



CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2012

INTERIM CONSOLIDATED BALANCE SHEETS

[in thousands of Canadian dollars, unaudited]

| | As at September 30, 2012 \$ | As at December 31, 2011 \$ |
|---|--------------------------------------|-------------------------------------|
| ASSETS | | <i>[note 24]</i> |
| Current | | |
| Cash and cash equivalents | 137,323 | 154,256 |
| Investments | - | 34,002 |
| Accounts receivable, net of allowance for doubtful accounts <i>[note 16[b]]</i> | 213,246 | 183,272 |
| Unbilled revenue <i>[note 16[b]]</i> | 258,292 | 262,058 |
| Income tax receivable | 6,640 | 11,312 |
| Inventories <i>[note 5]</i> | 6,405 | 6,891 |
| Regulatory assets <i>[note 9]</i> | 2,751 | - |
| Other assets <i>[note 6]</i> | 7,205 | 5,409 |
| Total current assets | 631,862 | 657,200 |
| Property, plant and equipment, net <i>[note 7]</i> | 2,455,824 | 2,399,497 |
| Intangible assets, net <i>[note 8]</i> | 133,101 | 112,982 |
| Regulatory assets <i>[note 9]</i> | 131,094 | 143,038 |
| Other assets <i>[note 10]</i> | 11,675 | 12,423 |
| Deferred income tax assets <i>[note 9]</i> | 195,754 | 202,367 |
| Total assets | 3,559,310 | 3,527,507 |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| Current | | |
| Accounts payable and accrued liabilities <i>[note 16[b]]</i> | 410,845 | 412,412 |
| Restructuring accrual <i>[note 12]</i> | 12,839 | - |
| Customers' advance deposits | 36,294 | 40,238 |
| Deferred revenue | 23,900 | 13,359 |
| Debentures <i>[note 13]</i> | 470,045 | - |
| Post-retirement benefits <i>[note 14]</i> | 8,847 | 7,915 |
| Other liabilities <i>[note 21]</i> | 1,807 | 2,182 |
| Regulatory liabilities <i>[note 9]</i> | - | 7,293 |
| Total current liabilities | 964,577 | 483,399 |
| Restructuring accrual <i>[note 12]</i> | 2,048 | - |
| Customers' advance deposits | 13,803 | 15,800 |
| Debentures <i>[note 13]</i> | 999,528 | 1,469,527 |
| Post-retirement benefits <i>[note 14]</i> | 242,009 | 236,411 |
| Other liabilities <i>[note 21]</i> | 9,740 | 11,301 |
| Regulatory liabilities <i>[note 9]</i> | 198,215 | 203,919 |
| Asset retirement obligations <i>[note 15]</i> | 4,960 | 4,902 |
| Total liabilities | 2,434,880 | 2,425,259 |
| Commitments, contingencies and subsequent events <i>[notes 21, 22 and 26]</i> | | |
| Shareholder's equity | | |
| Share capital <i>[note 19]</i> | 567,817 | 567,817 |
| Retained earnings | 556,613 | 534,431 |
| Total shareholder's equity | 1,124,430 | 1,102,248 |
| Total liabilities and shareholder's equity | 3,559,310 | 3,527,507 |

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

INTERIM CONSOLIDATED STATEMENTS OF NET INCOME AND COMPREHENSIVE INCOME

[in thousands of Canadian dollars, except for per share amounts, unaudited]

| | Three months ended | | Nine months ended | |
|---|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| | \$ | \$ | \$ | \$ |
| | | [note 24] | | [note 24] |
| Revenues | 751,270 | 738,352 | 2,160,630 | 2,129,186 |
| Costs | | | | |
| Purchased power | 596,459 | 585,552 | 1,723,942 | 1,694,031 |
| Operating expenses | 62,238 | 63,575 | 180,066 | 195,361 |
| Depreciation and amortization | 35,112 | 38,152 | 105,672 | 107,038 |
| | 693,809 | 687,279 | 2,009,680 | 1,996,430 |
| Income before the following: | 57,461 | 51,073 | 150,950 | 132,756 |
| Net financing charges | (18,517) | (18,856) | (55,337) | (55,818) |
| Gain on disposals of property, plant and equipment | - | 303 | - | 5,020 |
| Restructuring costs [note 12] | - | - | (27,796) | - |
| Income before income taxes | 38,944 | 32,520 | 67,817 | 81,958 |
| Income tax expense [note 18] | 4,508 | 3,538 | 4,669 | 3,254 |
| Net income and comprehensive income for the period | 34,436 | 28,982 | 63,148 | 78,704 |
| Basic and fully diluted net income per share [note 23] | 34,436 | 28,982 | 63,148 | 78,704 |

INTERIM CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY

[in thousands of Canadian dollars, unaudited]

| | Three months ended | | Nine months ended | |
|---|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| | \$ | \$ | \$ | \$ |
| Share capital [note 19] | 567,817 | 567,817 | 567,817 | 567,817 |
| Retained earnings, beginning of period | 528,177 | 501,221 | 534,431 | 471,562 |
| Net income for the period | 34,436 | 28,982 | 63,148 | 78,704 |
| Dividends [notes 19 and 20] | (6,000) | (6,000) | (40,966) | (26,063) |
| Retained earnings, end of period | 556,613 | 524,203 | 556,613 | 524,203 |
| Total shareholder's equity | 1,124,430 | 1,092,020 | 1,124,430 | 1,092,020 |

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

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

[in thousands of Canadian dollars, unaudited]

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|------------------|------------------------------------|------------------|
| | 2012 \$ | 2011 \$ | 2012 \$ | 2011 \$ |
| OPERATING ACTIVITIES | | | | |
| Net income for the period | 34,436 | 28,982 | 63,148 | 78,704 |
| Adjustments for non-cash items | | | | |
| Depreciation and amortization | 35,112 | 38,152 | 105,672 | 107,038 |
| Change in other non-current assets | 45 | 252 | 375 | 692 |
| Change in other non-current liabilities | (816) | 11,381 | (1,551) | 10,824 |
| Restructuring accrual | (2,366) | - | 2,048 | - |
| Post-retirement benefits | 2,176 | 11,042 | 6,530 | 33,127 |
| Deferred income taxes | 326 | (188) | 872 | (592) |
| Gain on disposals of property, plant and equipment | - | (303) | - | (5,020) |
| Changes in non-cash working capital balances | | | | |
| Increase in accounts receivable | (20,863) | (15,181) | (29,974) | (51,980) |
| Decrease in unbilled revenue | 14,557 | 57,177 | 3,766 | 45,685 |
| Decrease (increase) in income tax receivable | 12,413 | 8,000 | 4,672 | (2,563) |
| Decrease (increase) in inventories | (33) | 74 | 486 | 136 |
| Decrease (increase) in other current assets | (216) | 245 | (1,796) | (1,333) |
| Increase (decrease) in accounts payable and accrued liabilities | 13,955 | 16,465 | (1,567) | 16,457 |
| Increase (decrease) in restructuring accrual | (2,011) | - | 12,839 | - |
| Increase in deferred revenue | 4,641 | 8,008 | 10,541 | 16,614 |
| Decrease in other current liabilities | (55) | (11,996) | (375) | (12,260) |
| Net cash provided by operating activities | 91,301 | 152,110 | 175,686 | 235,529 |
| INVESTING ACTIVITIES | | | | |
| Purchase of property, plant and equipment [note 7] | (57,847) | (95,332) | (146,908) | (271,301) |
| Purchase of intangible assets [note 8] | (9,480) | (6,269) | (35,689) | (35,495) |
| Purchase of investments | - | - | - | (59,041) |
| Proceeds from investments | - | - | 34,000 | 25,000 |
| Net change in regulatory assets and liabilities | 5,847 | (15,987) | 1,937 | (43,032) |
| Proceeds on disposals of property, plant and equipment | 215 | 66 | 948 | 4,277 |
| Net cash used in investing activities | (61,265) | (117,522) | (145,712) | (379,592) |
| FINANCING ACTIVITIES | | | | |
| Dividends paid [notes 19 and 20] | (6,000) | (6,000) | (40,966) | (26,063) |
| Increase (decrease) in customers' advance deposits | (7,544) | 5,627 | (5,941) | (6,072) |
| Net cash used in financing activities | (13,544) | (373) | (46,907) | (32,135) |
| Net increase (decrease) in cash and cash equivalents during the period | 16,492 | 34,215 | (16,933) | (176,198) |
| Cash and cash equivalents, beginning of period | 120,831 | 119,738 | 154,256 | 330,151 |
| Cash and cash equivalents, end of period | 137,323 | 153,953 | 137,323 | 153,953 |
| Supplementary cash flow information | | | | |
| Total interest paid | 219 | 314 | 38,043 | 39,848 |
| Total income taxes (recovered) paid | (7,925) | (3,819) | (1,859) | 5,434 |

