toronto hydro corporation

ANNUAL INFORMATION FORM

FOR THE YEAR ENDED DECEMBER 31, 2009

March 8, 2010

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PART 1 - FORWARD-LOOKING INFORMATION

The Corporation includes forward-looking information in this Annual Information Form (the "AIF") within the meaning of applicable securities laws in Canada ("forward-looking information"). The purpose of the forward-looking information is to provide management's expectations regarding the Corporation's future results of operations, performance, business prospects and opportunities and may not be appropriate for other purposes. All forward-looking information is given pursuant to the "safe harbour" provisions of applicable Canadian securities legislation. The words "anticipates", "believes", "budgets", "could", "estimates", "expects", "forecasts", "intends", "may", "might", "plans", "projects", "schedule", "should", "will", "would" and similar expressions are often intended to identify forward-looking information, although not all forward-looking information contains these identifying words. The forward-looking information reflects management's current beliefs and is based on information currently available to the Corporation's management.

The forward-looking information in the AIF includes, but is not limited to, statements regarding LDC's 2010 base distribution revenue, the Corporation's plans to borrow to repay the Amended and Restated City Note, the impact of current economic conditions and financial market volatility on the Corporation's results of operations, performance, business prospects and opportunities, the potential transfer of streetlighting activities from TH Energy, the outcome of outstanding proceedings before the OEB, the estimated fair value of the Corporation's investments and the effect of changes in interest rates on future revenue requirements. The statements that make up the forward-looking information are based on assumptions that include, but are not limited to, the future course of the economy and financial markets, the receipt of applicable regulatory approvals and requested rate orders, the receipt of favourable judgments, the level of interest rates, the Corporation's ability to borrow, and the fair market value of the Corporation's investments.

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

Additional factors which could cause actual results or outcomes to differ materially from the results expressed or implied by forward looking information include, among other things:

Regulatory Developments - Changes to any of the laws, rules, regulations or policies applicable to the businesses carried on by Toronto Hydro.

Condition of Distribution Assets - LDC's ability to continue to maintain and operate the distribution system reliably and safely in the future.

Information Technology Infrastructure – LDC's ability to develop, maintain and manage a complex information technology systems infrastructure.

Electricity Consumption - The volume of electricity consumed by LDC's customers.

Market and Credit Risk - Credit risk with respect to customer non-payment and fluctuations in interest rates.

Additional Debt Financing - The Corporation's ability to arrange sufficient and cost-effective debt financing.

Work Force Renewal - Toronto Hydro's ability to attract and retain the required workforce.

Natural and Other Unexpected Occurrences - The effects of natural and other unexpected occurrences.

Insurance - Toronto Hydro's ability to obtain or maintain adequate insurance to cover all losses or liabilities that might arise at rates it considers reasonable.

Environmental Regulation - Toronto Hydro's compliance with Canadian federal, provincial and municipal environmental regulation. Changes in environmental regulation or enforcement may impose material additional costs on Toronto Hydro.

Investments - Material changes in Toronto Hydro's assessment of the estimated fair value of its investments.

Credit Rating - A credit rating change.

Labour Relations - Toronto Hydro's ability to develop plans and approaches that are acceptable to its labour unions.

Conflicts of Interest and Change of Ownership - The risks associated with being controlled by the City of Toronto as well as potential conflicts of interest that may arise between Toronto Hydro, the City of Toronto and related parties.

Real Property Rights - Toronto Hydro's ability to obtain formal access agreements with respect to certain terminal stations and municipal substations located on lands owned by the Province, the City of Toronto and others.

LDC Competition - More than one distribution licence could be issued for the same area and there is a possibility that in the future some business functions or activities could be separated from LDC and made open to more competition from non-regulated business entities, or that defined geographical areas within LDC's service area may be electrically supplied by a means other than through LDC's system.

The Corporation cautions that the above list of factors is not exclusive. These factors are discussed in more detail under "Risk Factors" in this AIF. Please review the section entitled "Risk Factors" in detail.

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

PART 2- GLOSSARY OF DEFINED TERMS

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

"ABCP" refers to non-bank asset-backed commercial paper.

"Affiliate Relationships Code" refers to the Affiliate Relationships Code for Electricity Distributors and Transmitters that was published by the OEB and became effective on April 1, 1999, as amended.

"Amended and Restated City Note" refers to the amended and restated City Note dated May 1, 2006 in the principal amount of $980,230,955. See note 14(b) to the Consolidated Financial Statements.

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

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

"Capital Assets" refers to the sum of property, plant and equipment and intangible assets, in each case, net of accumulated amortization. See note 4(f), note 4(g), note 6, and note 7 to the Consolidated Financial Statements.

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

"CDM" refers to Conservation and Demand Management.

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

"City Note" refers to the promissory note dated May 7, 2003 in the principal amount of $980,230,955 issued by the Corporation to the City of Toronto in consideration for the transfer by the City to the Corporation of the Replacement Note. See note 14(b) to the Consolidated Financial Statements.

"Consolidated Financial Statements" refers to the audited consolidated balance sheets of the Corporation as at December 31, 2009 and December 31, 2008 and the audited consolidated statements of retained earnings, income and cash flows of the Corporation for the years ended December 31, 2009 and December 31, 2008, together with the auditors' report thereon and the notes thereto, copies of which are available on the SEDAR website at www.sedar.com and attached to this Annual Information Form as Annex B.

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

"Corporation" refers to Toronto Hydro Corporation.

"CPAB" refers to Canadian Public Accountability Board.

"CTA" refers to the *Corporations Tax Act* (Ontario).

"DBRS" refers to DBRS Limited.

"Debentures" refers to the 6.11% Series 1 Senior Unsecured Debentures issued by the Corporation on May 7, 2003, the 5.15% Series 2 Senior Unsecured Debentures issued by the Corporation on November 14, 2007 and the 4.49% Series 3 Senior Unsecured Debentures issued by the Corporation on November 12, 2009. See note 14(a) to the Consolidated Financial Statements.

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

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

"Electricity Retailer Code of Conduct" refers to the Electricity Code of Conduct that was published by the OEB on August 18, 1999 and came into effect on February 29, 2000, as amended.

"Green Energy Act" refers to the *Green Energy and Green Economy Act, 2009* (Ontario).

"Held to Maturity" refers to long-term investments that the Corporation has determined will be held to maturity in accordance with the Canadian Institute of Chartered Accountants Handbook.

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

"IESO" refers to the Independent Electricity System Operator.

"Initial Note" refers to the promissory note dated July 1, 1999 in the principal amount of $947,000,000 issued by LDC to the City of Toronto in partial consideration for the assets in respect of the electricity distribution system transferred by the Toronto Hydro-Electric Commission and the City to LDC effective July 1, 1999. The Initial Note was non-interest bearing until December 31, 1999 and interest bearing thereafter at the rate of 6% per annum. See note 14(b) to the Consolidated Financial Statements.

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

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

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

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations" refers to Management's Discussion and Analysis of Financial Condition and Results of Operations of the Corporation for the year ended December 31, 2009, a copy of which is available at www.sedar.com and attached to this Annual Information Form as Annex C.

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

"Minister" or **"Ministerial"** refers to the Province's Minister of Energy and Infrastructure.

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

"MEU" refers to municipal electricity utility.

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

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

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

"OEB" refers to the Ontario Energy Board.

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

"OPA" refers to the Ontario Power Authority.

"Open Access" refers to the opening of Ontario's wholesale and retail electricity markets to competition pursuant to the requirement under the *Electricity Act, 1998* that transmitters and distributors of electricity in Ontario provide generators, retailers and consumers with non-discriminatory access to their transmission and distribution systems. Open Access commenced on May 1, 2002.

"OM&A" refers to Operations, Maintenance, and Administration.

"OPG" refers to Ontario Power Generation Inc.

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

"PILs" refers to the Payment In Lieu of Corporate Taxes regime contained in the *Electricity Act, 1998* (Ontario) pursuant to which MEUs that are exempt from tax under the ITA and the TA are required to make, for each taxation year, payments in lieu of taxes to the Ontario Electricity Financial Corporation. See note 4(b) and note 21 to the Consolidated Financial Statements.

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

"Rate Handbook" refers to the Electricity Distribution Rate Handbook issued by the OEB in March 2000, outlining the regulatory framework that the OEB will use to administer electricity distribution rates in Ontario.

"Rate of Return/Cost of Service Regulation" refers to a form of regulation under which the OEB determines a total allowed cost of service that a distributor may recover from customers through rates for a given rate year. The total allowed cost of service consists of approved distributor expenses, including OM&A, depreciation, and an allowance for income taxes, as well as an allowed rate of return on the equity and debt capital invested to finance the distributor. Distributor earnings are derived through the return component of the total cost of service, and no mark-up or discount is applied to other items of expense.

"Replacement Note" refers to the promissory note in the principal amount of $980,230,955 issued by LDC to the City of Toronto to replace the Initial Note effective January 1, 2000. The Replacement Note was transferred by the City of Toronto to the Corporation on May 7, 2003 in consideration for the issuance by the Corporation to the City of the City Note. See note 14(b) to the Consolidated Financial Statements. The Replacement Note was amended and restated effective May 1, 2006 to conform to certain changes made under the Amended and Restated City Note (as the context requires, "Replacement Note" refers to the amended and restated Replacement Note dated May 1, 2006).

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

"ROE" refers to return on equity.

"RPP" refers to the Regulated Price Plan created as a result of the *Electricity Restructuring Act, 2004*. The OEB has developed an RPP for residential, small business and certain other customers, which came into effect on April 1, 2005.

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

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

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

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

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

"Standard Supply" or "Standard Supply Service" refers to a distributor's obligation to sell electricity to Standard Supply Customers, or to give effect to such rates as determined by the OEB under section 79.16 of the *Ontario Energy Board Act, 1998*.

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

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

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

"Telecom" refers to Toronto Hydro Telecom Inc. See section 4.4 for further details regarding Telecom.

"THC Revolving Credit Facility" refers to the $500 million revolving credit facility with a syndicate of Canadian banks available to the Corporation. See note 12 to the Consolidated Financial Statements.

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

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

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

"Transfer By-law" refers to By-law No. 374-1999 of the City of Toronto made under section 145 of the *Electricity Act, 1998* (Ontario) pursuant to which the Toronto Hydro-Electric Commission and the City transferred their assets and liabilities and employees in respect of the electricity distribution system to LDC and in respect of electricity generation, co-generation and energy services to TH Energy. See note 1 to the Consolidated Financial Statements. The Transfer By-law permits the Treasurer of the City of Toronto to adjust the fair market value of the assets and the consideration paid in respect of the electricity distribution assets transferred to LDC as a consequence of OEB rate orders and permitted rates of return for 2000 or any subsequent year.

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

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

PART 3 - CORPORATE STRUCTURE

3.1 Name, Address, Incorporation

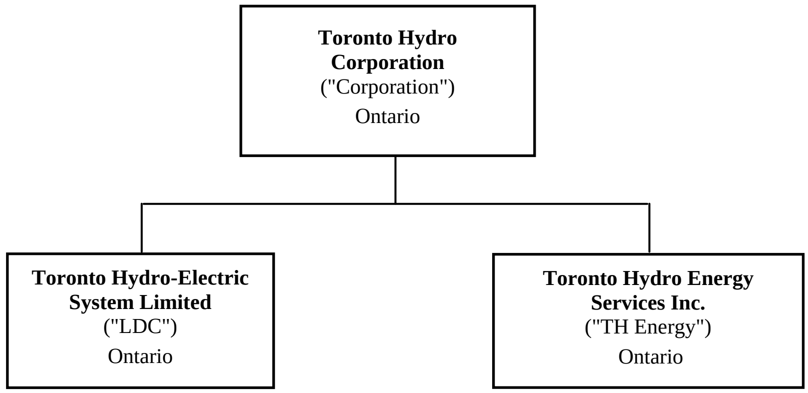
On January 1, 1998, the former municipalities of Metropolitan Toronto, Toronto, East York, Etobicoke, North York, Scarborough and York amalgamated to form the City of Toronto. At the same time, the electric commissions of Toronto, East York, Etobicoke, North York, Scarborough and York were combined to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

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

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

3.2 Inter-corporate Relationships

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



PART 4- BUSINESS OF TORONTO HYDRO

4.1 Toronto Hydro Corporation

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

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

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

4.2 Toronto Hydro-Electric System Limited

The principal business of Toronto Hydro is the distribution of electricity by LDC. LDC owns and operates $1.9 billion of Capital Assets comprised primarily of an electricity distribution system that delivers electricity to approximately 690,000 customers located in the City of Toronto. LDC is the largest municipal electricity distribution company in Canada and distributes approximately 18% of the electricity consumed in Ontario.

(a) LDC Distribution System

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

LDC's distribution system is serviced from 35 terminal stations and is comprised of approximately 23,800 primary switches, approximately 60,600 distribution transformers, 171 in-service municipal sub-stations, over 13,700 kilometres of overhead wires supported by approximately 140,800 poles and over 9,800 kilometres of underground wires.

(i) *Control Centre*

LDC has one control centre that operates four control districts. The control centre co-ordinates and monitors the distribution of electricity in the control districts, and provides isolation and work protection for internal staff and external customers. The control districts are linked to the distribution system by a voice and data communications network. LDC utilizes supervisory control and data acquisition (SCADA) systems to monitor and operate the distribution system. LDC is in the process of installing a distribution management system to facilitate work process harmonization, centralized monitoring, remote sectionalizing and isolation or restoration of primary voltage circuits.

(ii) *Terminal Stations*

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

(iii) *Distribution Transformers and Municipal Substations*

Distribution voltage electricity is distributed from the terminal stations to distribution transformers that are typically located in buildings or vaults or mounted on poles or surface pads and that are used to reduce or step down voltages to utilization levels for supply to customers. The distribution system includes approximately 60,600 distribution transformers. The distribution system also includes 171 in-service municipal sub-stations that are located in various parts of the City of Toronto and are used to reduce or step down electricity voltage prior to delivery to distribution transformers. LDC also delivers electricity at distribution voltages directly to certain commercial and industrial customers that own their own substations.

(iv) *Wires*

LDC distributes electricity through a network comprised of an overhead circuit of over 13,700 kilometres supported by approximately 140,800 poles and an underground circuit of over 9,800 kilometres.

(v) *Meters*

LDC provides its customers with meters through which electricity passes before reaching a distribution board or service panel that directs the electricity to end use circuits on the customer's premises. The meters are used to measure electricity consumption. LDC owns the meters and is responsible for their maintenance and accuracy. In accordance with the Province's Smart Meter Initiative, LDC had installed approximately 631,000 smart meters as at December 31, 2009.

(vi) *Reliability of Distribution System*

The table below sets forth certain industry recognized measurements of system reliability with respect to LDC's distribution system and the composite measures reported by the Canadian Electricity Association [(1)] for the twelve-month period ended December 31, 2008.

	LDC	**Canadian Electricity Association**
SAIDI	1.38	6.29
SAIFI	1.64	2.34
CAIDI	0.84	2.69

Note:

(1) From the 2008 Service Continuity Report on Distribution System Performance in Canadian Electrical Utilities, issued by the Canadian Electricity Association in September 2009, excluding significant events.

