii) compliance with accounting standards;
- (ix) compliance with legal and regulatory requirements; and
- (x) disagreements with management.

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

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

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

(f) ***Establish and Review Certain Procedures***

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

- (i) the review of the public disclosure of financial information extracted from the financial statements of the Corporation;
- (ii) the receipt, retention and treatment of complaints received by the Corporation with respect to accounting, internal controls or auditing matters; and

- (iii) the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.

4. Authority

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

5. Meetings and Proceedings

- (a) The Committee shall meet as frequently as required but not less frequently than four times each year.
- (b) Any Member or the Secretary may call a meeting of the Committee. The external auditors or the CFO may ask a Member to call a meeting of the Committee.
- (c) The Chair shall approve the agenda of each meeting of the Committee, including input from the officers and employees of the Corporation, external auditors, other Members and other directors of the Corporation as appropriate. Meetings will include presentations by management or professional advisors and consultants when appropriate and allow sufficient time to permit a full and open discussion of agenda items.
- (d) Unless waived by all Members, a notice of each meeting of the Committee confirming the date, time, place and agenda of the meeting, together with any supporting materials, shall be forwarded to each Member at least three days before the date of the meeting.
- (e) The quorum for each meeting of the Committee is two Members. In the absence of the Chair, the other Members may appoint one of their number as chair of a meeting. The Chair of a meeting shall not have a second or casting vote.
- (f) The Chair or a delegate of the Chair shall report to the Board following each meeting of the Committee.
- (g) The Secretary or a delegate of the Secretary shall keep minutes of all meetings of the Committee, including all resolutions passed by the Committee. Minutes of all meetings shall be distributed to the Members. The

minutes shall be available for review by the other directors of the Corporation after approval thereof by the Committee.

- (h) An individual who is not a Member may be invited to attend a meeting of the Committee for all or part of the meeting. A standing invitation to all meetings shall be given to the Chairman of the Board, the President and Chief Executive Officer of the Corporation, the CFO except where the meeting, or part of the meeting, is for Members only or a private session with the internal auditor or the external auditors. A standing invitation should be given to the internal auditor and the engagement partners of the external auditors for all meetings where financial information is reviewed and approved..
- (i) The Committee shall meet regularly alone and in private sessions with the internal audit leader, the external auditors and management of the Corporation to facilitate full communication.

6. Review

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