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

1. INCORPORATION

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

The Corporation supervises the operations and provides corporate, management services and strategic direction to two subsidiaries incorporated under the *Business Corporations Act* (Ontario) and wholly-owned by the Corporation:

[i] Toronto Hydro-Electric System Limited ["LDC"] (incorporated June 23, 1999) – distributes electricity to customers located in the City and is subject to rate regulation. LDC is also engaged in the delivery of Conservation and Demand Management ["CDM"] activities; and

[ii] Toronto Hydro Energy Services Inc. (incorporated June 23, 1999) – provides street lighting services.

The principal business of the Corporation and its subsidiaries is the distribution of electricity by LDC.

2. BASIS OF PRESENTATION

These unaudited interim consolidated financial statements of the Corporation have been prepared in accordance with United States ["US"] Generally Accepted Accounting Principles ["GAAP"] with respect to the preparation of interim financial information, and are presented in Canadian dollars. The disclosures in these statements do not conform in all respects to the requirements of US GAAP for annual consolidated financial statements. The Corporation's annual and interim consolidated financial statements were prepared in accordance with Part V of Canadian GAAP until December 31, 2011. The comparative consolidated financial statements have been adjusted retroactively from the consolidated financial statements previously presented to conform to the presentation of the Corporation's 2012 interim consolidated financial statements prepared in accordance with US GAAP. The Corporation's first US GAAP annual consolidated financial statements will be dated December 31, 2012.

A reconciliation of the consolidated balance sheets between Canadian GAAP and US GAAP as at January 1, 2011 and December 31, 2011 and a reconciliation of net income for the three months and nine months ended September 30, 2011 accompany the interim consolidated financial statements [note 24].

3. REGULATION

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

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

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

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

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

a) Electricity Distribution Rates

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

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

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

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

Pursuant to the Incentive Regulation Mechanism ["IRM"] framework, the OEB established, as a preliminary issue in the above application, that it would consider the question of whether the application filed by LDC under the COS framework was acceptable or whether it should be dismissed. The IRM framework provides for an adjustment to an electricity distributor's rates based on a formulaic calculation with the possibility to request an Incremental Capital

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

Module ["ICM"] to address specific capital expenditure needs not covered by the formulaic calculation. The review of an ICM application is done by the OEB following defined criteria, such as materiality, causation and prudence.

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

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

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

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

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

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

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

While the IRM/ICM Application proposed by LDC has been under consideration by the OEB, capital spending in 2012 has been maintained at a reduced amount. As it is no longer practical to achieve the previously requested capital spend of \$448,700,000 in 2012, an update to the IRM/ICM Application was submitted by LDC on October 31, 2012 modifying the requested capital expenditures for 2012 and 2013 to \$274,700,000 and \$579,100,000, respectively, and requesting that consideration for 2014 be deferred to a second phase of the proceeding, once LDC has received a decision from the OEB in respect of the 2012 and 2013 rate years.

The current application is expected to be subject to an in-depth review by the OEB over the next few months. 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 outcome of the current application could have a material impact on the Corporation's consolidated financial statements in the future.

b) CDM Activities

On March 31, 2010, the Minister of Energy and Infrastructure of Ontario, under the guidance of sections 27.1 and 27.2 of the *Ontario Energy Board Act, 1998* (Ontario), directed the OEB to establish CDM targets to be met by

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

electricity distributors. Accordingly, on November 12, 2010, the OEB amended LDC's distribution licence to require LDC, as a condition of its licence, to achieve 1,304 Gigawatt-Hours of energy savings and 286 Megawatts of summer peak demand savings over the period beginning January 1, 2011 through December 31, 2014.

Effective January 1, 2011, LDC entered into an agreement with the Ontario Power Authority ["OPA"] in the amount of approximately \$50,000,000 to deliver CDM programs extending from January 1, 2011 to December 31, 2014. As at September 30, 2012, LDC received approximately \$35,366,000 [December 31, 2011 - \$19,875,000] from the OPA for the delivery of CDM programs. All programs to be delivered are fully funded and paid in advance by the OPA. 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.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The interim consolidated financial statements of the Corporation have been prepared in accordance with US GAAP, including accounting principles prescribed by the OEB in the "Accounting Procedures Handbook for Electricity Distributors", and reflect the significant accounting policies summarized below:

a) Basis of consolidation

The interim consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

b) Regulation

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

Regulatory Assets and Liabilities

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

Contributions in aid of construction

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

Allowance for funds used during construction

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

c) Cash and cash equivalents

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

d) Investments

Investments with terms to maturity of greater than 90 days from their date of acquisition are classified as held to maturity and included in current assets.

e) Accounts receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. The carrying amount of accounts receivable is reduced through an allowance for doubtful accounts and the amount of the related impairment loss is recognized in the consolidated statements of net income and comprehensive income. Subsequent recoveries of receivables previously provisioned and written off are credited to the consolidated statements of net income and comprehensive income. Management estimates uncollectible accounts receivable after considering historical loss experience and the characteristics of existing accounts.

f) Inventories

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

g) Property, plant and equipment

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

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

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

| | |
|----------------------------|----------------|
| Distribution lines | 1.7% to 5.0% |
| Transformers | 3.3% to 5.0% |
| Stations | 2.5% to 10.0% |
| Meters | 2.5% to 6.7% |
| Buildings | 1.3% to 5.0% |
| Rolling stock | 12.5% to 25.0% |
| Other capital assets | 4.0% to 20.0% |
| Equipment and tools | 10.0% to 16.7% |
| Assets under capital lease | 14.3% to 25.0% |
| Computer hardware | 16.7% to 25.0% |
| Communications | 10.0% to 20.0% |

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

h) Intangible assets

Effective January 1, 2012, the Corporation revised its estimate of useful life of its Customer Care and Billing Customer Information System from five years to ten years due to an analysis completed related to the useful life assessment. This change has been accounted for on a prospective basis in the interim consolidated financial statements effective January 1, 2012. The change in estimate reduced amortization expense by approximately \$3,000,000 for the first nine months of 2012 with an offsetting increase in the carrying value of intangible assets. The change in estimate will decrease future amortization expense by \$4,000,000 per year over the term of the original useful life with no impact to the final year of the original useful life, and thereafter increase future amortization expense by \$4,000,000 per year.