(b) LDC Service Area and Customers

LDC serves approximately 690,000 customers located in the City of Toronto. The City of Toronto is the largest city in Canada with a population of approximately 2.5 million. The City of Toronto is a financial centre with large and diversified service and industrial sectors.

The table below sets out LDC's customer classes and certain operating data with respect to each class for each of the years in the two-year period ended December 31, 2009:

	Year ended December 31	
	2009	**2008**
Residential Service (1)		
Number of customers (as at December 31)......	611,357	605,509
kWh	5,037,152,555	5,215,687,193
Revenue	$605,486,836	$574,323,249
% of total service revenue	25.1%	24.7%
General Service (2)		
Number of customers (as at December 31)	78,840	78,589
kWh	16,855,384,268	17,415,436,352
Revenue	$1,597,055,413	$1,548,072,946
% of total service revenue	66.2%	66.7%
Large Users (3)		
Number of customers (as at December 31)	47	47
kWh	2,461,604,984	2,507,935,777
Revenue......	$209,468,491	$200,155,305
% of total service revenue	8.7%	8.6%
Total		
Number of customers (as at December 31)	690,244	684,145
kWh......	24,354,141,807	25,139,059,222
Revenue	$2,412,010,741	$2,322,551,500

Notes:

(1) "Residential Service" means a service that is for domestic or household purposes, including single family or individually metered multi-family units and seasonal occupancy.

(2) "General Service" means a service supplied to premises other than those receiving "Residential Service" and "Large Users" and typically includes small businesses and "bulk-metered" multi-unit residential establishments.

(3) "Large Users" means a service provided to a customer with a monthly peak demand of 5,000 kW or more averaged over a twelve-month period.

(c) LDC's Real Property

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

Property	**Total**	**Owned**	**Leased**	**Other** (1)
Terminal stations (1)	35 sites	8	-	27
Municipal sub-stations(1)	171 sites	157	4	10
Control centre	1 site	1	-	-
Operations centres (2)	6 sites	4	2	-

Notes:

(1) Certain terminal stations and municipal substations are located on lands owned by the Province, the City of Toronto and others. Where distribution lines cross over and run parallel with lands owned by railway companies, appropriate access rights, generally referred to as crossing agreements, have been obtained from the railway companies. LDC also owns the real property on which 33 municipal substations that are currently classified as decommissioned are located.

(2) LDC owns, leases or operates out of 6 centres which accommodate office, staff, crews, vehicles, equipment and material necessary to operate and monitor the electricity distribution systems.

Under the *Ontario Energy Board Act, 1998*, electricity distributors are entitled to apply to the OEB for authority to expropriate land required in connection with new or expanded electricity distribution lines or interconnections. If, after a hearing, the OEB is of the opinion that the expropriation of land is in the public interest, the OEB may make an order authorizing expropriation upon payment of specified compensation. The *Electricity Act, 1998* grandfathered thousands of existing unregistered easements, principally for distribution over third-party lands. The *Electricity Act, 1998* also authorizes electricity distributors to locate assets on, over or under public streets and highways.

(d) Regulation of LDC

The business of LDC is regulated by the OEB, which has broad powers relating to licensing and standards of conduct and service and the regulation of rates charged by LDC and other electricity distributors.

(i) *Distribution Licence*

The OEB has granted LDC a distribution licence. The term of the current licence is until October 16, 2023. The licence allows LDC to own and operate an electricity distribution system in the City of Toronto. Among other things, the licence provides that LDC may not carry on any business activity, other than the distribution of electricity, except through affiliated companies, may not impose charges for the distribution of electricity except in accordance with distribution rate orders approved by the OEB and must comply with industry codes established by the OEB. In addition to the distribution of electricity, under the terms of the *Electricity Restructuring Act, 2004* (Ontario) and the Green Energy Act, electricity distributors are also permitted to provide additional services related to the promotion of energy conservation, demand management and alternative, clean and renewable sources of energy.

(ii) *Industry Codes*

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

- *Affiliate Relationships Code.* The Affiliate Relationships Code establishes standards and conditions for the interaction between distributors and their affiliated companies.

- *Distribution System Code.* The Distribution System Code establishes the minimum conditions that a distributor must meet in carrying out its obligations to distribute electricity, including standards of service relating to customer connections, expansions and new facilities.

- *Retail Settlement Code.* The Retail Settlement Code outlines the obligations of a distributor with respect to its relationship with retail Market Participants and its role as a retail market settlement administrator.

- *Standard Supply Service Code.* The Standard Supply Service Code requires a distributor to provide Standard Supply Service to its Standard Supply Customers.

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

(iii) *Distribution Rates for LDC*

The continuing restructuring of Ontario's electricity industry and other regulatory developments, including current and possible future consultations between the OEB and interested stakeholders, may affect the distribution rates and other permitted recoveries.

On May 15, 2008, the OEB issued its decision regarding LDC's electricity distribution rates application for 2008 and 2009. In its decision, the OEB approved LDC's 2008 base distribution revenue requirement and rate base of $473.0 million and $1,968.9 million, respectively. As part of the decision, the deemed debt to equity structure of LDC was modified to 62.5% debt and 37.5% equity for 2008, and to 60.0% debt and 40.0% equity for 2009 and thereafter.

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

LDC filed a notice of clarification to the OEB with respect to the timing and the quantum of the expected reduction in distribution revenue. LDC's position was that the reduction in distribution revenue should be done after the deemed properties are sold and for the related actual net after-tax gain. In the event the OEB does not concur with LDC's position and orders an immediate reduction in distribution revenue, the Corporation would have to reduce its distribution revenue by the deemed amount less the net after-tax gain of the deemed properties already sold. At December 31, 2009, the reduction in distribution revenue would be approximately $8.1 million. Further to the notice of clarification filed by LDC in the fourth quarter of 2009, the OEB indicated that it intends to deal with this issue as part of LDC's 2010 electricity distribution rate application.

On February 24, 2009, the OEB issued the allowed ROE for LDC for the 2009 rate year. The percentage was set at 8.01%. In addition to the ROE, the OEB also set LDC's 2009 distribution revenue requirement and rate base at $482.5 million and $2,035.0 million, respectively

On August 28, 2009, LDC filed a rate application with the OEB seeking approval of the distribution revenue requirement and corresponding rates for the rate year May 1, 2010.

On December 11, 2009, the OEB issued revised Cost of Capital guidelines which set the initial allowed ROE for LDC for 2010 at 9.75%. The ROE formula will be adjusted to reflect the forecast long Canada Bond yield and A-rated Canadian Utility bond spreads when this data is released by the OEB on or about the beginning of March 2010. LDC will adjust its distribution rates to reflect the new guidelines as part of its rate finalization process for 2010 distribution rates.

On February 4, 2010, the OEB tentatively accepted a settlement proposal agreed to by LDC and various intervening parties. The settlement proposal captures a majority of issues, and provides for a 2010 capital budget of $350.0 million with a variance account to capture up to an additional $27.8 million of capital expenditures, and OM&A expenditures of $204.1 million. The settlement proposal does not settle issues relating to cost of capital (including applicability of new ROE guidelines to LDC), suite metering, and distributed generation, which are subject to a decision by the OEB in the first quarter of 2010. The final disposition of these matters could have a material impact on the final settlement.

(iv) *Smart Meters*

In support of the Province of Ontario's decision to install smart meters throughout Ontario by 2010, LDC launched its smart meter project in 2006. The project objective is to install smart meters and the supporting infrastructure by the end of 2010 for all residential and commercial customers. LDC had installed approximately 631,000 smart meters as at December 31, 2009.

In 2008, in connection with this initiative, the OEB approved the disposition of the balances incurred in 2006 and 2007. The OEB also approved the transfer from regulatory assets to property, plant and equipment of all capital expenditures incurred in 2006 and 2007. In a separate decision regarding LDC's electricity distribution rates for 2008, the OEB ordered LDC to record all future expenditures and revenues related to smart meters to a regulatory asset account and allowed LDC to keep the net book value of the stranded meters related to the deployment of smart meters in its rate base.

(v) *Street Lighting Activities*

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

On February 11, 2010, the OEB issued its decision in regards to these applications. In its decision, the OEB agreed that, under certain conditions, the treatment of a portion of the street lighting assets as regulated assets is justified. The OEB ordered the Corporation to provide a detailed valuation of the street light assets and to perform an operational review to determine which assets could become regulated assets. Management is currently evaluating the impact of this decision on its regulated and unregulated businesses and whether to transfer the streetlighting assets to LDC.

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

(vi) *Contact Voltage*

On June 30, 2009, LDC filed an application with the OEB seeking recovery of costs incurred for the unexpected impact of the remediation of safety issues on its electricity distribution infrastructure. LDC sought recovery of $14.4 million by way of fixed term rate riders of three years for the street lighting and unmetered scattered load rate classes, and one year for all other classes. On December 10, 2009, the OEB issued its decision which provides for the future recovery of $9.1 million of related expenditures. Accordingly, the Corporation has increased its regulatory assets and reduced its operating expenditures by $9.1 million for 2009.

(vii) *OEB PILs Proceeding*

In 2009, the OEB commenced its review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for all MEUs. The current proceeding is expected to provide guidance for the definition and calculation of such variances. The outcome of this proceeding could have a material impact on the financial position of the Corporation.

(viii) *Green Energy Act*

On May 14, 2009, the Green Energy Act received Royal Assent. The Green Energy Act, among other things: permits electricity distribution companies to own renewable energy generation facilities; obligates electricity distribution companies to provide priority connection access for renewable energy generation facilities; empowers the OEB to set CDM targets for electricity distribution companies as a condition of license; and requires electricity distribution companies to accommodate the development and implementation of a smart grid in relation to their systems. The legislation was largely enabling and provided that much of the implementation detail would be defined in subsequent regulations. The Corporation expects that the full implementation of the Green Energy Act will affect the manner and framework under which many of its business operations are currently conducted.

(e) Environmental Matters

LDC is subject to extensive Canadian federal, provincial and local regulation relating to the protection of the environment. The principal federal legislation is the *Canadian Environmental Protection Act, 1999* that regulates the use, import, export and storage of toxic substances, including PCBs and ozone-depleting substances. The principal provincial legislation is the *Environmental Protection Act*, which regulates releases and spills of contaminants, including PCBs and ozone-depleting substances, and waste management. Municipal by-laws regulate discharges of industrial sewage and storm water run-off to the municipal sewer system. In addition, both the provincial and federal governments have environmental assessment legislation that is designed to foster better planning and the identification and mitigation of potential environmental impacts of projects or undertakings prior to their commencement.

The Corporation recognizes a liability for the future environmental remediation of certain properties and for future removal and handling costs for contamination in distribution equipment in service and in storage. The liability is recognized when the asset retirement obligation is incurred and when the fair value is determined. As at December 31, 2009, the Corporation's asset retirement obligations amounted to $7.6 million. See note 4 (n) and note 17 to the Consolidated Financial Statements.

(i) *Environmental Management System*

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

(ii) *Environmental Permits, Licences and Approvals*

LDC is required under federal, provincial and municipal environmental legislation to obtain and maintain specified environmental permits and approvals. These permits and approvals relate to, among other things, waste disposal, discharges to water and impacts on aquatic habitat at river and stream crossings. In the normal course of its operations, LDC performs reviews to ensure that the proper environmental permits and approvals are maintained.

(iii) *Releases and Land Remediation*

Federal, provincial and municipal environmental legislation regulates the release of substances into the environment through the prohibition of discharges that have an adverse effect or a potentially adverse effect on the environment. Spills and leaks of substances occur in the normal course of LDC's operations, which could result in fines or clean-up costs being incurred in connection with these releases. LDC has an emergency response capability designed to respond to spills in a timely manner and to minimize the environmental impact of spills. LDC has voluntarily, from time to time, assessed and remediated sites for potential contamination (including PCBs). It is possible that additional costs could be incurred due to potential contamination at sites.

(iv) *Hazardous Substances*

LDC manages a number of hazardous substances (including PCBs). LDC continues to operate PCB-containing equipment that is expected to generate waste when removed. PCB-containing equipment (other than in-service cables which are tested and treated after they are no longer in service) has been identified and is in the process of being phased out as part of a program to be completed in accordance with new federal regulations governing the phase-out and destruction of PCB-containing equipment, which became effective in September 2008. These regulations require the phase-out and destruction of PCB-containing equipment by, depending on the PCB levels, December 31, 2009 (LDC has complied with the requirements applicable to the LDC as at December 31, 2009) or December 31, 2014.

(f) Conservation and Demand Management

In May 2007, LDC entered into agreements with the OPA to deliver OPA-funded CDM programs in the amount of approximately $60.0 million during the years from 2007 to 2010. All programs are fully funded by the OPA with any advance payments recorded on the Consolidated Balance Sheet as a deferred liability.

LDC participates in initiatives within the City of Toronto designed to achieve electricity demand reduction up to 300 MW for programs extending from May 2007 to December 2010, as well as in a variety of provincial standard offer programs that have been extended to 2010.

LDC delivered City of Toronto programs including mass market, low income, business incentive programs and data centre incentive programs. In addition, LDC delivered standard offer programs which included appliance retirement, *peaksaver*™, summer sweepstakes and a power savings blitz program.

4.3 Toronto Hydro Energy Services Inc.

TH Energy is a professional energy services company with 53 employees as at December 31, 2009.

TH Energy owns and operates streetlighting and expressway lighting assets located in the City of Toronto and provides street lighting services. As at December 31, 2009, TH Energy's Capital Assets amounted to $70.8 million. TH Energy has the sole right to provide maintenance and capital improvements to the streetlighting and expressway lighting systems throughout the City of Toronto until 2035.

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

A restructuring of TH Energy and its Streetlighting and Expressway Lighting assets is subject to an application with the OEB. See section 4.2(d) (v) under the heading "Toronto Hydro-Electric System Limited – Regulation of LDC-Street Lighting Activities".

4.4 Discontinued Operations

On July 31, 2008, the Corporation sold all of the shares of Telecom to Cogeco Cable Canada Inc. for cash consideration of $200.0 million. In connection with this transaction, the Corporation recorded a net gain of $118.7 million in the third quarter of 2008, and recorded an unfavourable post-closing adjustment of $1.9 million for the year ended December 31, 2009. The results of operations and financial position of Telecom have been segregated and presented as discontinued operations in the Consolidated Financial Statements.

On April 30, 2009, EBT Express, an equal partnership between the Corporation's wholly owned subsidiary 1455948 Ontario Inc. and OPG EBT Holdco Inc., sold its interest in SPi to ERTH Corporation for cash consideration of approximately $5.2 million subject to post-closing adjustments and transaction costs. The Corporation's share of the sale proceeds from this transaction as it relates to 1455948 Ontario Inc. was approximately $2.6 million. In connection with this transaction and other activities related to this business, the Corporation recorded a net gain of $1.2 million in the second quarter of 2009. The results of operations and financial position of SPi have been segregated and presented as discontinued operations in the Consolidated Financial Statements. See note 27 to the Consolidated Financial Statements.