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

| | |
|-------------------|----------------|
| Computer software | 10.0% to 25.0% |
| Contributions | 4.0% |

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

i) Deferred debt issuance costs

Debt issuance costs arising from the Corporation's debenture offerings are capitalized within Other assets on the consolidated balance sheets. The deferred charge is amortized over the life of the debenture, using the effective interest method of amortization, and is included in net financing charges.

j) Restructuring

Restructuring charges are recorded based upon planned employee termination dates, site closure and consolidation plans, and contract terminations. Restructuring charges can include severance costs to eliminate a specified number of employee positions, infrastructure charges to vacate facilities and consolidate operations, and contract cancellation costs. The timing of associated cash payments is dependent upon the type of restructuring charge and can extend over a multi-year period.

k) Workplace Safety and Insurance Act

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

l) Revenue recognition

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

Other revenues, which include revenues from electricity distribution related services, revenues from the delivery of street lighting services and revenues from demand billable activities, are recognized as the services are rendered.

m) Financial instruments

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

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

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

- Cash equivalents, comprising short-term investments, are classified as “Held for Trading” and are measured at fair value. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Investments are classified as “Held to Maturity” and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Accounts receivable and unbilled revenue are classified as “Loans and Receivables” and are measured at amortized cost, which, upon initial recognition, are considered equivalent to fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Accounts payable and accrued liabilities are classified as “Other Financial Liabilities” and are initially measured at fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Obligations under capital lease are classified as “Other Financial Liabilities” and are initially measured at fair value. Subsequent measurements are based on a discounted cash flow analysis and approximate the carrying value as management believes that the fixed interest rates are representative of current market rates.
- Customers’ advance deposits are classified as “Other Financial Liabilities” and are initially measured at fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of the current portion, and the discounted long-term portion approximates the carrying value, taking into account interest accrued on the outstanding balance.
- Debentures are classified as “Other Financial Liabilities” and are initially measured at fair value. The carrying amounts of the debentures are carried at amortized cost, based on an initial fair value as determined at the time using a quoted market price for similar debt instruments. The fair value of the debentures is calculated by discounting the related cash flows at the estimated yield to maturity of similar debt instruments [note 16[a]]. While the Corporation has the option to redeem some or all of the debentures at its discretion, this option has no value and has not been recorded in the consolidated financial statements.

n) Fair value measurements

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

- *Level 1:* Unadjusted quoted prices in active markets for identical assets or liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis;

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

- *Level 2:* Other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly or indirectly; and
- *Level 3:* Unobservable inputs, supported by little or no market activity, used to measure the fair value of the assets or liabilities to the extent that observable inputs are not available.

o) Employee future benefits

Multi-employer pension plan

The Corporation provides a pension plan for its full-time employees through the Ontario Municipal Employees Retirement System ["OMERS"]. OMERS is a multi-employer, contributory, defined benefit pension plan established in 1962 by Ontario for employees of municipalities, local boards and school boards. Both participating employers and employees are required to make plan contributions based on participating employees' contributory earnings. The OMERS plan is accounted for as a defined contribution plan where the Corporation recognizes the expense related to this plan as contributions are made. The Corporation is not responsible for any other contractual obligations other than the contributions.

As at December 31, 2011, OMERS had approximately 263,000 active members. As at September 30, 2012, approximately 1,600 members are current employees of the Corporation.

Post-retirement benefits other than pension

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

The Corporation periodically measures its accumulated benefit obligation for accounting purposes as at December 31 of the applicable year. The latest actuarial valuation was performed as at January 1, 2010.

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

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

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

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

p) Asset retirement obligations

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

q) Customers' advance deposits

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

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

r) Income Taxes

Under the Electricity Act, the Corporation is required to make Payments In Lieu of Corporate Taxes ["PILs"] to the Ontario Electricity Financial Corporation. These payments are calculated in accordance with the *Income Tax Act* (Canada) and the *Taxation Act, 2007* (Ontario) (for years ending after 2008) or the *Corporations Tax Act* (Ontario) (for years ending prior to 2009) as modified by regulations made under the Electricity Act and related regulations. This effectively results in the Corporation paying taxes similar to what would be imposed under the federal and Ontario tax acts.

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

ASC 980 requires the recognition of deferred income tax assets and liabilities and related regulatory liabilities and assets for the amount of deferred income taxes expected to be refunded to, or recovered from, customers in future electricity distribution rates. As at September 30, 2012, LDC recorded a deferred income tax asset and a corresponding regulatory liability of \$194,695,000 with respect to its rate-regulated activities that will be included in the rate-setting process [note 9].

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

s) *Use of estimates*

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

t) *Future Accounting Pronouncements*

A number of new standards and interpretations are not yet effective for the period ended September 30, 2012. The Corporation continues to analyze these standards and has initially determined that the following could have a significant effect on the consolidated financial statements.

In December 2011, the Financial Accounting Standards Board issued Accounting Standards Update [“ASU”] No. 2011-11, “Balance Sheet (Topic 210): *Disclosures about Offsetting Assets and Liabilities*” [“ASU 2011-11”]. The amendments require an entity to disclose both gross and net information about financial instruments and transactions eligible for offset in the consolidated balance sheets. ASU 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Retrospective application is required. The adoption of this amendment is expected to increase disclosures related to offsetting assets and liabilities and is not expected to have an impact to the Corporation’s consolidated balance sheets.

5. INVENTORIES

Inventories consist of the following:

| | September 30 2012 \$ | December 31 2011 \$ |
|--|----------------------------|---------------------------|
| Consumables, tools and other maintenance items | 1,798 | 1,745 |
| Fuses | 1,600 | 1,625 |
| Drums and reels | 819 | 938 |
| Other | 2,188 | 2,583 |
| | 6,405 | 6,891 |

For the three months and the nine months ended September 30, 2012, the Corporation recognized operating expenses of \$2,019,000 and \$5,628,000 related to inventory used to service electrical distribution assets [three months and nine months ended September 30, 2011 - \$2,228,000 and \$6,379,000].

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

6. CURRENT PORTION OF OTHER ASSETS

Current portion of other assets consists of the following:

| | September 30 2012 \$ | December 31 2011 \$ |
|---------------------|----------------------------|---------------------------|
| Prepaid expenses | 6,419 | 4,487 |
| Debt issuance costs | 786 | 922 |
| | 7,205 | 5,409 |

7. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consist of the following:

| | September 30 2012 | | | December 31 2011 | | |
|----------------------------|----------------------|-----------------------------------|-------------------------|---------------------|-----------------------------------|-------------------------|
| | Cost \$ | Accumulated depreciation \$ | Net book value \$ | Cost \$ | Accumulated depreciation \$ | Net book value \$ |
| Land | 16,761 | — | 16,761 | 16,761 | — | 16,761 |
| Distribution lines | 2,930,907 | 1,473,241 | 1,457,666 | 2,850,401 | 1,441,333 | 1,409,068 |
| Transformers | 666,576 | 373,428 | 293,148 | 652,102 | 360,398 | 291,704 |
| Stations | 283,419 | 143,480 | 139,939 | 277,905 | 137,246 | 140,659 |
| Meters | 243,700 | 131,431 | 112,269 | 238,459 | 124,117 | 114,342 |
| Buildings | 158,768 | 67,697 | 91,071 | 154,932 | 62,403 | 92,529 |
| Rolling stock | 73,496 | 42,242 | 31,254 | 78,016 | 43,154 | 34,862 |
| Other capital assets | 70,527 | 47,073 | 23,454 | 68,802 | 44,108 | 24,694 |
| Equipment and tools | 44,944 | 33,389 | 11,555 | 44,208 | 31,785 | 12,423 |
| Assets under capital lease | 13,538 | 2,461 | 11,077 | 14,269 | 1,251 | 13,018 |
| Computer hardware | 49,454 | 38,927 | 10,527 | 44,625 | 35,602 | 9,023 |
| Communications | 31,697 | 25,950 | 5,747 | 31,537 | 23,912 | 7,625 |
| Construction in progress | 251,356 | — | 251,356 | 232,789 | — | 232,789 |
| | 4,835,143 | 2,379,319 | 2,455,824 | 4,704,806 | 2,305,309 | 2,399,497 |

For the three months and the nine months ended September 30, 2012, AFUDC in the amount of \$235,000 and \$720,000 [three months and nine months ended September 30, 2011 - \$1,198,000 and \$2,793,000] was capitalized to property, plant and equipment and credited to net financing charges.

As at September 30, 2012, the net book value of stranded meters related to the deployment of smart meters amounting to \$18,300,000 [December 31, 2011 - \$20,366,000] was included in property, plant and equipment. In the absence of rate regulation, property, plant and equipment would have been \$18,300,000 lower as at September 30, 2012 [December 31, 2011 - \$20,366,000 lower].

For the three months and the nine months ended September 30, 2012, the Corporation recorded depreciation expense of \$30,329,000 and \$90,102,000 [three months and nine months ended September 30, 2011 - \$31,732,000 and

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

\$91,555,000] of which \$488,000 and \$1,498,000 [three months and nine months ended September 30, 2011 - \$534,000 and \$630,000] related to assets under capital lease.

8. INTANGIBLE ASSETS, NET

Intangible assets consist of the following:

| | September 30 2012 | | | December 31 2011 | | |
|---------------------------------------|----------------------|-----------------------------------|-------------------------|---------------------|-----------------------------------|-------------------------|
| | Cost \$ | Accumulated amortization \$ | Net book value \$ | Cost \$ | Accumulated amortization \$ | Net book value \$ |
| Computer software | 228,674 | 169,376 | 59,298 | 222,598 | 154,186 | 68,412 |
| Contributions | 12,280 | 1,820 | 10,460 | 14,059 | 1,440 | 12,619 |
| Software in development | 23,159 | — | 23,159 | 15,598 | — | 15,598 |
| Contributions for work in progress | 40,184 | — | 40,184 | 16,353 | — | 16,353 |
| | 304,297 | 171,196 | 133,101 | 268,608 | 155,626 | 112,982 |

For the three months and the nine months ended September 30, 2012, the Corporation acquired \$9,480,000 and \$35,689,000 of intangible assets [three months and nine months ended September 30, 2011 - \$6,269,000 and \$35,495,000]. Contributions for work in progress relate to payments for connection projects to increase electricity distribution system capacity. All intangible assets are subject to amortization when they become available for use. Software in development and contributions for work in progress relate to assets not currently available for use and therefore are not amortized.

For the three months and the nine months ended September 30, 2012, \$1,795,000 and \$6,076,000 of software in development was transferred to computer software [three months and nine months ended September 30, 2011 - \$40,247,000 and \$49,130,000].

For the three months and the nine months ended September 30, 2012, AFUDC in the amount of \$350,000 and \$993,000 [three months and nine months ended September 30, 2011 - \$174,000 and \$1,066,000] was capitalized to intangible assets and credited to net financing charges.

For the three months and the nine months ended September 30, 2012, the Corporation recorded amortization expense on intangible assets of \$4,783,000 and \$15,570,000 [three months and nine months ended September 30, 2011 - \$6,420,000 and \$15,483,000].

As at September 30, 2012, estimated future amortization expense related to intangible assets is as follows:

| | \$ |
|---------------------|--------|
| 2012 ⁽¹⁾ | 4,810 |
| 2013 | 16,270 |
| 2014 | 16,990 |
| 2015 | 15,684 |
| 2016 | 12,728 |

⁽¹⁾ The amount disclosed represents the period October 1, 2012 to December 31, 2012.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

9. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

| | September 30 2012 \$ | December 31 2011 \$ [note 24] |
|--|----------------------------|--|
| Smart meters | 57,077 | 61,422 |
| Accounting policy changes | 61,702 | 64,785 |
| Settlement variances | 8,346 | 14,119 |
| Regulatory assets recovery account | 3,573 | 931 |
| Other | 3,147 | 1,781 |
| | 133,845 | 143,038 |
| Less: Current portion of regulatory assets | 2,751 | — |
| Long-term portion of regulatory assets | 131,094 | 143,038 |

Regulatory liabilities consist of the following:

| | September 30 2012 \$ | December 31 2011 \$ [note 24] |
|---|----------------------------|--|
| Deferred income taxes | 194,695 | 200,436 |
| Regulatory assets recovery account | — | 7,293 |
| Income and other taxes variance account | 2,390 | 2,365 |
| Other | 1,130 | 1,118 |
| | 198,215 | 211,212 |
| Less: Current portion of regulatory liabilities | — | 7,293 |
| Long-term portion of regulatory liabilities | 198,215 | 203,919 |

For the three months ended September 30, 2012, LDC disposed of approved regulatory assets amounting to \$1,094,000, and for the nine months ended September 30, 2012, LDC disposed of approved net regulatory liabilities amounting to \$9,939,000, through permitted distribution rate adjustments [three months and nine months ended September 30, 2011 - approved net regulatory liabilities of \$10,298,000 and \$24,816,000].

The regulatory assets and liabilities of the Corporation are as follows:

a) Smart Meters

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

assets, and the transfer of the net book value of the stranded meters from property, plant and equipment to regulatory assets.

As at September 30, 2012, smart meter capital expenditures, net of accumulated depreciation, totalling \$54,456,000 were recorded to regulatory assets [December 31, 2011 - \$59,227,000]. These expenditures would otherwise have been recorded as property, plant and equipment and intangible assets under US GAAP for unregulated businesses. In the absence of rate regulation, property, plant and equipment and intangible assets would have been \$51,382,000 and \$3,074,000 higher, respectively, as at September 30, 2012 [December 31, 2011 - \$54,825,000 and \$4,402,000 higher, respectively].

For the three months and the nine months ended September 30, 2012, smart meter depreciation expense of \$1,590,000 and \$4,771,000 [three months and nine months ended September 30, 2011 - \$1,590,000 and \$4,771,000] were deferred which would have been expensed under US GAAP for unregulated businesses. In the absence of rate regulation, for the three months and the nine months ended September 30, 2012, depreciation expense would have been \$1,590,000 and \$4,771,000 higher [three months and nine months ended September 30, 2011 - \$1,590,000 and \$4,771,000 higher].

For the three months and the nine months ended September 30, 2012, smart meter customer revenues of \$1,506,000 and \$4,392,000 were deferred [three months and nine months ended September 30, 2011 - \$1,473,000 and \$4,405,000]. In the absence of rate regulation, for the three months and the nine months ended September 30, 2012, revenue would have been \$1,506,000 and \$4,392,000 higher [three months and nine months ended September 30, 2011 - \$1,473,000 and \$4,405,000 higher].

b) Accounting Policy Changes

This regulatory asset account relates to the accounting policy changes upon adoption of US GAAP, primarily related to the expected future electricity distribution charges to customers arising from timing differences in the recognition of actuarial losses and prior service costs of other post-retirement benefits [note 24]. The period in which recovery is expected cannot be determined at this time.

c) Settlement Variances

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

The balance for settlement variances continues to be calculated and attracts carrying charges in accordance with the OEB's direction. For the three months and the nine months ended September 30, 2012, settlement variances of \$nil and \$12,249,000 were disposed through rate adjustments [three months and nine months ended September 30, 2011 - \$10,176,000 and \$25,090,000].

d) Regulatory Assets Recovery Account

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

On April 9, 2010, the OEB approved the disposition of net regulatory liabilities of \$68,140,000, consisting of credit balances for settlement variances and income and other taxes variances of \$58,225,000 and \$11,900,000,

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

respectively, and intangible assets debit balance of \$1,985,000, over a two-year period commencing on May 1, 2010 and ending on April 30, 2012.