4.5 Additional Information Regarding Toronto Hydro

(a) Employees

At December 31, 2009, Toronto Hydro had 1,703 employees, of whom 1,612 were employed by LDC. In addition, 1,219 employees are members of bargaining units represented by the Canadian Union of Public Employees, Local One ("CUPE One"), of whom 1,189 were employed by LDC. Finally, 39 engineers are represented by the Society of Energy Professionals.

On December 22, 2008, CUPE One ratified collective agreements governing inside and outside employees for a five-year period expiring January 31, 2014. The collective agreements implemented a wage increase of 3.0% on December 22, 2008 and provide for general wage increases of 3.0%, effective on each of February 1, 2010, 2011, 2012 and 2013, respectively. The collective agreements also contain cost of living escalator clauses that provide for wage adjustments corresponding to the percentage change in the Consumer Price Index. The escalator clauses will not become effective until after 2010 and only if certain prescribed thresholds are exceeded.

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

Full time employees of Toronto Hydro participate in OMERS, a multi-employer, contributory, defined benefit pension plan established in 1962 by the Province for employees of municipalities, local boards and school boards in Ontario. Plan benefits are determined on a formula based on the highest average contributory earnings and years of service with an offset for Canada Pension Plan benefits and are indexed to increases in the Consumer Price Index, subject to an annual maximum of 6%. Any increase in the Consumer Price Index above 6% per year is carried forward for later years. Both participating employers and participating employees are required to make plan contributions based on participating employees' contributory earnings.

In addition to OMERS, Toronto Hydro provides other retirement and post-employment benefits to employees, including medical, dental and life insurance benefits. See note 4(m) and note 15 to the Consolidated Financial Statements.

(b) Specialized Skills and Knowledge

Trades and technical jobs play a critical role in the safe and reliable design, construction and maintenance of LDC's distribution system. These jobs include overhead and underground trades as well as designers and engineers. LDC hires experienced workers when available, along with apprentices to trades and technical positions. LDC continues to build on its trades training expertise by investing in internal training plans and apprenticeship programs, with the expectation that trades apprentices require up to 54 months to become fully competent and capable of performing all aspects of the job.

(c) Health and Safety

Toronto Hydro has established and maintains key safety priorities including safe work practices, accident investigation and safety performance management. LDC has reduced lost time accident frequencies from 5.5 per 200,000 hours worked in 1998 to 0.3 per 200,000 hours worked in 2009.

(d) Insurance

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

PART 5 - RELATIONSHIP WITH THE CITY OF TORONTO

5.1 Shareholder Direction

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

- the objectives of the City in connection with its relationship with Toronto Hydro;
- the principles that govern the operations of Toronto Hydro;
- the matters in addition to those set out in the OBCA that require the approval of the City as the sole shareholder of Toronto Hydro; and
- certain financial and administrative arrangements between the Corporation and the City.

(a) Objectives

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

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

(b) Principles Governing Operations

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

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

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

(c) Shareholder Approval

In addition to those matters set out in the OBCA, the following matters, among others, require the approval of the City as the sole shareholder of the Corporation:

- creating any indebtedness ranking senior to the City Note while the City Note is held by the City;
- subject to certain exceptions in the case of LDC, creating any security over the assets of the Corporation or LDC;
- in the case of LDC, providing any financial assistance to any person other than in accordance with the Shareholder Direction;
- in the case of the Corporation and LDC, making any investment in or providing any financial assistance to any subsidiary of the Corporation (other than LDC), other than trade payables incurred in the ordinary course of business on customary terms and an investment in or financial assistance to a subsidiary that originally was an investment in or financial assistance to LDC, in

excess of 12% of the shareholder's equity of LDC as shown in its most recent financial statements; and

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

The City has authorized the Corporation to provide up to $500 million in financial support with respect to prudential requirements and as security for obligations under third-party contracts. See note 20 to the Consolidated Financial Statements.

(d) Financial Performance

The Shareholder Direction provides that the Board will use its best efforts to ensure that Toronto Hydro meets certain financial performance standards, including those relating to credit rating and dividends.

(e) Credit Rating

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

(f) Dividends

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

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

The Corporation declared and paid dividends to the City totalling $25.2 million in 2009 and $116.4 million in 2008. The 2008 dividend payments included a special dividend of $75.0 million paid on December 31, 2008, in relation to the sale of all the shares of Telecom. See note 22 and note 30(d) to the Consolidated Financial Statements.

On March 5, 2010, the Corporation declared dividends in the amount of $6.0 million with respect to the first quarter of 2010, payable to the City on March 31, 2010.

LDC declared and paid dividends to the Corporation amounting to, $25.0 million in 2007, $25.0 million in 2008 and $nil in 2009.

TH Energy declared and paid dividends to the Corporation amounting to $25.0 million in 2007, $nil in 2008 and $nil in 2009.

5.2 Indebtedness to the City of Toronto

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

The Replacement Note was issued to replace the Initial Note effective January 1, 2000. The principal amount of the Replacement Note was increased from $947,000,000 to $980,230,955 and the interest rate under the Replacement Note was increased from 6.0% to 6.8% as authorized under the Transfer By-law to reflect certain changes made by the OEB to the permitted cost of debt for purposes of setting distribution rates. See note 14(b) to the Consolidated Financial Statements.

On May 7, 2003, the City of Toronto transferred to the Corporation the Replacement Note in consideration for the issue by the Corporation to the City of the City Note in the same principal amount. See note 14(b) to the Consolidated Financial Statements.

On September 5, 2006, the Corporation announced that it had agreed to amend and restate the City Note effective May 1, 2006. The Amended and Restated City Note fixed the interest rate at 6.11% and established an agreed repayment schedule: $245,058,000 on the last business day before each of December 31, 2007, December 31, 2009, December 31, 2011 and on May 6, 2013. Interest is calculated and payable quarterly in arrears on the last business day of March, June, September and December of each year. The first and second repayments of the Amended and Restated City Note were made, as scheduled, on December 31, 2007 and December 31, 2009, respectively. See note 14(b) to the Consolidated Financial Statements.

The Amended and Restated City Note contains covenants and events of default which are similar to those provided for under the terms of the Debentures. Upon the occurrence of an event of default under the Amended and Restated City Note, the City may declare the principal amount of the Amended and Restated City Note, together with accrued and unpaid interest thereon, to be immediately due and payable.

The Amended and Restated City Note is also:

- convertible in whole or in part at any time and from time to time into debt securities issued by the Corporation or any of its subsidiaries (subject to applicable law and compliance by the Corporation with covenants contained in its outstanding indebtedness); and

- assignable in whole or in part at any time and from time to time without the consent of the Corporation.

The Amended and Restated City Note is a direct unsecured obligation of the Corporation and ranks equally with all other unsecured and unsubordinated indebtedness of the Corporation, including the Debentures and the THC Revolving Credit Facility.

5.3 Services Provided to the City of Toronto

Toronto Hydro provides certain services to the City of Toronto at commercial and regulated rates, including consolidated electricity billing services and street lighting services. In addition, the City of Toronto and its agencies have entered into energy efficiency service contracts with TH Energy and CDM contracts with LDC. See note 23 to the Consolidated Financial Statements.

PART 6 - TAXATION

(a) Tax Regime

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

The Corporation and each of its subsidiaries are MEUs for purposes of the PILs regime contained in the *Electricity Act, 1998*. The *Electricity Act, 1998* provides that MEU that is exempt from tax under the ITA, the CTA and the TA is required to make, for each taxation year, a PILs to the Ontario Electricity Financial Corporation in an amount equal to the tax that it would be liable to pay under the ITA and the TA (for years ending after 2008) or the CTA (for years ending prior to 2009) if it were not exempt. The PILs regime came into effect on October 1, 2001, at which time the Corporation and each of its subsidiaries were deemed to have commenced a new taxation year for purposes of determining their respective liabilities for PILs.

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

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

The *Electricity Act, 1998* also provides that a municipal corporation or MEU is required to pay a transfer tax when it transfers Electricity Property. An interest in Electricity Property includes any interest in a corporation, partnership or other entity that derives its value in whole or in part from Electricity Property. The transfer tax is generally the prescribed percentage (currently 33%) of the fair market value of the interest transferred. The amount of transfer tax payable where the interest that is transferred is an interest in a corporation, partnership or other entity, is calculated in accordance with a special rule. The amount of transfer tax payable by a MEU on a transfer of Electricity Property may be reduced by:

- any PILs made by the MEU in respect of the part of the taxation year to and including the date that the transfer takes place or a previous taxation year;
- any amount that the MEU has paid as tax under Parts II, II.1 or III of the CTA (Ontario) in respect of the part of the taxation year to and including the date that the transfer takes place or a previous taxation year;
- any amount that the MEU has paid as tax under Part III of the TA in respect of the part of the taxation year to and including the date that the transfer takes place or a previous taxation year; and
- the tax for which the MEU would be liable under Part I of the ITA if the MEU had no income for the taxation year other than the capital gain or income in respect of the disposition of eligible capital property arising on the transfer of the property subject to the transfer tax.

Transfers of Electricity Property made to a municipal corporation, MEU, Hydro One Inc. or Ontario Power Generation Inc. will generally be exempt from the transfer tax if the transfer is made after October 16, 2009.

In addition, a refund of transfer tax will generally be made where such tax had been paid on the sale or transfer of Electricity Property and where the proceeds of that transfer were reinvested in certain other capital or depreciable assets used in electricity activity after October 16, 2006 and, subject to certain deeming rules, before the end of the second taxation year following the taxation year in which the liability to pay the transfer tax arose.

PILs are deductible in computing the transfer tax only to the extent that they have not been previously applied to reduce transfer tax payable by a municipal corporation or a MEU.

The Rate Handbook and the 2006 Rate Handbook provided for distribution rate adjustments to permit recoveries relating to PILs. These recoveries are recalculated and submitted for recovery by LDC in each cost of service distribution rate application. See note 4(b) and note 21 to the Consolidated Financial Statements.

(b) Tax Contingencies

The Ministry of Revenue has issued assessments in respect of payments in lieu of additional municipal and school taxes under section 92 of *the Electricity Act, 1998* (Ontario) that are in excess of the amounts LDC believes are payable. The dispute arose as a result of inaccurate information incorporated into Ontario Regulation 224/00, correction of which has been requested by LDC.

As of December 31, 2009, the balance assessed by the Ministry of Revenue above the balance provisioned by the Corporation amounts to $8.7 million. The Corporation has been proactive with the Ministry of Revenue and the Ministry of Finance to resolve this issue. However, there can be no assurance that the Corporation will not have to pay the full assessed balance in the future.

PART 7 - RISK FACTORS

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

7.1 Regulatory Developments

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

- the OEB may not set a lower recovery for LDC's cost of capital;
- the full cost of providing service to distribution customers will be permitted to be recovered through distribution rates;
- the OEB will not permit competitors to provide distribution services in a distributor's licensed area, or loads within LDC's service area to become electrically served by a means other than through LDC's system;
- the OEB will allow recovery for revenue lost as a consequence of the emergence and adoption of new technologies such as distributed generation, or unanticipated effects of conservation and demand management;
- parts of LDC's services will not be separated from LDC and opened to competition; or
- regulatory or other changes will not be made to the PILs regime.

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

The OEB regularly conducts consultations with interested stakeholders with respect to a number of issues that may affect electricity distributors. See Annex A - Regulation of Ontario's Electricity Industry as it Relates to Toronto Hydro for further details.

7.2 Condition of Distribution Assets

LDC's ability to continue to maintain and operate the distribution system reliably and safely in the future will depend on, among other things, the OEB allowing recovery of costs in respect of LDC's maintenance program and capital expenditure requirements for distribution plant refurbishment and replacement.

7.3 Information Technology Infrastructure

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

7.4 Electricity Consumption

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

7.5 Market and Credit Risk

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

LDC is also exposed to fluctuations in interest rates as its regulated rate of return is derived using a formulaic approach, which is based in part on a forecast of long-term Government of Canada bond yields coupled with an equity risk premium. LDC estimates that a 1% (100 basis points) reduction in long-term Government of Canada bond yields used in determining its regulated rate of return would reduce LDC’s net income by approximately $4.7 million.

The Corporation is also exposed to fluctuations in interest rates in the valuation of its post-employment benefit obligations. The Corporation estimates that a 1% (100 basis points) increase in the discount rate used to value these obligations would decrease the accrued benefit obligation, as at December 31, 2009, by $20.0 million, and a 1% (100 basis points) decrease in the discount rate would increase the accrued benefit obligation, as at December 31, 2009, by $28.5 million.

7.6 Additional Debt Financing

The Corporation expects to borrow to repay the Amended and Restated City Note when required to do so under the terms of the Amended and Restated City Note, and to finance the renewal of LDC's electricity infrastructure. The Corporation's ability to arrange sufficient and cost-effective debt financing could be adversely affected by a number of factors, including financial market conditions, the regulatory environment in Ontario, the Corporation's results of operations and financial condition, the ratings assigned to the Corporation and its debt securities by credit rating agencies, the current timing of debt maturities and general economic conditions.

7.7 Work Force Renewal

Over the next nine years, approximately 600 LDC employees will be eligible for retirement. This number represents approximately 40% of LDC's workforce (with a significant number of potential retirements occurring in supervisory, trades and technical positions). Accordingly, LDC will be required to attract and retain skilled employees. There can be no assurance that LDC will be able to attract and retain the required workforce.

7.8 Natural and Other Unexpected Occurrences

The facilities of LDC are exposed to the effects of natural and other unexpected occurrences. Although LDC's facilities are constructed, operated and maintained to withstand severe weather conditions, there can be no assurance that they will successfully do so in all circumstances. For example, an ice storm in January 1998 caused significant damage to transmission and distribution facilities in Ontario, Québec and the north-eastern United States. Any major damage to LDC's facilities could result in lost revenues and repair costs that are substantial in amount. If it sustained a large uninsured loss caused by natural or other unexpected occurrences, LDC would apply to the OEB for the recovery of the loss. There can be no assurance that the OEB would approve, in whole or in part, such an application.

7.9 Insurance

Although Toronto Hydro maintains insurance as described under "Business of Toronto Hydro" above, there can be no assurance that Toronto Hydro will be able to obtain or maintain adequate insurance in the future at rates it considers reasonable or that insurance will continue to be available. Further, there can be no assurance that available insurance will cover all losses or liabilities that might arise in the conduct of Toronto Hydro's business. Toronto Hydro self-insures against certain risks (e.g., business interruption and physical damage to certain automobiles). The occurrence of a significant uninsured claim or a claim in excess of the insurance coverage limits maintained by Toronto Hydro could have a material adverse effect on Toronto Hydro.

7.10 Environmental Regulation

Toronto Hydro is subject to Canadian federal, provincial and municipal environmental regulation. Failure to comply with environmental regulation could subject Toronto Hydro to fines and other penalties. In addition, releases of hazardous substances now or in the past on or from properties owned, leased, occupied or used by Toronto Hydro or as a result of Toronto Hydro's operations could lead to governmental orders requiring investigation, control and/or remediation of releases. The presence or release of hazardous substances could also lead to claims by third parties for harm as a result of the existence of these substances.

Changes in environmental regulation or enforcement may impose material additional costs on Toronto Hydro. In addition, new approvals or permits or renewals of existing approvals and permits may require environmental assessment and/or result in the imposition of conditions which may result in significant compliance costs. The process for obtaining environmental permits and approvals, including any necessary environmental assessment, can be lengthy, contentious and expensive.