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

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

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

e) Deferred Income Taxes

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

As at September 30, 2012, LDC recorded a deferred income tax asset and a corresponding regulatory liability of \$194,695,000 [December 31, 2011 - \$200,436,000] with respect to its rate-regulated activities that will be included in the rate-setting process.

f) Income and Other Taxes Variance Account

The income and other taxes variance regulatory liability account relates to the differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in the rate adjustment model. As at September 30, 2012, the balance in this account consisted of an over-recovery from customers of \$2,390,000 [December 31, 2011 - \$2,365,000].

10. OTHER ASSETS

Other long-term assets consist of the following:

| | September 30 2012 \$ | December 31 2011 \$ |
|---------------------|----------------------------|---------------------------|
| Prepaid expenses | 7,213 | 7,331 |
| Debt issuance costs | 4,462 | 5,092 |
| | 11,675 | 12,423 |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

11. CREDIT FACILITIES

The Corporation is a party to a revolving credit facility with a syndicate of Canadian chartered banks [“Revolving Credit Facility”]. On October 10, 2012, the amount the Corporation may borrow under the Revolving Credit Facility was increased from \$400,000,000 to \$600,000,000 and the expiry date extended from May 3, 2013 to October 10, 2017. An amount up to \$210,000,000 (formerly \$140,000,000) is available in the form of letters of credit.

Additionally, the Corporation is a party to:

- a demand facility with a Canadian chartered bank for \$75,000,000 (increased from \$50,000,000 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 \$20,000,000 for the purpose of working capital management [“Working Capital Facility”].

As at September 30, 2012, no amounts had been drawn under either the Revolving Credit Facility or the Working Capital Facility [December 31, 2011 - \$nil]. As at September 30, 2012, \$48,975,000 had been drawn on the Prudential Facility [December 31, 2011 - \$45,077,000].

12. RESTRUCTURING

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

For the nine months ended September 30, 2012, the costs incurred as a result of these operating cost reduction initiatives amounted to \$27,796,000 and were comprised of ongoing termination charges of \$23,668,000 and one-time termination incentive charges of \$4,128,000, of which \$14,887,000 remains unpaid as at September 30, 2012.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

13. DEBENTURES

Debentures consist of the following:

| | September 30 2012 \$ | December 31 2011 \$ |
|--|----------------------------|---------------------------|
| Senior unsecured debentures | | |
| Series 1 – 6.11% due May 7, 2013 | 224,988 | 224,976 |
| Series 2 – 5.15% due November 14, 2017 | 249,854 | 249,835 |
| Series 3 – 4.49% due November 12, 2019 | 249,954 | 249,951 |
| Series 5 – 6.11% due May 6, 2013 | 245,057 | 245,057 |
| Series 6 – 5.54% due May 21, 2040 | 199,859 | 199,857 |
| Series 7 – 3.54% due November 18, 2021 | 299,861 | 299,851 |
| Total debentures | 1,469,573 | 1,469,527 |
| Less: Current portion of debentures | 470,045 | — |
| Long-term portion of debentures | 999,528 | 1,469,527 |

All debentures of the Corporation rank equally.

The Corporation may redeem some or all of the debentures at any time prior to maturity at a price equal to the greater of the Canada Yield Price (determined in accordance with the terms of the debentures) and par, plus accrued and unpaid interest up to and excluding the date fixed for redemption. Also, the Corporation may, at any time and from time to time, purchase debentures for cancellation, in the open market, by tender or by private contract, at any price. The debentures contain certain covenants which, subject to certain exceptions, restrict the ability of the Corporation and LDC to create security interests, incur additional indebtedness or dispose of all or substantially all of their assets.

14. EMPLOYEE FUTURE BENEFITS

a) Pension

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

| Pension Plan, Employer Identification Number / Pension Number | Funded Status as at December 31, 2011 | Contributions | | | |
|--|--|------------------------------------|------------|-----------------------------------|------------|
| | | Three months ended September 30 | | Nine months ended September 30 | |
| | | 2012 \$ | 2011 \$ | 2012 \$ | 2011 \$ |
| OMERS, 564191 | 89% | 4,251 | 3,654 | 13,139 | 10,944 |

The Corporation's contributions do not represent more than five percent of total contributions to the plan as indicated in OMERS's most recently available annual report for the year ended December 31, 2011. As of the end of the year, no funding improvement plan or rehabilitation plan had been implemented or was pending.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

For 2012, OMERS contribution rates are 8.3% up to the year's maximum pensionable earnings ["YMPE"] and 12.8% over YMPE for normal retirement age of 65 [2011 - 7.4% up to YMPE and 10.7% over YMPE for normal retirement age of 65].

b) *Post-retirement benefits other than pension*

The components of net periodic benefit cost are:

| | Three months ended September 30 | | Nine months ended September 30 | |
|--|------------------------------------|--------------|-----------------------------------|---------------|
| | 2012 | 2011 | 2012 | 2011 |
| | \$ | \$ | \$ | \$ |
| Service cost | 1,287 | 977 | 3,863 | 2,931 |
| Interest cost | 2,914 | 2,877 | 8,743 | 8,631 |
| Amortization of net actuarial loss | 762 | 158 | 2,285 | 474 |
| Amortization of prior service cost | 266 | 273 | 799 | 819 |
| Net periodic benefit cost | 5,229 | 4,285 | 15,690 | 12,855 |
| Capitalized as part of property, plant and equipment | 1,882 | 1,627 | 5,291 | 4,926 |
| Charged to operations | 3,347 | 2,658 | 10,399 | 7,929 |

15. ASSET RETIREMENT OBLIGATIONS

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

| | September 30 2012 | December 31 2011 |
|---------------------------------------|----------------------|---------------------|
| | \$ | \$ |
| Balance, beginning of period | 4,902 | 5,005 |
| ARO liabilities settled in the period | (166) | (688) |
| Accretion expense | 130 | 173 |
| Revision in estimated cash flows | 94 | 412 |
| Balance, end of period | 4,960 | 4,902 |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

16. FINANCIAL INSTRUMENTS

a) *Recognition and measurement*

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

| | September 30 2012 | | December 31 2011 | |
|--|-------------------------|---------------------------|-------------------------|---------------------------|
| | Carrying value \$ | Fair value ⁽¹⁾ | Carrying value \$ | Fair value ⁽¹⁾ |
| Cash and cash equivalents | 137,323 | 137,323 | 154,256 | 154,256 |
| Investments | — | — | 34,002 | 34,002 |
| Accounts receivable, net of allowance for doubtful accounts | 213,246 | 213,246 | 183,272 | 183,272 |
| Unbilled revenue | 258,292 | 258,292 | 262,058 | 262,058 |
| Accounts payable and accrued liabilities | 410,845 | 410,845 | 412,412 | 412,412 |
| Obligations under capital lease | 11,547 | 11,547 | 13,172 | 13,172 |
| Customers' advance deposits | 50,097 | 50,097 | 56,038 | 56,038 |
| Senior unsecured debentures | | | | |
| Series 1 – 6.11% due May 7, 2013 | 224,988 | 231,456 | 224,976 | 238,359 |
| Series 2 – 5.15% due November 14, 2017 | 249,854 | 286,266 | 249,835 | 284,126 |
| Series 3 – 4.49% due November 12, 2019 | 249,954 | 282,817 | 249,951 | 275,575 |
| Series 5 – 6.11% due May 6, 2013 | 245,057 | 252,076 | 245,057 | 259,578 |
| Series 6 – 5.54% due May 21, 2040 | 199,859 | 257,666 | 199,857 | 245,096 |
| Series 7 – 3.54% due November 18, 2021 | 299,861 | 319,449 | 299,851 | 306,696 |

⁽¹⁾ The fair value measurement of financial instruments recorded at amortized cost for which the fair value has been disclosed, including obligations under capital lease, are included in Level 2 of the fair value hierarchy.

b) *Financial Risks*

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

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

Credit risk

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

The Corporation's credit risk associated with accounts receivable is primarily related to electricity bill payments from LDC customers. LDC has approximately 716,000 customers, the majority of which are residential. LDC collects security deposits from customers in accordance with direction provided by the OEB. As at September 30, 2012, LDC held security deposits in the amount of \$50,097,000 [December 31, 2011 - \$56,038,000].

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

Credit risk associated with accounts receivable is as follows:

| | September 30 2012 \$ | December 31 2011 \$ |
|--|----------------------------|---------------------------|
| Total accounts receivable | 224,952 | 196,259 |
| Less: Allowance for doubtful accounts | (11,706) | (12,987) |
| Total accounts receivable, net | 213,246 | 183,272 |
| Of which: | | |
| Outstanding for not more than 30 days | 187,397 | 155,274 |
| Outstanding for more than 30 days and not more than 120 days | 25,007 | 24,777 |
| Outstanding for more than 120 days | 12,548 | 16,208 |
| Less: Allowance for doubtful accounts | (11,706) | (12,987) |
| Total accounts receivable, net | 213,246 | 183,272 |

Unbilled revenue represents amounts for which the Corporation has a contractual right to receive cash through future billings and are unbilled at period-end. As at September 30, 2012, total unbilled revenue was \$258,292,000 [December 31, 2011 - \$262,058,000]. Unbilled revenue is considered current.

As at September 30, 2012, there were no significant concentrations of credit risk with respect to any class of financial assets or counterparties. The Corporation's maximum exposure to credit risk is equal to the carrying value of its financial assets.

Interest rate risk

The Corporation is exposed to interest rate risk through holding certain financial instruments, and short-term borrowings under the Corporation's Revolving Credit Facility [note 11] may expose the Corporation to fluctuations in short-term interest rates. The Corporation attempts to minimize interest rate risk by issuing long-term fixed rate debt, and by extending or shortening the term of its short-term money market investments by assessing the monetary policy stance of the Bank of Canada, while ensuring that all payment obligations are met on an ongoing basis.

Under an IRM framework, the Corporation's allowed return on equity will be fixed for all years that fall under the IRM period. Since the return on equity is fixed, a fluctuation of interest rates will not affect the return on equity and therefore will not require a hypothetical sensitivity analysis.

Liquidity risk

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

| September 30, 2012 | | | |
|--|----------------------------|--|----------------------------|
| | Due within 1 year \$ | Due between 1 year and 5 years \$ | Due after 5 years \$ |
| Financial liabilities | | | |
| Accounts payable and accrued liabilities | 410,845 | — | — |
| Obligations under capital lease | 2,311 | 9,170 | 1,713 |
| Senior unsecured debentures | | | |
| Series 1 – 6.11% due May 7, 2013 | 225,000 | — | — |
| Series 2 – 5.15% due November 14, 2017 | — | — | 250,000 |
| Series 3 – 4.49% due November 12, 2019 | — | — | 250,000 |
| Series 5 – 6.11% due May 6, 2013 | 245,057 | — | — |
| Series 6 – 5.54% due May 21, 2040 | — | — | 200,000 |
| Series 7 – 3.54% due November 18, 2021 | — | — | 300,000 |
| Interest payments on debentures | 74,520 | 183,200 | 335,322 |
| | 957,733 | 192,370 | 1,337,035 |

Hedging and Derivative risk

As at September 30, 2012 and December 31, 2011, the Corporation had not entered into hedging and derivative financial instruments.

Foreign exchange risk

As at September 30, 2012, the Corporation had limited exposure to the changing values of foreign currencies. While the Corporation purchases goods and services which are payable in US dollars, and purchases US currency to meet the related payables commitments when required, the impact of these transactions is not material to the interim consolidated financial statements.

17. FINANCIAL GUARANTEES

The City has authorized the Corporation to provide financial assistance to its subsidiaries, and LDC to provide financial assistance to other subsidiaries of the Corporation, in the form of letters of credit and guarantees, for the purpose of enabling them to carry on their businesses, up to an aggregate amount of \$500,000,000. As at September 30, 2012, no financial assistance was provided by the Corporation or LDC to subsidiaries of the Corporation.

18. INCOME TAXES

The Corporation's effective tax rate for the three months and the nine months ended September 30, 2012 was 11.58% and 6.88% [three months and nine months ended September 30, 2011 - 10.88% and 3.97%]. The effective tax rate for the three months and the nine months ended September 30, 2012 was higher than the three months and the nine months ended September 30, 2011, primarily due to recording deferred income taxes against regulatory assets and liabilities.

Income tax expense for the three months and the nine months ended September 30, 2012 was \$4,508,000 and \$4,669,000 [three months and nine months ended September 30, 2011 - \$3,538,000 and \$3,254,000]. The change in

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

income tax expense between the three months and the nine months ended September 30, 2012 and September 30, 2011 was primarily due to recording deferred income taxes against regulatory assets and liabilities.

19. SHARE CAPITAL

Share capital consists of the following:

| | September 30 2012 \$ | December 31 2011 \$ |
|---|----------------------------|---------------------------|
| Authorized The authorized share capital of the Corporation consists of an unlimited number of common shares | | |
| Issued and outstanding 1,000 common shares | 567,817 | 567,817 |

Dividends

The shareholder direction adopted by the City with respect to the Corporation provides that the Board of Directors of the Corporation will use its best efforts to ensure that the Corporation meets certain financial performance standards, including those relating to the credit rating and dividends.

Subject to applicable law, the shareholder direction provides that the Corporation will pay dividends to the City each year amounting to the greater of \$25,000,000 or 50% of the Corporation’s consolidated net income for the year. The dividends are not cumulative and are payable as follows:

- [i] \$6,000,000 on the last day of each of the first three fiscal quarters during the year;
- [ii] \$7,000,000 on the last day of the fiscal year; and
- [iii] the amount, if any, by which 50% of the Corporation’s annual consolidated net income for the year exceeds \$25,000,000, within ten days after the approval of the Corporation’s audited consolidated financial statements for the year by the Board of Directors of the Corporation.

On March 2, 2012, the Board of Directors of the Corporation declared dividends in the amount of \$28,966,000. The dividends were comprised of \$22,966,000 with respect to net income for the year ended December 31, 2011, which was paid to the City on March 12, 2012, and \$6,000,000 with respect to the first quarter of 2012, which was paid to the City on March 30, 2012.

On May 17, 2012, the Board of Directors of the Corporation declared a dividend in the amount of \$6,000,000 with respect to the second quarter of 2012, which was paid to the City on June 29, 2012.