7.11 Investments

Toronto Hydro held $88.0 million of ABCP notes impacted by the liquidity crisis that arose in the Canadian market in August 2007. At the time Toronto Hydro purchased these notes, they were rated R1(High), by DBRS, the highest credit rating issued for commercial paper. Following the liquidity crisis, a group representing banks, asset providers and major investors was formed to oversee the restructuring of the impacted ABCP notes.

The estimation by Toronto Hydro of the fair value of its investments was $47.9 million at December 31, 2009 and is subject to significant risks and uncertainties, including the timing and amount of future cash flows, market liquidity and the quality of the underlying assets and financial instruments. Accordingly, there can be no assurance that Toronto Hydro's assessment of the estimated fair value of its long term investments will not change materially in subsequent periods.

See note 8 to the Consolidated Financial Statements.

7.12 Credit Rating

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

7.13 Labour Relations

Toronto Hydro's ability to operate successfully in the restructured electricity industry in Ontario will depend in part on its ability to make changes to existing work practices and procedures to adapt to changing circumstances. Toronto Hydro's ability to make these changes will depend in part on its ability to develop plans and approaches that are acceptable to its labour unions. There can be no assurance that Toronto Hydro will be able to secure the support of its labour unions in this regard.

7.14 Conflicts of Interest and Change of Ownership

The City of Toronto owns all of the outstanding shares of the Corporation and has the power to determine the composition of the Board and influence Toronto Hydro's major business and corporate decisions, including its financing programs and dividend payments. A conflict may arise between the City's role as the sole shareholder and major debt holder of the Corporation and its role as the administrator of the City budget and other matters for the residents of the City. The City of Toronto may decide to sell all or part of Toronto Hydro; however the Corporation is not aware of any plan or decision by the City to do so. In this event, depending on the nature of the transaction, the Corporation's credit ratings may be negatively affected.

7.15 Real Property Rights

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

7.16 LDC Competition

In the past, there had been one electricity distributor in each region of Ontario. Under the current regulatory regime, a person must obtain a licence from the OEB in order to own and operate a distribution system. LDC has the right to distribute electricity in the City of Toronto. Although the distribution licence specifies the area in which the distributor is authorized to distribute electricity, unless otherwise provided, the licence does not provide exclusive distribution rights for such area.

The Corporation believes that the complexities and potential inefficiencies that would be created by having multiple electricity distributors authorized to serve a single area are likely to result in the continuation of the practice of having a single electricity distributor authorized to serve a single area. In addition, the Corporation believes that there are significant barriers to entry with respect to the business of electricity distribution in Ontario, including the cost of maintaining a distribution system, OEB regulation of distribution rates and the level of regulatory compliance required to operate a distribution system. However, the Corporation recognizes that more than one distribution licence could be issued for the same area and there is a possibility that in the future some business functions or activities could be separated from LDC and made open to competition from non-regulated business entities, or that defined geographical areas within LDC's service area may be electrically supplied by a means other than through LDC's system.

PART 8 - CAPITAL STRUCTURE

8.1 Share Capital

The authorized capital of the Corporation consists of an unlimited number of common shares of which 1,000 common shares are issued and outstanding as at the date of this AIF. The City of Toronto is the sole shareholder of the Corporation. See note 22 to the Consolidated Financial Statements.

8.2 Debentures

On May 7, 2003, the Corporation issued $225.0 million 6.11% senior unsecured Debentures due May 7, 2013. On November 14, 2007 the Corporation issued $250.0 million 5.15% senior unsecured Debentures due November 14, 2017. On November 12, 2009, the Corporation issued $250.0 million 4.49% senior unsecured Debentures due November 12, 2019. See note 14(a) to the Consolidated Financial Statements.

On December 12, 2008, the Corporation filed under its MTN Program a new shelf prospectus providing for the issuance of up to $1 billion of debentures during the 25 month period following the date of the prospectus. The net proceeds from the sale of debentures issued under the shelf prospectus will be used by the Corporation for general corporate purposes which may include the repayment of existing indebtedness outstanding to the City of Toronto under the terms of the City Note.

As at the date of this AIF the Debentures are rated "A" (high) by DBRS and "A" by S&P.

DBRS rates long-term debt instruments by rating categories ranging from a high of "AAA" to a low of "D". A DBRS rating may be modified by the addition of "high" or "low" to indicate relative standing within the major rating categories. The "A" category is characterized as "satisfactory credit quality". S&P rates long-term debt instruments by rating categories ranging from a high of "AAA" to a low of "D". An S&P rating may be modified by the addition of a plus or minus to indicate relative standing within the major rating categories. The "A" category is characterized as somewhat more susceptible to the adverse changes in circumstances and economic conditions than obligations in higher categories; however, the obligor's capacity to meet the financial commitment on the obligation is still strong.

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

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

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

PART 9 - DIRECTORS AND OFFICERS

9.1 Directors and Officers

The following table sets forth, for each of the directors and officers of the Corporation, the name, municipality of residence, office, principal occupation and, if a director, the date on which the person became a director. The City is the sole shareholder of the Corporation and has adopted the Shareholder Direction which sets out corporate governance principles with respect to Toronto Hydro. See "Part 5 - Relationship with the City of Toronto". The City elects or appoints all of the directors of the Corporation. There are currently 10 directors. Three of the directors are councillors of the City of Toronto and are not considered independent because of their positions. None of the other directors has a direct or indirect material relationship with the Corporation and are independent.

Name [1] and Municipality of Residence	Office	Principal Occupation	Director Since	Expiry of Current Term
Clare R. Copeland [2] Toronto, Ontario	Director and Chair of the Board of Directors	Chief Executive Officer, Falls Management Company	June 23, 1999	November 30, 2010
Patricia Callon Toronto, Ontario	Director and Chair-designate	Director, Consultation, Canadian Securities Transition Office	August 1, 2005	November 30, 2010
Brian Chu Toronto, Ontario	Director	Partner, Bogart Robertson & Chu (a law firm)	August 1, 2005	November 30, 2010
Derek Cowbourne Toronto, Ontario	Director	Corporate Director	December 1, 2008	November 30, 2010
Paulette Kennedy Toronto, Ontario	Director	Commissioner, Ontario Securities Commission	December 1, 2008	November 30, 2010

Name [1] and Municipality of Residence	Office	Principal Occupation	Director Since	Expiry of Current Term
Shoba Khetrapal Toronto, Ontario	Director	Corporate Director	December 1, 2008	November 30, 2010
Bill Rupert Toronto, Ontario	Director	Corporate Director	December 1, 2008	November 30, 2010
Joe Pantalone Toronto, Ontario	Director	Deputy Mayor and Councillor, City of Toronto	January 1, 2009	November 30, 2010
Gordon Perks Toronto, Ontario	Director	Councillor, City of Toronto	December 6, 2006	November 30, 2010
Bill Saundercook Toronto, Ontario	Director	Councillor, City of Toronto	December 4, 2003	November 30, 2010
Anthony Haines Toronto, Ontario	President and Chief Executive Officer	President and Chief Executive Officer, Toronto Hydro Corporation	N/A	N/A
Jean-Sebastien Couillard Toronto, Ontario	Chief Financial Officer	Chief Financial Officer, Toronto Hydro Corporation	N/A	N/A
Ave Lethbridge Toronto, Ontario	Vice-President, Organizational Effectiveness & Environment, Health & Safety	Vice-President, Organizational Effectiveness & Environment, Health & Safety, Toronto Hydro Corporation	N/A	N/A
Blair H. Peberdy Toronto, Ontario	Vice-President, Communications and Public Affairs	Vice-President, Communications and Public Affairs, Toronto Hydro Corporation	N/A	N/A
Lawrence D. Wilde Mississauga, Ontario	Vice-President, General Counsel and Corporate Secretary	Vice-President, General Counsel and Corporate Secretary, Toronto Hydro Corporation	N/A	N/A

Notes:

(1) No director serves as a director of another reporting issuer except for Mr. Copeland, who serves as a director of RioCan Real Estate Investment Trust, Danier Leather Inc., Chesswood Income Trust (formerly called Cars4U), Entertainment One Ltd. and M.D.C. Holdings, Inc.

(2) Mr. Copeland was a director of Moneysworth & Best Shoe Care Inc. ("M&B") and he and the other directors, officers and significant shareholders of M&B were subject to an order of the Ontario Securities Commission dated July 21, 2000 that required such persons to cease trading in the securities of M&B in connection with the failure of M&B to file certain financial statements. Mr Copeland resigned prior to the issuance of the cease trade order. Mr Copeland was a director of White Rose Crafts and Nursery Sales Inc. that filed a voluntary assignment into bankruptcy in June 2002. Mr Copeland resigned from this position in June 2002. Mr. Copeland sat on the board of directors of Playdium Entertainment Corporation, which filed an application under the *Companies' Creditors Arrangement Act* (Canada) in February 2001. Mr. Copeland resigned from this position in May 2001. In each instance, Mr Copeland had either been placed onto the board of directors by the leading bank or had been asked to join the board when the company was already in difficulty due to his corporate restructuring experience.

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

(a) been a director, chief executive officer or chief financial officer of any company (including the Corporation) that was the subject of a cease trade or similar order or an order that denied the company access to any exemption under securities legislation for a period of more than 30 consecutive days, where such order was issued while the director or executive officer was acting in the capacity as director, chief executive officer or chief financial officer;

(b) been a director, chief executive officer or chief financial officer of any company (including the Corporation) that was the subject of a cease trade or similar order or an order that denied the company access to any exemption under securities legislation for a period of more than 30 consecutive days, where such order was issued after the director or executive officer ceased to be a director, chief executive officer or chief financial officer and which resulted from an event that occurred while that person was acting in the capacity as director, chief executive officer or chief financial officer;

(c) been a director, chief executive officer or chief financial officer of any company (including the Corporation) that, while that person was acting in that capacity or within a year of that person ceasing to act in that capacity, became bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold its assets; or

(d) become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold the assets of such director or executive officer.

9.2 Principal Occupations

All of the directors and senior officers of the Corporation have held the principal occupations identified above with the same or associated companies or organizations for five years or more, except for:

(a) Mr. Copeland, whose principal occupation was corporate director between March 2002 and October 2004 and who was Chairman and Chief Executive Officer of OSF Inc. (a manufacturer of retail store interiors) between March 2000 and March 2002;

(b) Ms. Callon, who was a Consultant with the Ontario Securities Commission between September 2005 and August 2009 and a Vice-President and Associate General Counsel of Canadian Imperial Bank of Commerce prior to September 2005;

(c) Mr. Cowbourne, who held various executive positions with the IESO prior to April 1, 2008;

(d) Ms. Kennedy, who was the Chief Financial Officer and Chief Auditor of AEGON Canada Inc. prior to January 2008.

(e) Ms. Khetrapal, who was the Vice President and Chief Financial Officer of Weekenders International prior to December 2006;

(f) Mr. Rupert, who was a Managing Director of the OEB from July 2004 to December 2005, a board member of the OEB from May 2006 to October 2008 and a partner with Ernst & Young LLP prior to July 2004;

(g) Mr. Perks, who was a Senior Campaigner, Toronto Environmental Alliance prior to November 2006;

(h) Mr. Haines was the Chief Administrative Officer of the Corporation from May, 2005 to August, 2006 and the President of the LDC from September, 2006 until his appointment as President and Chief Executive Officer of the Corporation effective October 1, 2009. Prior to joining Toronto Hydro, Mr. Haines was Chief Operating Officer with Hydro Ottawa Limited; and

(i) Mr. Couillard, who held various positions with TH Energy and the Corporation between March 2002 and May 2005.

9.3 Committees of the Board of Directors

The board of directors of the Corporation has established four committees.

(a) The Audit Committee is responsible for overseeing the adequacy and effectiveness of financial reporting, accounting systems and internal controls. The Audit Committee reviews the Corporation's quarterly and annual financial statements as well as financial statements prepared in connection with securities offerings or required by applicable regulatory authorities, reviews the audit plans of the external auditors, reviews officers' personal expenses on an annual basis and recommends the auditor for appointment by the Corporation's sole shareholder. Members of the Audit Committee are Mr. Chu, Ms. Kennedy, Ms. Khetrapal and Mr. Rupert. Mr. Chu is the Chair of the Audit Committee. See section 9.4 "Audit Committee" below.

(b) The Corporate Governance Committee is responsible for considering and making recommendations to the Board with respect to matters relating to the corporate governance of Toronto Hydro, including board and committee composition and mandates, and guidelines for assessing the effectiveness of the Board and its committees and procedures to ensure that the Board functions independently from management. Management undertakes orientation and education programs for new directors. Members of the Corporate Governance Committee are Mr. Cowbourne, Mr. Chu and Ms. Kennedy. Mr. Cowbourne is the Chair of the Corporate Governance Committee.

(c) The Compensation Committee is responsible for reviewing the performance and remuneration of senior executives and succession planning for senior management positions. Members of the Compensation Committee are: Ms. Callon, Mr. Bastable, Mr. Copeland and Mr. Rupert. Ms. Callon is the Chair of the Compensation Committee. Mr. Bastable is a member of the Board of Directors of the LDC.

(d) The Health and Safety Committee is responsible for considering and making recommendations to the Board with respect to matters of health and safety. Members of the Health and Safety Committee are Mr. Williams, Ms. Callon and Ms. Khetrapal. Mr. Williams is the Chair of the Health and Safety Committee. Mr. Williams is a member of the Board of Directors of the LDC.

9.4 Audit Committee

(a) Composition of the Audit Committee

The Board has established the Audit Committee to assist the board in fulfilling its corporate governance and oversight responsibilities with respect to financial reporting, internal financial control structure, financial risk management systems and external audit functions. The Audit Committee is comprised of Mr. Chu (Chair), Ms. Kennedy, Ms. Khetrapal and Mr. Rupert, each of whom is independent and financially literate within the meaning of applicable Canadian securities laws.

(b) Relevant Education and Experience

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

Mr. Chu holds a Juris Doctor from the University of Toronto and is a member of the Law Society of Upper Canada. Mr. Chu is a founding partner of the law firm of Bogart Robertson and Chu, practicing corporate and commercial real estate law. Mr. Chu served as Chair of the Audit Committee of Centennial College (from 1996 to 2000) and as a member of the Finance Committee of the Ontario College of Art and Design (from 1999 to 2005). Mr. Chu served as the Chair of the Finance and Audit Committee of the Laidlaw Foundation (from November 2006 to June 2008) and continues as a member of that Committee. Mr. Chu serves on the Finance and Operations Committee of the

Centennial Centre of Science and Technology (Ontario Science Centre). Mr. Chu has been a member of the Canadian Tax Foundation since 1986.

Ms. Kennedy is a chartered accountant and holds a Bachelor of Commerce degree from McMaster University. Ms. Kennedy has held a variety of senior financial management and accounting positions including Chief Financial Officer and Chief Auditor, AEGON Canada Inc. (2003-2008), Senior Vice-President and Chief Internal Auditor, Sobeys Inc. (2002-2003), Chief Auditor, Sun Life Financial Inc. (1997-2000) and Vice-President Finance and Actuarial (2001-2002) Sun Life Financial Inc. Ms. Kennedy is currently a Commissioner of the Ontario Securities Commission, a member of the Business Board of the University of Toronto and Vice-Chair of the University of Toronto Audit Committee.

Ms. Khetrapal holds a Masters degree in Economics, is a certified director of the Institute of Corporate Directors and a member of the Toronto Chartered Financial Analysts Society. She is Vice Chair of St. Joseph's Health Centre and Chair of its Audit Committee. She is a member of the Board of Directors of Cancer Care Ontario and Vice Chair of its Audit Committee. She is also a member of the Board of Directors of The Public Accountants Council ("PAC"), the Audit Committee of PAC and the Canada Pension Plan Review Tribunal. Previous positions held include Vice President and Treasurer, Moore Corporation Limited, Director, Economics & Planning Canadian Pacific Enterprises Limited and member of the Board of Directors of Moore Group Services BVBA-Belgium, Peak Technologies Canada Ltd., Moore Holdings Ltd. - Australia and the Ontario Casino Corporation.

Mr. Rupert holds a Bachelor of Science degree from Trent University and a Masters in Business Administration from McMaster University. Mr. Rupert, a Chartered Accountant, was a partner of Ernst & Young LLP for 19 years and worked in the firm’s assurance and advisory practices. From 1982 to 1984, Mr. Rupert was a Practice Fellow at the Financial Accounting Standards Board in the United States. From 2004 to 2006, he was the Managing Director, Regulatory Policy Development at the OEB. From 2006 to 2008, Mr. Rupert served as a Board Member at the OEB. He is a Fellow of the Institute of Chartered Accountants of Ontario.

(c) Charter

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

- managing the relationship between the Corporation and its external auditors, including: appointing and replacing the external auditors, subject to shareholder approval; setting the compensation of the external auditors subject to the approval of the Board or the shareholder, as applicable; overseeing the work of the external auditors (including resolving disagreements between management and the external auditors with respect to financial reporting); pre-approving all audit services and permitted non-audit services to be provided to the Corporation and its subsidiary entities by the external auditors; ensuring that the external auditors report to the Audit Committee in a timely manner with respect to all required matters; reviewing and approving the hiring policies of the Corporation with respect to present and former partners and employees of the external auditors; ensuring the rotation of the audit partner having primary responsibility for the audit of the Corporation, the audit partner responsible for reviewing the audit and the external auditors at such intervals as may be required; and reviewing and assessing the performance, independence and objectivity of the external auditors;

- overseeing the external audit of the Corporation, including: reviewing and approving the engagement letter and the audit plan (including identified financial risk areas); reviewing and assessing the accounting and reporting practices and principles used by the Corporation in preparing its financial statements; reviewing and assessing the results of the external audit and the external auditors' opinion on the financial statements; reviewing and discussing with the external auditors and management any management or internal control letters issued or proposed to be issued by the external auditors; reviewing and discussing with the external auditors any problems or difficulties encountered by them in the course of their audit work and management's response; and reviewing and discussing with legal counsel any legal matters that may have a material impact on the financial statements, operations, assets or compliance policies of the Corporation and any material reports or enquiries received by the Corporation and its subsidiary entities from regulators or government agencies;

- reviewing, approving and, where required, recommending to the board for approval, the financial statements, management's discussion and analysis of financial condition and results of operations and interim financial reports of the Corporation, annual information form and other public disclosure of financial information extracted from the financial statements of the Corporation with particular focus on the quality and appropriateness of accounting and reporting practices and principles and any changes thereto, major estimates or judgments, including alternative treatments of financial information discussed by management and the external auditors, the results of such discussions and the treatment preferred by the external auditors, material financial risks, material transactions, material adjustments, compliance with loan agreements, material off-balance sheet transactions and structures, compliance with accounting standards, compliance with legal and regulatory requirements and disagreements with management;

- overseeing the internal financial control structure and financial risk management systems of the Corporation, including: reviewing and discussing with management and the external auditors and the quality and adequacy of internal control over the financial reporting structures of the Corporation (including any major deficiencies or weakness and the steps taken by management to rectify these deficiencies or weaknesses); reviewing and discussing with management and the external auditors the risk assessment and risk management policies of the Corporation, the major financial risk exposures of the Corporation and the steps taken by management to monitor and control these exposures; and reviewing and discussing with the Chief Executive Officer and the Chief Financial Officer of the Corporation the procedures undertaken by them in connection with the certifications required to be given by them in connection with annual and other filings required to be made by the Corporation under applicable securities laws; and

- establishing adequate policies and procedures, or requiring that adequate policies and procedures are established, with respect to the following (and annually assessing the adequacy of these procedures): the review of the public disclosure of financial information extracted from the financial statements of the Corporation; the receipt, retention and treatment of complaints received by the Corporation with respect to accounting, internal accounting controls or auditing matters; and the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.

(d) Policy on the Provision of Services by the External Auditors

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

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

- the Audit Committee has pre-approved certain audit and permitted non-audit services as services that the auditors may provide to Toronto Hydro, including: services that constitute the agreed scope of the external audit or interim reviews of Toronto Hydro; services that are outside the agreed scope of, but are consistent with, the external audit or interim reviews of Toronto Hydro; tax services that do not compromise the independence and objectivity of the external auditors in relation to the external audit; and other services of an advisory nature that do not compromise the independence and objectivity of the external auditors in relation to the external audit work; and

- an authorization process has been established which provides, among other things: the Chief Financial Officer may authorize in advance all engagements of the external auditors to provide pre-approved services (other than audit services) to Toronto Hydro up to a maximum of $25,000 for any engagement and up to a maximum of $100,000 for all engagements in any fiscal quarter (the Chief Financial Officer must report all such authorized engagements to the Audit Committee at its next meeting); the Chair of the Audit Committee may authorize in advance all engagements of the external auditors to provide pre-approved services (other than audit services) to Toronto Hydro up to a maximum of $50,000 for any engagement and up to a maximum of $100,000 for all engagements in any fiscal quarter (the Chair must report all such authorized engagements to the Audit Committee at its next meeting); and the Audit Committee must authorize in advance all engagements of the external auditors to provide pre-approved services to Toronto Hydro above the prescribed thresholds and all engagements to provide services that are not pre-approved services regardless of the dollar value of the services.

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

(e) External Auditors Service Fees

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

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

	Year ended December 31,	
	2009	**2008**
Audit fees[(1)]……………………………………………….	$530,582	$689,515
Audit-related fees[(2)]	$192,784	$154,500
Tax fees[(3)]	$0	$0
All other fees[(4)]	$226,337	$54,145

Notes:

(1) Includes fees for audit services.

(2) Includes fees for interim reviews, assurance and related services that are reasonably related to the performance of the audit or review of the Corporation's financial statements and are not reported under (1) above.

(3) Includes fees for professional services rendered in respect of tax compliance, tax advice and tax planning.

(4) Includes fees for products and services other than those referred to in notes (1), (2) and (3) above. Amount shown relates to professional fees in respect of the MTN Program, the annual CPAB levy, and other miscellaneous fees.

9.5 Code of Business Conduct

All employees, officers and directors of Toronto Hydro are required to comply with the principles set out in the Code of Business Conduct, which was implemented by Toronto Hydro in 2004. The Code provides for the appointment of an Ethics and Compliance Officer and establishes a direct hotline to the Ethics and Compliance Officer by which perceived violations of the principles set out in the Code may be reported, anonymously or otherwise. The Ethics and Compliance Officer reports quarterly to the Audit Committee on the nature of complaints received including those related to audit and accounting matters.

9.6 Board Assessments

(a) Independence

The Board of Directors of Corporation consists of 10 directors, all of whom are appointed by the sole shareholder of the Corporation, the City of Toronto. Three of the directors are Councillors of the City of Toronto but none of the other directors has a direct or indirect material relationship with the Corporation and are independent. No members of management sit on the Board. The Board meets regularly in the absence of management to discuss the management of the Corporation.

(b) Orientation and Continuing Education

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

On an on-going basis, as part of regular and special Board meetings, directors receive presentations and reports on topics related to Toronto Hydro's businesses and the obligations and responsibilities of directors. Topics covered are either suggested by management or requested by the directors. As well, directors receive information from management in response to any actions arising at a board meeting or otherwise. Directors are also periodically provided with orientation sessions with senior management and facility tours to assist them in understanding Toronto Hydro's businesses.

(c) Ethical Business Conduct

The directors as well as the officers and employees of Toronto Hydro are required to comply with the principles set out in the Code of Business Conduct. The Code is part of Toronto Hydro's internal control framework. The Code provides for the appointment of an Ethics and Compliance Officer to whom perceived violations of the principles set out in the Code may be reported. The Ethics and Compliance Officer is responsible for overseeing the investigation of all complaints received and reports quarterly to the Audit Committee on the nature and status of all complaints received including those relating to audit and accounting matters.

(d) Board, Committee and Director Assessments

The Corporate Governance Committee oversees a process used to evaluate the effectiveness of the Board and its committees. The process consists of a written questionnaire that is completed periodically by each director. The directors' responses to the questionnaire are compiled into a summary report that is reviewed by the Corporate Governance Committee. This report and recommended remedial actions are presented by the Chair of the Corporate Governance Committee to the Board for review and consideration.

PART 10 - EXECUTIVE COMPENSATION

10.1 Compensation Discussion and Analysis

(a) General Objectives of Compensation Program

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

(b) Process for Establishing Compensation

The Corporation’s executive compensation program is supervised by the Compensation Committee under the direction of the Board. The Compensation Committee operates under a written charter adopted by the Board. The primary function of the Compensation Committee is to advise and assist the Board in overseeing the compensation structure and benefit plans and programs of the Corporation and its subsidiaries and assessing the performance and compensation of the President and Chief Executive Officer (the "CEO"). The Compensation Committee recommends to the Board objectives for the CEO, assesses the CEO's performance against those objectives on a periodic basis and recommends compensation and bonus arrangements to the Board based on the achievement of those objectives. While the CEO sets the compensation and bonus amounts for the other NEOs (as defined in subsection 10.2(a) below), the Compensation Committee is responsible for reviewing the performance and remuneration of the other NEOs.

Compensation levels are reviewed annually and individual and corporate performance objectives are established. Corporate performance objectives are measured in terms of the attainment of certain financial and non-financial targets set at the beginning of the year. Corporate performance objectives are typically based on objective standards which are not modified during the year.

The Corporation periodically reviews the levels of compensation provided to the NEOs to ensure competitiveness. An external consultant is retained to recommend compensation levels for the NEOs to the Compensation Committee and CEO. These recommendations are based on a review of the appropriate comparative markets. Periodically NEO positions are benchmarked to comparable roles using a number of different survey sources. Typically these have included the Mercer Benchmark Database, Hay Group Utility Sector survey and additional studies as required. The Mercer Benchmark Database allows comparisons to be made to different segments of the market to ensure reasonableness including GTA industrials, national industrials, and executives in companies with comparable revenues (excluding flow through revenues), crown corporations and public sector. These collective data sources are reviewed to establish the recommendations for a competitive pay position. The recommendations are designed to establish, over a reasonable period of time, total compensation in the range of the 50^{th} percentile of those companies within the data base.

(c) Elements of Compensation

For the fiscal year ended December 31, 2009, the principal components of compensation for NEOs were:

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

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

(i) *Base Salary*

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

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

(ii) *Performance-Based Incentive Compensation*

All NEOs receive a portion of their annual compensation in the form of performance-based cash bonuses. The annual performance pay awards are closely aligned with the Corporation's performance and are designed to reward NEOs for reaching individual and corporate objectives established at the beginning of each calendar year. Annual performance pay awards are expressed as a percentage of base salary and are designed to retain and motivate NEOs and to reward them for their performance during the preceding year.

Each NEO’s performance compensation is based on a pre-determined "weighting" of corporate, affiliates and individual performance objectives. (See individual NEO weightings under section 10.2(b)(ii) below). Position weightings vary by role to reflect the performance focus of the role and may change from year to year.

Corporate performance objectives are based on yearly corporate objectives, which are based on financial and other measures. Each subsidiary has its own corporate objectives, which are outlined in a document referred to as a scorecard. See "Compensation of NEOs – Narrative Discussion" below.

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

Committee. The objectives of the other NEOs are reviewed and approved by the CEO. The individual objectives are intended to be reasonably difficult to attain and to encourage success in an individual's performance. Individual objectives are often but not always achieved by an NEO in any given year. NEOs review their objectives and measurements throughout the year, with one formal mid-year review with the Chair of the Board, in the case of the CEO, and with the CEO, in the case of the other NEOs, to track achievement to-date and revise performance goals as may be necessary to reflect any change in corporate priorities.

In the case of the CEO an annual performance evaluation in respect of his individual performance goals is conducted by the Chair of the Board who provides a recommendation to the Compensation Committee regarding the performance-based incentive compensation to be paid to the CEO. The amount paid to the CEO is approved by the Board after review of the recommendation of the Compensation Committee. In the case of each of the other NEOs, an annual performance evaluation in respect of the individual objectives for each individual is conducted by the CEO, who determines the amount of performance-based incentive compensation to be paid to each other NEO.

Each NEO’s annual performance-based incentive compensation for a fiscal year is determined and paid in one lump sum in the next fiscal year. Accordingly, amounts reflected in respect of a particular year (i.e., 2009) represent the annual performance-based incentive compensation paid to the NEO for the achievement of performance goals in respect of that fiscal year (i.e., 2009) but which amounts are paid in the following fiscal year (i.e. 2010).

(iii) *Other Bonuses or Special Payments*

From time to time, the Corporation may provide special cash incentives or bonuses to compensate NEOs for exceptional performance. Special bonuses are approved by the Compensation Committee prior to being paid.

(iv) *Other Personal Benefits and Perquisites*

The Corporation provides NEOs with other personal benefits and perquisites that the Corporation believes are reasonable and consistent with its overall compensation program to better enable the Corporation to attract and retain superior employees for key positions. Benefits include health, dental, group life insurance, short-term and long-term disability, accidental death & dismemberment, a fitness subsidy and educational reimbursements.

(v) *Pension Plan*

The NEOs participate in OMERS, a multi-employer, contributory, defined benefit pension plan established in 1962 by the Province for employees of municipalities, local boards and school boards in Ontario. Plan benefits are determined by a formula based on the highest 5-year average of contributory earnings and years of service. Plan benefits are indexed to increases in the Consumer Price Index subject to an annual maximum of 6%. Both participating employers and participating employees are required to make plan contributions based on the participating employees' contributory earnings. All full-time employees of the Corporation are entitled to participate in OMERS and it is generally available to all employees.

(vi) *Retirement Benefits Other than Pension*

In addition to the OMERS pension plan noted above, the Corporation has a number of unfunded benefit plans providing post-retirement benefits to most of its employees, including NEOs. The Corporation pays certain medical, dental, and life insurance benefits on behalf of its retired employees if they have met the years of service requirement as part of the Corporation’s overall compensation package. Post-retirement benefits aid in attracting and especially retaining key talent to ensure the long-term success of the organization.