On August 17, 2012, the Board of Directors of the Corporation declared a dividend in the amount of \$6,000,000 with respect to the third quarter of 2012, which was paid to the City on September 28, 2012.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

20. RELATED PARTIES

For the Corporation, transactions with related parties include transactions with the City. All transactions with the City are conducted at prevailing market prices and normal trade terms.

| Transactions with Related Parties Summary | Three months ended September 30 | | Nine months ended September 30 | |
|---|------------------------------------|--------|-----------------------------------|---------|
| | 2012 | 2011 | 2012 | 2011 |
| | \$ | \$ | \$ | \$ |
| Revenues | 58,274 | 53,091 | 168,957 | 156,159 |
| Operating expenses and capital expenditures | 4,420 | 6,177 | 16,462 | 15,513 |
| Dividends | 6,000 | 6,000 | 40,966 | 26,063 |

| Transactions with Related Parties Summary | September 30 | December 31 |
|---|--------------|-------------|
| | 2012 | 2011 |
| | \$ | \$ |
| Accounts receivable | 5,650 | 8,412 |
| Unbilled revenue | 9,528 | 8,692 |
| Other assets | 8,965 | 7,279 |
| Accounts payable and accrued liabilities | 24,424 | 25,085 |
| Advance deposits | 8,850 | 8,714 |

Revenues represent amounts charged to the City primarily for electricity, street lighting services, and ancillary services. Operating expenses and capital expenditures represent amounts charged by the City for purchased road cut repairs, property taxes and other services. Dividends represent dividends paid to the City [note 19].

Accounts receivable represent receivables from the City primarily for electricity, street lighting and ancillary services. Unbilled revenue represents receivables from the City related to the provision of electricity and other services provided and not yet billed. Other assets represent amounts primarily for prepaid land leases from the City and prepaid property taxes to the City. Accounts payable and accrued liabilities represent amounts payable to the City relating to road cut repairs and other services, as well as funds received from the City for the construction of electricity distribution assets. Advance deposits represent funds received from the City for future expansion projects.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

21. COMMITMENTS

Operating lease obligations and future commitments

As at September 30, 2012, the future minimum annual lease payments under property and equipment operating leases and future commitments with remaining terms from one to five years and thereafter were as follows:

| | \$ |
|---|---------------|
| 2012 ⁽¹⁾ | 1,494 |
| 2013 | 22,883 |
| 2014 | 7,513 |
| 2015 | 6,565 |
| 2016 | 6,427 |
| Thereafter | 3,407 |
| Total amount of future minimum payments ⁽²⁾ | 48,289 |

⁽¹⁾ The amount disclosed represents the balance due over the period October 1, 2012 to December 31, 2012.

⁽²⁾ Refer to note 16 for repayments of senior unsecured debentures.

Capital lease obligations

As at September 30, 2012, the future minimum annual lease payments under capital leases with remaining lease terms from one to five years and thereafter were as follows:

| | \$ |
|---|---------------|
| 2012 ⁽¹⁾ | 578 |
| 2013 | 2,311 |
| 2014 | 2,302 |
| 2015 | 2,295 |
| 2016 | 2,283 |
| Thereafter | 3,425 |
| Total amount of future minimum lease payments | 13,194 |
| Less: interest and executory costs | 1,647 |
| | 11,547 |
| Current portion included in Other liabilities | 1,807 |
| Long-term portion included in Other liabilities | 9,740 |

⁽¹⁾ The amount disclosed represents the balance due over the period October 1, 2012 to December 31, 2012.

22. CONTINGENCIES

a) Legal Proceedings

In the ordinary course of business, the Corporation is subject to various litigation and claims with customers, suppliers, former employees and other parties. On an ongoing basis, the Corporation assesses the likelihood of any adverse judgments or outcomes as well as potential ranges of probable costs and losses. A determination of the provision required, if any, for these contingencies is made after an analysis of each individual issue. The provision

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

may change in the future due to new developments in each matter or changes in approach, such as a change in settlement strategy. The Corporation and its subsidiaries are subject to various legal actions that arise in the normal course of business and if damages were awarded under these actions, the Corporation and its subsidiaries would make a claim under their liability insurance which the Corporation believes would cover any damages which may become payable by the Corporation and its subsidiaries in connection with these actions.

Christian Helm Class Action

On December 6, 2010, a statement of claim in a proposed class action was issued against LDC. The claim sought general and special damages in the amount of \$100,000,000 for disgorgement of unjust gains allegedly resulting from the receipt of interest on overdue accounts in contravention of the *Interest Act* (Canada). On April 30, 2012, a settlement reached by the parties was approved by Order of the Ontario Superior Court of Justice. Pursuant to the terms of the Order, LDC was required to pay the amount of \$5,836,000 plus costs in settlement of all claims, substantially all of which had been paid as at September 30, 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.

2 Secord Avenue

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

2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of \$30,000,000 as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action seeks damages in the amount of \$10,000,000 from LDC. Both actions are at a preliminary stage and the certification hearing has yet to occur. Statements of defence to the main action and to the third party claim have not been filed. Accordingly, given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

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 \$30,000,000 as compensation for damages allegedly suffered as a result of the fire at 2369 Lakeshore Boulevard West. Subsequently, in March 2010, the plaintiff in the main action amended its statement of claim to add LDC as a defendant. The plaintiff in the main action seeks damages in the amount of \$400,000 from LDC. LDC has filed a statement of defence, crossclaim and counterclaim. Examinations for discovery have not taken place, notwithstanding a court ordered timetable to have them completed by February 29, 2012. 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.

On August 29, 2011, LDC was served with a statement of claim by the owner of the building and the property management company for the building seeking damages in the amount of \$2,000,000 as a result of the fire at 2369 Lakeshore Boulevard West. LDC has filed a statement of defence and counterclaim. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of 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.

b) OEB PILs Proceeding

The OEB conducted a review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for certain Municipal Electricity Utilities ["MEUs"]. On June 24, 2011, the OEB issued its decision for these MEUs and provided guidelines for the calculation and further disposition of the balances accumulated in the PILs regulatory variance accounts. The OEB has issued interrogatories and decisions for other MEUs subsequent to its previous decision.

LDC has reviewed the balances of its PILs regulatory variance accounts and applied the guidelines provided by the OEB. As at September 30, 2012, LDC estimated its liability at approximately \$5,724,000. This balance has been recorded in the Corporation's interim 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.

c) Payments in Lieu of Additional Municipal and School Taxes

The Ministry of Finance had issued assessments in respect of payments in lieu of additional municipal and school taxes under section 92 of the Electricity Act that were in excess of the amounts LDC believed were payable. The dispute arose as a result of inaccurate information incorporated into Ontario Regulation 224/00. The Corporation 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.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

23. NET INCOME PER SHARE

The weighted daily average number of shares outstanding for the three months and the nine months ended September 30, 2012 was 1,000 [three months and nine months ended September 30, 2011 - 1,000]. Basic and fully diluted net income per share was determined by dividing the net income for the period by the weighted daily average number of shares outstanding.

24. US GAAP TRANSITION

Publicly accountable enterprises in Canada were required to adopt IFRS for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. On September 10, 2010, the Accounting Standards Board granted an optional one-year deferral for IFRS adoption for entities subject to rate regulation. The Corporation elected to take the optional one-year deferral of its adoption of IFRS. In the absence of a definitive plan to consider the issuance of a rate-regulated accounting standard by the International Accounting Standards Board, the Corporation decided to evaluate the option of adopting US GAAP effective January 1, 2012 as an alternative to IFRS. On 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 accounting policies set out in note 4 have been applied consistently in preparing the interim consolidated financial statements for the nine months ended September 30, 2012 and the comparative periods.