(vii) *Termination Benefits*

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

10.2 Compensation of Named Executive Officers

(a) Summary Compensation Table

The following table provides a summary of the compensation earned during the years ended December 31, 2008 and 2009, by the CEO of the Corporation, the CFO of the Corporation, the three most highly compensated executive officers of Toronto Hydro who were serving as executive officers at December 31, 2009, and each individual who would be amongst the three most highly compensated executive officers of the Corporation, but for the fact that such individuals were not executive officers on December 31, 2009 (collectively, the "Named Executive Officers" or "NEOs"):

Summary Compensation Table[1]

NEO Name and Principal Position	Year	Salary [2] ($)	Non-Equity Incentive Plan Compensation[3] (Annual) ($)	All Other Compensation[4] ($)	Total Compensation ($)
Anthony Haines[5] President and Chief Executive Officer, Toronto Hydro Corporation	2009 2008	$325,744 $309,383	$224,166 $217,372	$129,161[8] $38,792[9]	$679,071 $565,547
David S. O'Brien [5] [6] President and Chief Executive Officer, Toronto Hydro Corporation	2009 2008	$415,245 $389,319	$312,912 $387,802	$168,658[10] $44,479[11]	$896,815 $821,600
Jean-Sebastien Couillard Chief Financial Officer, Toronto Hydro Corporation	2009 2008	$231,542 $224,443	$111,796 $133,751	$57,913 [12] $29,551[13]	$401,251 $387,745
Blair Peberdy Vice-President, Communications & Public Affairs, Toronto Hydro Corporation	2009 2008	$186,225 $180,783	$64,976 $70,793	$94,068[14] $25,904[15]	$345,269 $277,480
Lawrence Wilde Vice-President, General Counsel & Corporate Secretary Toronto Hydro Corporation	2009 2008	$202,088 $196,246	$83,679 $106,877	$44,664[16] $34,265[17]	$330,431 $337,388
Pankaj Sardana Vice-President, Treasurer & Regulatory Affairs, Toronto Hydro –Electric System Limited	2009 2008	$185,365 $185,240	$67,176 $66,832	$58,134[18] $32,636[19]	$310,675 $284,708
Robert King[7] Chief Operating Officer, Toronto Hydro –Electric System Limited	2009 2008	$210,870 $210,660	$108,162 $111,491	$21,948[20] $29,293[21]	$340,980 $351,444

Notes:

(1) Amounts shown in this table are in Canadian dollars and have been rounded to the nearest dollar.

(2) Amounts shown include retroactive salary increases, salary continuance payments, and regular salary earnings.

(3) Each NEO's annual performance-based incentive compensation for a fiscal year is determined and paid in the next fiscal year. Accordingly and except as otherwise noted below, amounts reflected in respect of a particular year (i.e., 2009) represent the annual performance-based incentive compensation paid to the NEO for the achievement of performance goals in respect of that fiscal year (i.e. 2009) but which amounts are paid in the following fiscal year (i.e. 2010).

(4) Amounts shown in this column include the aggregate value of perquisites and other personal benefits, where such perquisites and personal benefits are worth $50,000 or more, or 10% or more of the NEO's total salary. Perquisites or other personal benefits that exceed 25 per cent of the total value of perquisites and other personal benefits, reported for an NEO, have been identified in footnotes to follow. Perquisites have been calculated by using the actual cost.

(5) Mr. O'Brien retired as President & Chief Executive Officer of the Corporation effective September 30, 2009. Mr. O'Brien continued as a special advisor to the President & Chief Executive Officer with the Corporation until December 31, 2009. The Board appointed Mr. Haines as President & Chief Executive Officer of the Corporation effective October 1, 2009. Mr. Haines continued as the President of the LDC which was his office prior to October 1, 2009.

(6) Upon retirement in 2009, Mr. O'Brien was paid his performance-based incentive compensation for achievement of performance objectives for 2009. No other retirement or termination payment was made to Mr. O'Brien.

(7) Mr. King entered into a severance agreement with LDC effective March 1, 2009 which provided for a bonus payable for 2009 which was equal to the average of his bonuses paid in 2007 and 2008.

(8) Amount shown includes $65,288 for payout of unused vacation and 19,227 for vehicle lease costs.

(9) Amount shown includes $18,187 for vehicle lease costs.

(10) Amount shown includes $117,420 for payout of unused vacation and 22,717 for vehicle lease costs.

(11) Amount shown includes $25,073 for vehicle lease costs.

(12) Amount shown includes $7,194 for pay out of unused vacation and $15,476 for vehicle lease costs.

(13) Amount shown includes $14,635 for vehicle lease costs.

(14) Amount shown includes $56,604 for payout of unused vacation and 11,632 for vehicle lease costs.

(15) Amount shown includes $12,957 for vehicle lease costs.

(16) Amount shown includes $13,469 for vehicle lease costs.

(17) Amount shown includes $13,531 for vehicle lease costs.

(18) Amount shown includes $12,833 for payout of unused vacation and 13,830 for vehicle lease costs.

(19) Amount shown includes $14,352 for vehicle lease costs.

(20) Amount shown includes $13,342 for vehicle lease costs.

(21) Amount shown includes $14,862 for vehicle lease costs.

(b) Compensation of NEOs – Narrative Discussion

(i) *Base Salary*

Mr. Haines, Mr. Couillard, Mr Peberdy, Mr. Wilde and Mr. Sardana have each entered into an employment agreement with the Corporation.

These employment agreements provide for an annual base salary of $350,000 for 2009 (commencing October 1, 2009) in the case of Mr. Haines, $232,000 for 2009 in the case of Mr. Couillard, $186,000 for 2009 in the case of Mr. Peberdy, $202,000 for 2009 in the case of Mr. Wilde and $186,000 for 2009 in the case of Mr. Sardana.

(ii) *Performance-Based Incentive Compensation*

The target amount of each NEO’s annual performance-based incentive compensation is as follows: For the period from January 1, 2009 to September 30, 2009, 50% of the base salary, and for the period of October 1, 2009 to December 31, 2009, 65% of the base salary, in the case of Mr. Haines, 40% of the base salary in the case of Mr. Couillard, 30% of the base salary in the case of Mr. Peberdy, 35% of the base salary in the case of Mr. Wilde, and 30% of the base salary in the case of Mr. Sardana.

In the case of Mr. Haines, the Compensation Committee, and, in the case of the other NEOs, the CEO, may determine to increase the target amount of the bonus by up to 50% for each NEO in the event that the Corporation has exceeded the corporate objectives and that NEO has exceeded his individual objectives for a given year.

The weighting attributed to each NEO’s annual performance-based bonus is as follows:

a) Mr. Haines: For the period from January 1, 2009 to September 30, 2009, 20% based on his individual performance and 80% based on the performance of the LDC and for the period of October 1, 2009 to December 31, 2009, 20% based on his individual performance and 80% based on the performance of the Corporation;

b) Mr. Couillard: 40% based on his individual performance, 35% based on the performance of LDC, 5% based on the performance of TH Energy and 20% based on the performance of the Corporation;

c) Mr. Peberdy: 40% based on his individual performance and 60% based on the performance of the Corporation;

d) Mr. Wilde: 40% based on his individual performance and 60% based on the performance of the Corporation; and

e) Mr. Sardana: 40% based on his individual performance and 60% based on the performance of LDC.

The individual performance objectives for each of the NEOs are established based on areas of strategic and operational emphasis related to each NEO's respective responsibilities and portfolios, employee engagement and communication, customer service and stakeholder relations.

Each of the NEOs achieved his individual objectives for 2009.

The corporate performance objectives of the Corporation, LDC and TH Energy are summarized below:

Corporation

Objective	Target	Weight (%)
Call Centre Service	70%	5
SAIDI (minutes)	84	5
Distribution Plant Capital per unit	1.0	30
SAIFI	2.1	5
Safety (% with no injury)	94%	5
Safety Leadership	80%	5
Attendance (# of days absent)	9.25	5
Consolidated Operating Expense	$215.3m	20
Consolidated Net Income	$52.1m	20

LDC

Objective	Target	Weight (%)
Call Centre Service	70%	10
SAIDI (minutes)	84	5
Feeder Performance	55	5
Distribution Plant Capital per unit	1.0	30
SAIFI	2.1	5
Safety (% with no injury)	94%	5
Safety Leadership	80%	5
Attendance (# of days absent)	9.25	5
Operating Expense	$195.5m	15
Net Income	$60.1m	15

TH Energy

Objective	Target	Weight (%)
Safety (% with no injury)	98%	7.5
Safety Leadership	80	5.0
Consolidated Revenue	$22.5m	20.0
Consolidated EBITDA	$2.6m	25
Consolidated Booked Sales	$5.6m	5
Generation Projects Complete	100%	15
Customer Committed Sales	90%	7.5
Street Light SLA (High Priority)	95%	5.0
Street Light SLA (Medium Priority)	95%	5.0
Street Light SLA (Low Priority)	95%	5.0

The Corporation achieved all of its performance objectives except for the objective related to net income. LDC achieved all of its performance objectives except for the objective related to net income. TH Energy achieved all of its performance objectives except for those objectives related to street lighting services.

For information with respect to Mr. O'Brien (who ceased to be an employee of the Corporation as at December 31, 2009) and Mr. King (who was no longer an employee of the Corporation as at March 1, 2009) see section 10.2(a) above.

(iii) *Pension Benefits*

The NEOs participate in OMERS, a multi-employer, contributory, defined benefit pension plan established in 1962 by the Province for employees of municipalities, local boards and school boards in Ontario. All obligations to make payments to retirees under this pension plan are the responsibility of OMERS. None of the Corporation or LDC or any affiliate have any obligation to make payment to any NEO in respect of this pension plan and accordingly, no obligations are accrued on the financial statements of the Corporation.

(iv) *Retirement Benefits Other than Pension*

As of December 31, 2009, Mr. Haines, Mr. Couillard, Mr. Peberdy, Mr. Wilde, and Mr. Sardana are not eligible for post-retirement medical, dental, and life insurance benefits. Mr. King, who entered into a severance agreement with LDC effective March 1, 2009, and Mr. O'Brien who ceased being an employee as at December 31, 2009 are eligible for post-retirement medical, dental and life insurance benefits. Life insurance benefits are based on 50% of basic annual earnings prior to retirement, reduced by 2.5% each anniversary after retirement to a maximum of 25% of their salary at retirement.

(v) *Termination Benefits*

If the employment of Mr. Haines is terminated without cause by the Corporation then Mr. Haines is entitled to a payment equal to 24 months of base salary and performance pay that would have been paid had he continued to work for 24 months (approximately $1,119,000) with the performance pay based on the average annual performance pay during the 3 years preceding the date of termination. If the employment of Mr. Couillard, Mr. Peberdy, Mr. Wilde or Mr. Sardana is terminated without cause by the Corporation then each is entitled to a payment equal to 18 months of base salary and performance pay that would have been paid had he continued to work for 18 months (approximately $508,000 in the case of Mr. Couillard, approximately $379,000 in the case of Mr. Peberdy, approximately $432,000 in the case of Mr. Wilde and approximately $379,000 in the case of Mr. Sardana) with the amount of the performance pay being based on the average annual performance pay during the 3 years preceding the date of termination.

For information with respect to Mr O'Brien (who ceased to be an employee of the Corporation as at December 31, 2009) and Mr. King (who was no longer an employee of the Corporation as at March 1, 2009), see section 10.2(a) above.

10.3 Compensation of Directors

(a) Director Compensation Table

Director Name	Fees Earned ($)	All other compensation ($)	Total ($)
Clare Copeland[(1)]	$75,000	$6,595 [(6)]	$81,595
Patricia Callon[(1)(2)]	$38,500	Nil	$38,500
Brian Chu[(1)]	$29,500	Nil	$29,500
Derek Cowbourne[(3)]	$26,500	Nil	$26,500
Paulette Kennedy[(3)]	$26,500	Nil	$26,500
Shoba Khetrapal[(3)]	$30,500	Nil	$30,500
Bill Rupert[(3)]	$32,500	Nil	$32,500
Mike Richmond[(3)(4)]	$14,250	Nil	$14,250
Deputy Mayor Joe Pantalone[(3)]	Nil	Nil	Nil
Councillor Gordon Perks[(5)]	Nil	Nil	Nil
Councillor Bill Saundercook[(5)]	Nil	Nil	Nil

Notes:

(1) Re-appointed as a Director effective December 1, 2008 for a two year term expiring November 30, 2010.

(2) Ms. Callon was appointed Chair Designate effective January 1, 2009.

(3) Appointed as a Director effective December 1, 2008 for a two year term expiring November 30, 2010.

(4) Mr. Richmond resigned as a director of the Corporation and TH Energy effective June 22, 2009.

(5) Re-appointed December 1, 2008 for a term commencing January 1, 2009 expiring November 30, 2010.

(6) An amount in respect of health and dental plan benefits.

(b) Compensation of Directors – Narrative Discussion

Directors of the Corporation, other than Councillors of the City of Toronto, are compensated for their services as directors through a combination of retainer fees and meeting attendance fees. These fees are set by the sole shareholder of the Corporation, the City of Toronto. The annual retainer fees are as follows: chair of the Board – $75,000 and each of the other directors – $12,500. The meeting attendance fees are as follows: each meeting of the Board and the subsidiaries attended – $1,000 and each meeting of the Audit Committee, Corporate Governance Committee, Compensation Committee and Health and Safety Committee attended — $1,000, subject to annual maximum fees per committee member of $5,000 for the Audit Committee, Corporate Governance Committee, and the Health and Safety Committee and $4,000 for the Compensation Committee. The Chair receives no meeting attendance fees. Councillors of the City of Toronto receive no remuneration for their services as directors of the Corporation.

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

PART 11- LEGAL PROCEEDINGS

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

11.1 Late Payment Charges Class Action

On April 22, 2004, in a decision in a class action commenced against The Consumers' Gas Company Limited (now Enbridge Gas Distribution Inc., hereinafter referred to as "Enbridge"), the Supreme Court of Canada (the "Supreme Court") ruled that Enbridge was required to repay the portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. Although the claim related to charges collected by Enbridge after the enactment of section 347 of the *Criminal Code* in 1981, the Supreme Court limited recovery to charges collected after the action was initiated in 1994. The Supreme Court remitted the matter back to the Ontario Superior Court of Justice for a determination of the plaintiffs' damages. The parties reached a settlement of this class action. The Ontario Superior Court of Justice has approved this settlement.

On February 4, 2008, the OEB, in response to an application filed by Enbridge, ruled that all of Enbridge's costs related to settlement of the class action lawsuit, including legal costs, settlement costs and interest, are recoverable from ratepayers. The representative plaintiff in the class action lawsuit has made a petition to the Lieutenant Governor in Council ("Cabinet") under subsection 34(1) of the *Ontario Energy Board Act, 1998*, Schedule B. for an order that the matter be submitted back to the OEB for reconsideration. The Cabinet dismissed the petition.

LDC was not a party to the Enbridge class action. It is, however, subject to the two class actions described below in which the issues are analogous.

The first is an action commenced in April 1994 against a predecessor of LDC and other Ontario MEUs under the *Class Proceedings Act*, *1992* (Ontario) seeking $500 million in restitution for late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is at a preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and the classes have not been certified. After the release by the Supreme Court of its 2004 decision in the Enbridge case, the plaintiffs in this proposed class action indicated their intention to proceed with the litigation.