The Corporation has adjusted amounts reported previously in its interim and annual consolidated financial statements prepared in accordance with Canadian GAAP. For reporting purposes, the transition date to US GAAP is January 1, 2011, which is the commencement of the 2011 interim comparative period to the Corporation's 2012 interim consolidated financial statements. An explanation of how the transition from Canadian GAAP to US GAAP has affected the Corporation's interim consolidated financial statements is set out in the following tables and accompanying notes.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

The reconciliation of the January 1, 2011 consolidated balance sheet from Canadian GAAP to US GAAP is as follows:

| CONSOLIDATED BALANCE SHEET | | | | |
|---|--------------|-----------------------------|--|-----------------------|
| [in thousands of Canadian dollars] | | | | |
| As at January 1, 2011 | Notes | Canadian GAAP \$ | Transitional Adjustments \$ | US GAAP \$ |
| ASSETS | | | | |
| Current | | | | |
| Regulatory assets | A | — | 3,555 | 3,555 |
| Other | B | 805,310 | 718 | 806,028 |
| Total current assets | | 805,310 | 4,273 | 809,583 |
| Regulatory assets | A | 85,113 | 29,224 | 114,337 |
| Other | B | 2,448,191 | 4,132 | 2,452,323 |
| Total assets | | 3,338,614 | 37,629 | 3,376,243 |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | | | |
| Current | | | | |
| Customers' advance deposits | C | — | 50,630 | 50,630 |
| Post-retirement benefits | A | — | 7,415 | 7,415 |
| Regulatory liabilities | A | — | 36,654 | 36,654 |
| Other | C | 639,751 | (18,790) | 620,961 |
| Total current liabilities | | 639,751 | 75,909 | 715,660 |
| Customers' advance deposits | C | 45,462 | (31,840) | 13,622 |
| Debentures | B | 1,164,780 | 4,850 | 1,169,630 |
| Post-retirement benefits | A | 169,897 | 22,715 | 192,612 |
| Regulatory liabilities | A | 273,706 | (34,005) | 239,701 |
| Other | | 5,639 | — | 5,639 |
| Total liabilities | | 2,299,235 | 37,629 | 2,336,864 |
| Total shareholder's equity | | 1,039,379 | — | 1,039,379 |
| Total liabilities and shareholder's equity | | 3,338,614 | 37,629 | 3,376,243 |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

The reconciliation of the December 31, 2011 consolidated balance sheet from Canadian GAAP to US GAAP is as follows:

| CONSOLIDATED BALANCE SHEET | | | | |
|---|--------------|-----------------------------|--|-----------------------|
| [in thousands of Canadian dollars] | | | | |
| As at December 31, 2011 | Notes | Canadian GAAP \$ | Transitional Adjustments \$ | US GAAP \$ |
| ASSETS | | | | |
| Current | | | | |
| Other | B | 656,278 | 922 | 657,200 |
| Total current assets | | 656,278 | 922 | 657,200 |
| Regulatory assets | A | 77,322 | 65,716 | 143,038 |
| Other | B | 2,722,177 | 5,092 | 2,727,269 |
| Total assets | | 3,455,777 | 71,730 | 3,527,507 |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | | | |
| Current | | | | |
| Customers' advance deposits | C | — | 40,238 | 40,238 |
| Post-retirement benefits | A | — | 7,915 | 7,915 |
| Regulatory liabilities | A | — | 7,293 | 7,293 |
| Other | C | 448,061 | (20,108) | 427,953 |
| Total current liabilities | | 448,061 | 35,338 | 483,399 |
| Customers' advance deposits | C | 35,930 | (20,130) | 15,800 |
| Debentures | B | 1,463,514 | 6,013 | 1,469,527 |
| Post-retirement benefits | A | 179,541 | 56,870 | 236,411 |
| Regulatory liabilities | A | 210,280 | (6,361) | 203,919 |
| Other | | 16,203 | — | 16,203 |
| Total liabilities | | 2,353,529 | 71,730 | 2,425,259 |
| Total shareholder's equity | | 1,102,248 | — | 1,102,248 |
| Total liabilities and shareholder's equity | | 3,455,777 | 71,730 | 3,527,507 |

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

The reconciliation of net income from Canadian GAAP to US GAAP for the three months and the nine months ended September 30, 2011 are as follows:

| RECONCILIATION OF NET INCOME FROM CANADIAN GAAP TO US GAAP | | | |
|---|-------|---|--|
| [in thousands of Canadian dollars] | | | |
| | Notes | Three months ended September 30 2011 \$ | Nine months ended September 30 2011 \$ |
| Net income, Canadian GAAP | | 28,982 | 78,704 |
| Revenues | D | 3,847 | 9,552 |
| Purchased power and other | D | 559 | 1,493 |
| Operating expenses | D, E | (4,406) | (13,568) |
| Income tax recovery | E | — | 2,523 |
| Net income, US GAAP | | 28,982 | 78,704 |

Notes to the transitional adjustments

A. Post-retirement benefits

Under Canadian GAAP, unamortized actuarial gains and losses and unamortized prior service costs are not recorded on the consolidated balance sheets. Under US GAAP, all actuarial gains and losses and prior service costs are fully recognized in OCI in the period in which they arise and are presented within equity as Accumulated Other Comprehensive Income [“AOCI”]. Due to the rate-regulated nature of the Corporation’s business, the impact to AOCI on transition and the impact to OCI on a go-forward basis will be reclassified to a regulatory asset account [note 9[b]]. This reclassification results in the full recognition of the benefit obligation as a liability on the Corporation’s consolidated balance sheets and no balance reported in OCI and AOCI. A portion of the benefit obligation will also be presented as a current liability on the consolidated balance sheets. The current portion is the amount by which the actuarial present value of benefits included in the benefit obligation is payable in the next 12 months.

B. Debt issuance costs

Under Canadian GAAP, debt issuance costs are netted against the principal balance of the related debenture. Under US GAAP, debt issuance costs are recognized as deferred charges. This presentation difference results in an increase in other current assets and other assets and an offsetting increase to debentures.

C. Customers’ advance deposits

Under US GAAP, deposits that are due on demand or will be due on demand within one year from the end of the reporting period have been reclassified as current liabilities.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

[all tabular amounts in thousands of Canadian dollars, unaudited]

D. Demand billable income and expenses

Under US GAAP, associated costs related to demand billable income have been reclassified on the consolidated statements of net income and comprehensive income. There is no impact to the overall net income.

E. Income tax recovery

Under Canadian GAAP, all ITCs are recognized as a reduction of the related expenditure. Under US GAAP, the benefits of the refundable apprenticeship and co-operative ITCs are recognized as a reduction of the related expenditure. All other ITCs are recorded as a reduction of income tax expense in the current period to the extent that realization of such benefits is more likely than not.

25. SEASONAL OPERATIONS

The Corporation's quarterly results are impacted by changes in revenues resulting from variations in seasonal weather conditions, the fluctuations in electricity prices and the timing and recognition of regulatory decisions. 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/cooling in the third quarter.

26. SUBSEQUENT EVENTS

The Corporation has evaluated the events and transactions occurring after the consolidated balance sheet date through November 15, 2012 when the Corporation's interim consolidated financial statements were available to be issued after the approval by the Corporation's Board of Directors, and identified the following event and transaction which required recognition in the interim consolidated financial statements and/or disclosure in the notes to the interim consolidated financial statements:

Dividends

On November 15, 2012, the Board of Directors of the Corporation declared a dividend in the amount of \$7,000,000 with respect to the fourth quarter of 2012. The dividend is payable on December 31, 2012.