The second is an action commenced in November 1998 against a predecessor of LDC under the *Class Proceedings Act*, *1992* (Ontario) seeking $64.0 million in restitution for late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is also at a preliminary stage. Pleadings have closed and examinations for discovery have been conducted but, as in the first action, the classes have not been certified.

The claims made against LDC and the definitions of the plaintiff classes are identical in both actions. As a result, any damages payable by LDC in the first action would reduce the damages payable by LDC in the second action, and vice versa.

The determination of whether the late payment charges collected by LDC from its customers were in excess of the interest limit stipulated in section 347 of the *Criminal Code* is fact specific in each circumstance. Also, decisions of the OEB are fact specific in each circumstance and the decision of the OEB in respect of Enbridge's application for recovery of costs related to the settlement is not necessarily determinative of the outcome of any similar application which LDC may make to the OEB in the future.

On January 15, 2010, a conditional settlement was reached for both actions pursuant to which the defendants would pay the amount of $17 million plus costs and taxes in settlement of all claims. The amount paid by each MEU will be its proportionate share of the settlement amount based on its percentage of distribution service revenue over the period for which it has exposure for repayment of late payment penalties exceeding the interest rate limit in the *Criminal Code*. While the amounts have not yet been determined, it is anticipated that LDC's share of the settlement amount will be in the range of $7.5 million to $9.5 million. The settlement is conditional upon a sufficient number of MEUs participating so as to collect the full amount of the settlement funds payable to the plaintiffs. It is also conditional upon court approval. All the MEUs involved in the settlement, including LDC, will request an order from the OEB allowing for the future recovery from customers of all costs related to the proposed settlement. LDC has not accrued any liabilities in relation to this proposed settlement. There is no guarantee that the OEB will allow for total or partial recovery of such costs in the future. The outcome of the OEB decision in this regard could have an adverse material impact on the consolidated results of operations and financial position of the Corporation in the future.

11.2 3650 Kingston Road

An action was commenced against LDC in March 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of $30.0 million as compensation for damages allegedly suffered as a result of a fire and explosion in the electrical room at 3650 Kingston Road on March 19, 2009. This action is at a preliminary stage. A statement of claim has been served on LDC but a statement of defence has not been filed. The proceedings of other parties to the action have revealed that the damages are likely to have been caused by a party other than LDC and LDC is making a motion to have LDC dismissed from the action. While it is not possible at this time to state conclusively, it is unlikely that LDC will be found liable for damages. If damages were awarded against LDC, LDC would make a claim under its liability insurance which LDC believes would cover such damages. Accordingly, this action is not likely to have a material effect on the financial performance of the Corporation.

11.3 2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of $30.0 million as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. This action is at a preliminary stage. A third party claim has been served on LDC but a statement of defence to the third party claim has not been filed. Accordingly, given the preliminary status of this action, it is not possible at this time to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

Another third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice seeking damages in the amount of $30.0 million as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. This action is at a preliminary stage. A third party claim has been served on LDC and a statement of defence to the third party claim has not been filed. Accordingly, given the preliminary status of this action, it is not possible at this time to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

11.4 2 Secord Avenue

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of $30.0 million as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence has been filed, and a certification order issued. Affidavits of Documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

Another action was commenced against LDC in February 2009 in the Ontario Superior Court of Justice seeking damages in the amount of $20.0 million as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence has been filed, and a certification order issued. Affidavits of Documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

By order of the court, these two actions, together with a third smaller non-class action commenced in April 2009 involving the same incident, will be tried at the same time or consecutively. Consequently, documentary discovery and examinations for discovery will be joined for all three actions.

PART 12- MATERIAL CONTRACTS

Except for the following, Toronto Hydro has not entered into any material contract (other than contracts entered into in the ordinary course of business) in the most recently completed financial year, or before the most recently completed financial year, if such contract is still in effect:

(a) the Amended and Restated City Note described under Part 5 - Relationship with the City of Toronto; and

(b) the indenture and the supplemental indentures under which the Debentures were issued.

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

PART 13 - INTERESTS OF EXPERTS

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

PART 14 - ADDITIONAL INFORMATION

Additional information relating to the Corporation, including copies of the Consolidated Financial Statements and Management's Discussion and Analysis, are available on the SEDAR website at www.sedar.com and attached to this Annual Information Form as Annex B and C, respectively.

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

TABLE OF CONTENTS

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

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

1. Introduction

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

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

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

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

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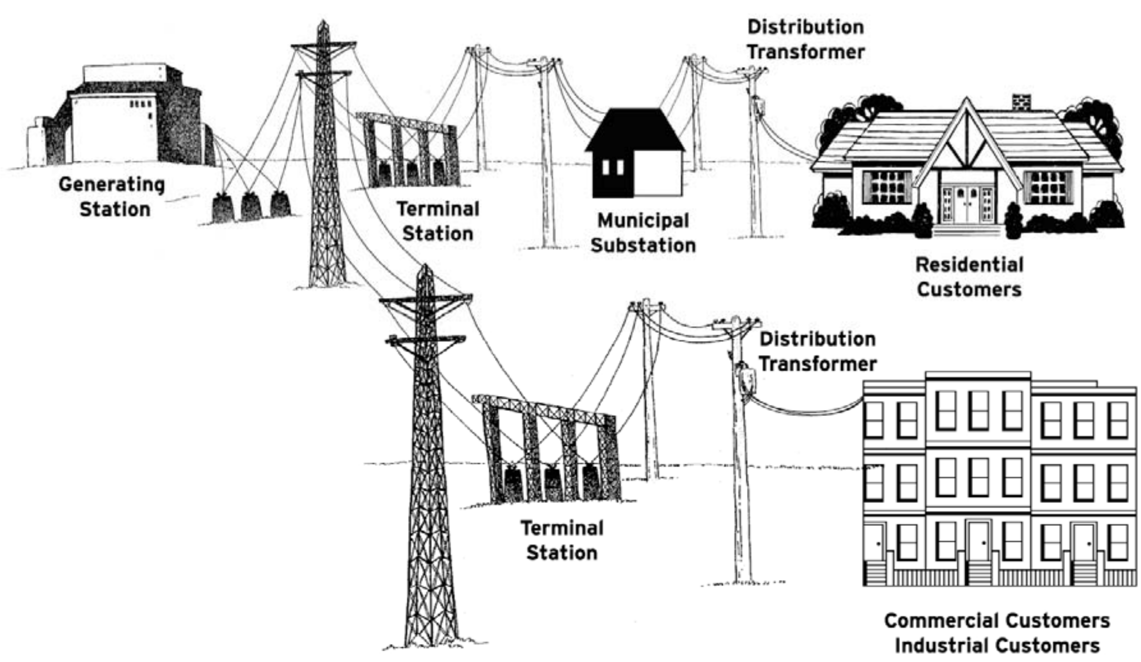

2. Industry Structure

The *Electricity Act, 1998* and the *Ontario Energy Board Act, 1998* establish the broad legislative framework for Ontario's competitive electricity market. The *Electricity Act, 1998* permitted the restructuring of Ontario's electricity industry, and enabled the implementation of open access to transmission and distribution systems. The *Ontario Energy Board Act, 1998* expanded the jurisdiction and mandate of the OEB to include regulation of the electricity and natural gas markets.

Under the *Electricity Act, 1998*, the former Ontario Hydro was reorganized into five separate corporations (listed below under their current names):

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

Additionally, the *Electricity Act, 1998* requires electricity utilities in Ontario to keep their distribution businesses separate from their other businesses.

On May 1, 2002, the Province opened the wholesale and retail electricity markets to competition by providing generators, retailers and consumers with Open Access to Ontario's transmission and distribution network. The IESO, itself licensed by the OEB, became responsible for providing oversight of the market and maintaining the security and reliability of electricity supply in Ontario.

The *Electricity Restructuring Act, 2004* established the OPA, as a non-profit, self-financed corporation with the mandate to ensure long-term electricity supply adequacy in Ontario. The OPA is authorized to enter into contracts for the supply, as well as the conservation, of electricity, and is responsible for developing an integrated power system supply plan in furtherance of its mandate.

The *Electricity Restructuring Act, 2004* also created a hybrid wholesale electricity market under which the output from generators owned and operated by OPG are to be provided at prices to be determined by the OEB on regulated heritage assets. These prices and quantities are combined with prices and quantities resulting from contracts with non-utility generators and with residual prices and quantities, determined in the spot market, to form a blended wholesale price for electricity. The OEB is also responsible for determining commodity prices charged to consumers, by setting RPP and TOU thresholds and rates.

The business of LDC and other electricity distributors is regulated by the OEB, which has broad powers relating to licensing, standards of conduct and service, and the regulation of distribution rates charged by LDC and other electricity distributors, and transmission rates charged by Hydro One Networks Inc. and other transmitters.

Under the current regulations, LDC continues to have an obligation to connect and supply customers in accordance with the *Electricity Act, 1998*, and the conditions of its distribution licence and rate orders. The OEB provides a framework for the review of electricity distribution utilities' revenue requirements so that rates may be periodically re-established.

3. Regulation of Distributors

3.1 Industry Codes

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

(1) Affiliate Relationships Code;

(2) Distribution System Code;

(3) Retail Settlement Code; and

(4) Standard Supply Service Code.

These codes are summarized below.

Affiliate Relationships Code

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

The Affiliate Relationships Code prescribes standards of conduct for a utility with respect to the following: the Degree of Separation from Affiliates; Sharing of Services and Resources; Transfer Pricing; Financial Transactions with Affiliates; Equal Access to Services; and Confidentiality of Customer Information.

On May 16, 2008, the OEB, following consultations held with stakeholders, released amendments to the Affiliate Relationship Code. The amendments revised existing definitions and established new definitions, and revised distributor rights and responsibilities. Generally, the amendments revised restrictions on distributors, and imposed certain new restrictions on distributors, most notably in the area of sharing 'strategic business information' with affiliates.

Distribution System Code

The Distribution System Code establishes the minimum conditions that a distributor must meet in carrying out its obligations to distribute electricity under its licence and under the *Energy Competition Act, 1998*, and has been amended as the regulatory environment has evolved. Generally, the Distribution Service Code prescribes the rights and responsibilities of distributors and distribution customers with respect to the following: connections; connection agreements and conditions of service; expansion projects; alternative bids (available to customers for work otherwise done by the distributor); metering; operations; disconnection and security deposits; and other matters.

Retail Settlement Code

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

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

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

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

Standard Supply Service Code

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

Under the Standard Supply Service Code, a distributor's rates for Standard Supply Service must be approved by the OEB and must consist of the price of electricity and an administrative charge that will allow the distributor to cover its costs of providing the service.

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

Joint Code Amendments Related to Smart Meters

On May 14, 2007, the OEB issued proposed amendments to the Distribution System Code, the Retail Settlement Code, and the Standard Supply Code, all of which were intended to facilitate the implementation of the government's Smart Meter Initiative ("SMI"). Amended provisions of these codes came into force June 27, 2007 with a further minor amendment to the Standard Supply Code coming into force on September 17, 2007.

The OEB stated in its Notice of Amendment to a Code that "The Proposed Amendments were intended to: ensure that the Board's regulatory instruments accommodate the Province's SMI and related policies; ensure that smart metering is implemented on a cost effective basis during the transition period; and provide greater clarity regarding the roles and responsibilities of licensed electricity distributors in relation to settlement using smart meter data and the billing of consumers with smart meters during the transition period."

Among other things, the amended Distribution System Code provides that "a distributor shall, upon being requested to do so, enter into an agreement with the Smart Metering Entity or the IESO, in a form approved by the Board, which sets out the respective roles and responsibilities of the distributor and the Smart Metering Entity or the IESO in relation to metering and the information required to be exchanged to allow for the conduct of these respective roles and responsibilities."

The form of agreement LDC is required to enter into with the Smart Metering Entity is not yet known. There can be no assurance that the substance of the agreement will be congruent with LDC's plans, or that LDC has not or may not in the future incur costs in connection with the agreement, or with smart metering generally, that will be found to be unrecoverable by the OEB pursuant to the agreement or other legislation or regulations.

3.2 Distribution Rates

Cost of Service Regulation

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

Other Regulated Charges

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

Settlement variances

The OEB has allowed LDC to defer settlement variances from May 1, 2002 to December 31, 2009. This balance represents the variances between amounts charged by LDC to customers (based on regulated rates) and the corresponding cost of non-competitive electricity service incurred by LDC after May 1, 2002. The settlement variances relate primarily to service charges, non-competitive electricity charges, imported power charges, and charges related to the manner in which the output of specific generation assets are priced in Ontario.

PILs

OEB regulatory practice provides for the recovery of forecast PILs liabilities through distribution rates. LDC is generally at risk for variances between forecast and actual PILs paid, excluding variances arising from changes in tax rates not assumed in the setting of rates for the period in question, which are disposed of through deferral accounts. As at December 31, 2009, LDC has accumulated a PILs variance amount representing differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in the rate adjustment model.

3.3 OEB Policy Development and Other Initiatives

Smart Meter Initiative

Smart Meters are designed to provide customers with timely consumption information that, when combined with variable time-of use pricing plans offered by distributors, will allow consumers to better manage their demand for electricity and ultimately result in more efficient use of Ontario's existing supply of electricity.

The Province had established targets for the installation of 800,000 Smart Meters by December 31, 2007 and installation of Smart Meters for all Ontario customers by December 31, 2010. The OEB consulted with stakeholders to identify options and address issues with regard to these targets.

The proposed phased-in installation plan will take several years and will initially focus on large consumers and residential and commercial consumers in large urban areas. Distributors will be responsible for owning, installing, operating and maintaining Smart Meters as they are rolled out across the Province. LDC will also continue to be responsible for the customer interface, including billing and access to Smart Meter information data (with third parties), and will be held harmless from the stranding of existing meter assets.

On November 3, 2005, following the issuance of the OEB’s January 26, 2005 Smart Meter Implementation Plan to the Minster of Energy, the *Energy Conservation Responsibility Act, 2005* (Bill 21) was introduced into the legislature. Bill 21 removes barriers to, and promotes opportunities for, energy conservation. Bill 21 established the *Energy Conservation Leadership Act, 2005* and made certain amendments to the *Electricity Act, 1998* and the *Ontario Energy Board Act, 1998* in support of this government initiative.

Amendments to the *Electricity Act, 1998* under Bill 21 include the establishment of a Smart Metering Entity whose responsibility it is to collect, manage and aggregate data related to the consumption or use of electricity. The amendments also set out requirements of distributors, retailers and other persons vis-à-vis the Smart Metering Entity. Specifically, Distributors, retailers and other persons will be required to provide the Smart Metering Entity with the information it requires to fulfil its objects or conduct its business.

On March 28, 2006, Bill 21 was assented to, and on July 26, 2006, the province of Ontario announced that the IESO will act as the Smart Metering Entity.

Amendments to the *Ontario Energy Board Act, 1998* under Bill 21 permit the Minister to issue directives to the OEB relating to the Ontario government's smart metering initiatives. Such directives may require the OEB to amend conditions in licences it issues, and may address the regulatory and accounting treatment of costs to ensure that distributors, transmitters, retailers or other persons are not financially disadvantaged by the implementation of the Ontario government's smart metering initiatives.

OEB Consultations

The OEB consults with interested stakeholders with respect to a number of areas that may affect electricity distributors. The outcomes of several of these consultations (described below) are unknown at this time. However, LDC is subject to codes which are the instruments of regulatory policy and which may be revised as a result of, or in spite of, the consultations being undertaken. There can be no assurance that LDC will not be adversely affected by changes in any of the codes or other regulatory instruments, policies, or guidelines to which it is subject.

Cost of Capital

On March 16, 2009, the OEB announced a consultation to help it determine whether current economic and financial market conditions warrant an adjustment to any of the Cost of Capital parameter values (Return on Equity, Long Term Debt rate, and/or Short Term Debt rate) set by the Board.

On December 11, 2009, the OEB released its decision on this matter which reset the ROE to 9.75% (up from 8.01%). The capital structure remains 60% debt and 40% equity. Short-term Debt Rate is refined to base the applicable Bankers' Acceptance rate spread on real market quotes. Long-term Debt Rate is refined – it will continue to be based on the Long Canada Bond Forecast but will include an A-rated utility bond index yield, consistent with the refinement to the ROE formula. The OEB will review the application of the new method in five-year increments to ensure that the formula-generated ROE continues to meet the Fair Return Standard. The first such regular review will be conducted in 2014.

PILs Proceeding

In 2009, the OEB commenced its review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for all MEUs. The current proceeding is expected to provide guidance for the definition and calculation of such variances. The outcome of this proceeding could have a material impact on the financial position of the Corporation.

4. Regulation of Retailers

4.1 General

Electricity retailers may:

- sell or offer to sell electricity to consumers;
- act as agent or broker with respect to the sale of electricity; or
- act or offer to act as the agent or broker for a consumer with respect to the sale of electricity.

The key regulatory instruments authorized by the *Electricity Act, 1998* and the *Ontario Energy Board Act, 1998*, which regulate the electricity retailing and gas marketing activities of TH Energy, are described below.

4.2 Electricity Retailer Licence

On March 7, 2000, the OEB issued an electricity retailer licence to TH Energy. This licence was renewed on March 7, 2005. The licence allows TH Energy to retail electricity subject to the terms and conditions contained in the licence.

- The licence is effective as of March 7, 2005 and terminates on March 6, 2010, although the term may be unilaterally extended by the OEB.

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

4.3 Gas Marketer Licence

On March 7, 2000, the OEB issued a natural gas marketer licence to TH Energy. This licence was renewed on March 7, 2005, and extends to March 6, 2010. The licence allows TH Energy to carry on business as a gas marketer subject to the terms and conditions contained in the licence. TH Energy does not currently engage in any gas marketing activities.

4.4 Wholesaler Licence

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

4.5 Electricity Generation Licence

On December 18, 2002, the OEB issued an electricity generation licence to TH Energy. The electricity generation licence was actually issued to TH Energy and TREC Windpower Co-operative (No.1) Incorporated (the co-venturers), in connection with a wind turbine located at Exhibition Place in the City. The licence allows the co-venturers to generate electricity or provide ancillary services for sale through the IESO-administered markets, or directly to another person, subject to the terms and conditions contained in the licence which can be summarized as follows:

- *Term, Amendments* – The licence was effective as of December 18, 2002 and terminates on December 17, 2022, although the term may be extended by the OEB. The licence may be amended by the OEB on the application of any person, if it considers the amendment to be necessary in order to implement a directive issued under the *Ontario Energy Board Act, 1998*, or in the public interest, having regard to the objectives of the OEB and the purposes of the *Electricity Act, 1998*.

- *Information Disclosure* –The co-venturers are required to provide the OEB with information regarding any material change in circumstances that adversely affects or is likely to adversely affect its ability to comply with the conditions of the licence, as soon as practicable, but in any event within fifteen days of the date upon which the change occurs.

- *Obligation to Comply with Market Rules* – The co-venturers are obligated to comply with all applicable market rules under the *Electricity Act, 1998*.

4.6 Electricity Retailer Code of Conduct

The Electricity Retailer Code of Conduct:

- prohibits certain sales practices, including exerting undue pressure on or misleading consumers;

- prescribes the content of offering documents and contracts between retailers and residential and small business customers; and

- requires retailers to provide timely, accurate and verifiable comparisons, and ensure that all descriptions and promises made in promotional material are accurate.

The Electricity Retailer Code of Conduct also provides that a retailer may not request a distributor to allow the retailer to supply electricity to a consumer without the consumer's written consent. Retailers are also required to keep customer information confidential subject to certain limited exceptions, including for billing or market operation purposes and compliance with applicable law or legal process

4.7 Energy Consumers' Bill of Rights

The *Ontario Energy Board Act, 1998* was amended on July 1, 2002. Among other things, the purpose of this amendment was to strengthen consumer rights with respect to unfair practices by electricity and natural gas retailers. The amendments strengthened consumer rights by, among other things, enhancing consumers' cancellation rights after signing a contract with a retailer, requiring consumers to reaffirm any contract renewal, and providing the OEB with increased enforcement powers.

The *Electricity Pricing, Conservation and Supply Act, 2002* established additional notice and disclosure requirements for retailers carrying on business after December 2002.

In August 2003, the *Ontario Energy Board Act, 1998* was amended to introduce certain changes to the mechanics relating to reaffirmation of retail contracts.

ANNEX B
CONSOLIDATED FINANCIAL STATEMENTS

ANNEX B

CONSOLIDATED FINANCIAL STATEMENTS

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AUDITORS' REPORT

To the Shareholder of
Toronto Hydro Corporation

We have audited the consolidated balance sheets of **Toronto Hydro Corporation** [the "Corporation"] as at December 31, 2009 and 2008 and the consolidated statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Canada,
February 26, 2010 [except as to note 30[d], which is as of March 5, 2010].

CONSOLIDATED BALANCE SHEETS

[in thousands of dollars]

As at December 31	2009 $	2008 $
ASSETS		
Current		
Cash and cash equivalents	**211,370**	340,492
Accounts receivable, net of allowance for doubtful accounts *[note 19[b]]*	**150,281**	131,582
Unbilled revenue *[note 19[b]]*	**295,647**	266,061
Payments in lieu of corporate taxes receivable	**15,932**	24,006
Inventories *[note 5]*	**6,224**	5,069
Prepaid expenses	**3,331**	2,503
Assets from discontinued operations *[note 27]*	**514**	-
Total current assets	**683,299**	769,713
Property, plant and equipment, net *[note 6]*	**1,919,954**	1,853,606
Intangible assets, net *[note 7]*	**73,829**	66,701
Investments *[note 8]*	**47,930**	52,908
Regulatory assets *[note 9]*	**68,193**	26,213
Other assets *[note 10]*	**7,615**	7,862
Future income tax assets *[note 21]*	**253,149**	2,809
Assets held for sale *[note 11]*	**5,258**	-
Total assets	**3,059,227**	2,779,812
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities *[note 19[b]]*	**316,768**	294,839
Current portion of other liabilities *[note 13]*	**18,001**	17,382
Deferred revenue	**421**	3,274
Current portion of promissory note payable *[note 14]*	**-**	245,058
Liabilities from discontinued operations *[note 27]*	**1,549**	890
Total current liabilities	**336,739**	561,443
Long-term liabilities		
Debentures *[note 14]*	**720,475**	471,521
Promissory note payable *[note 14]*	**490,115**	490,115
Post-employment benefits *[note 15]*	**161,348**	152,771
Regulatory liabilities *[note 9]*	**308,575**	83,516
Other liabilities *[note 16]*	**1,473**	2,230
Asset retirement obligations *[note 17]*	**7,552**	6,528
Customers' advance deposits	**34,696**	30,283
Future income tax liabilities *[note 21]*	**-**	114
Total long-term liabilities	**1,724,234**	1,237,078
Total liabilities	**2,060,973**	1,798,521
Commitments and contingencies *[notes 24, 25 and 30]*		
Shareholder's equity		
Share capital *[note 22]*	**567,817**	567,817
Retained earnings	**430,437**	413,474
Total shareholder's equity	**998,254**	981,291
Total liabilities and shareholder's equity	**3,059,227**	2,779,812

ON BEHALF OF THE BOARD:

CR Copeland

Clare R. Copeland, Director

Brian Chu

Brian Chu, Director

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

CONSOLIDATED STATEMENTS OF INCOME

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

Year ended December 31	**2009** **$**	**2008** **$**
Revenues	**2,461,671**	2,380,084
Costs		
Purchased power and other	**1,953,657**	1,884,296
Operating expenses	**210,889**	203,429
Depreciation and amortization	**162,970**	156,159
	2,327,516	2,243,884
Income before interest, change in fair value of investments and provision for payments in lieu of corporate taxes	**134,155**	136,200
Interest income	**3,207**	12,328
Interest expense		
Long-term debt	**(73,061)**	(71,542)
Other interest	**(697)**	(3,212)
Change in fair value of investments *[note 8]*	**(1,049)**	(22,033)
Income before provision for payments in lieu of corporate taxes	**62,555**	51,741
Provision for payments in lieu of corporate taxes *[note 21]*	**19,742**	5,745
Income from continuing operations	**42,813**	45,996
Income (loss) from discontinued operations - net of tax *[note 27]*	**(680)**	123,016
Net income	**42,133**	169,012
Basic and fully diluted net income per share from continuing operations *[note 26]*	**42,813**	45,996
Basic and fully diluted net income (loss) per share from discontinued operations *[note 26]*	**(680)**	123,016
Basic and fully diluted net income per share	**42,133**	169,012

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

[in thousands of dollars]

Year ended December 31	**2009** **$**	**2008** **$**
Retained earnings, beginning of year	**413,474**	360,878
Net income	**42,133**	169,012
Dividends *[note 22]*	**(25,170)**	(116,416)
Retained earnings, end of year	**430,437**	413,474

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

[in thousands of dollars]

Year ended December 31	**2009** **$**	**2008** $
OPERATING ACTIVITIES		
Income from continuing operations	**42,813**	45,996
Adjustments for non-cash items		
Depreciation and amortization	**162,970**	156,159
Change in fair value of investments *[note 8]*	**1,049**	22,033
Net change in other assets and liabilities	**(972)**	(225)
Payments in lieu of corporate taxes	**8,074**	(1,826)
Post-employment benefits	**8,577**	8,719
Future income taxes *[note 21]*	**416**	1,864
Changes in non-cash working capital balances		
Decrease (increase) in accounts receivable	**(19,061)**	18,514
Decrease (increase) in unbilled revenue	**(29,586)**	10,290
Increase in inventories	**(1,155)**	(523)
Increase in prepaid expenses	**(904)**	(1,047)
Increase in accounts payable and accrued liabilities	**23,016**	7,941
Decrease in deferred revenue	**(2,786)**	(1,429)
Net cash provided by operating activities	**192,451**	266,466
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	**(218,149)**	(188,792)
Purchase of intangible assets	**(31,156)**	(25,789)
Accumulated cash received from conduit trusts *[note 8]*	**3,929**	-
Net change in regulatory assets and liabilities	**(58,743)**	16,717
Net cash used in investing activities	**(304,119)**	(197,864)
FINANCING ACTIVITIES		
Decrease in promissory note payable	**(245,058)**	-
Dividends paid *[note 22]*	**(25,170)**	(116,416)
Proceeds from debentures	**248,399**	-
Increase in customers' advance deposits	**5,013**	3,694
Net cash used in financing activities	**(16,816)**	(112,722)
Net cash used in continuing operations	**(128,484)**	(44,120)
Net cash provided by (used in) discontinued operations *[note 27]*	**(638)**	168,610
Net increase (decrease) in cash and cash equivalents during the year	**(129,122)**	124,490
Cash and cash equivalents, beginning of year	**340,492**	216,002
Cash and cash equivalents, end of year	**211,370**	340,492
Supplementary cash flow information		
Total interest paid	**72,714**	72,606
Payments in lieu of corporate taxes	**14,803**	33,751

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

1. INCORPORATION

On June 23, 1999, Toronto Hydro Corporation [the “Corporation”] was incorporated under the Business Corporations Act (Ontario) [the “BCA”] along with two wholly-owned subsidiary companies, Toronto Hydro-Electric System Limited [“LDC”] and Toronto Hydro Energy Services Inc. [“TH Energy”]. The incorporation was required in accordance with the provincial government's *Electricity Act, 1998*.

Under the terms of By-law No. 374-1999 of the City of Toronto [“Transfer By-law”] made under section 145 of the *Electricity Act, 1998* and in accordance with continuity of interest accounting, the former Toronto Hydro-Electric Commission and the City of Toronto [the “City”] transferred, at book value, their assets and liabilities (effective July 1, 1999) associated with:

[a] electricity distribution to LDC in consideration for the issuance of equity securities of LDC and long-term notes payable to the City; and

[b] electricity generation, co-generation and energy services to TH Energy in consideration for the issuance of equity securities of TH Energy.

The equity securities of LDC and TH Energy were subsequently transferred by the City to the Corporation in consideration for the issuance of equity securities of the Corporation to the City.

The book value of the assets transferred at July 1, 1999 was $1,548,048,000. The principal amount of the long-term notes payable to the City was $980,231,000 and the value of the common shares of the Corporation received by the City was $567,817,000.

The Corporation supervises the operations of, and provides corporate and management services and strategic direction to two principal subsidiaries (each of which is listed below, incorporated under the BCA and wholly-owned, directly or indirectly, by the Corporation):

[a] LDC (incorporated June 23, 1999) – which distributes electricity to customers located in the City and is subjected to rate regulation. LDC is also engaged in the delivery of Conservation and Demand Management [“CDM”] activities; and

[b] TH Energy (incorporated June 23, 1999) – which owns and operates street lighting and expressway lighting assets located in the City.

The principal business of the Corporation is the regulated distribution of electricity by LDC.

2. REGULATION

In April 1999, the government of Ontario initiated a restructuring of Ontario’s electricity industry. The restructuring was intended, among other things, to facilitate competition in the generation and sale of electricity, to protect the interests of consumers with respect to prices and the reliability and quality of electricity service and to promote economic efficiency in the generation, transmission and distribution of electricity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

The Ontario Energy Board [the “OEB”] has regulatory oversight of electricity matters in the Province of Ontario. The *Ontario Energy Board Act, 1998* sets out the OEB's authority to issue a distribution licence which must be obtained by owners or operators of a 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 obligations to connect and service customers.

The continuing restructuring of Ontario’s electricity industry and other regulatory developments, including current and possible future consultations between the OEB and interested stakeholders, may affect the distribution rates and other permitted recoveries in the future.

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

[i] *Distribution Rate*. The distribution rate is designed to recover the costs incurred by LDC in delivering electricity to customers and the OEB-allowed rate of return. Distribution rates are regulated by the OEB and typically comprise a fixed charge and a usage-based (consumption) charge.

The volume of electricity consumed by LDC’s customers during any period is governed by events largely outside LDC’s control (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 Related Regulated Adjustments*. The electricity price and related regulated adjustments represent a pass through of the commodity cost of electricity.

[iii] *Retail Transmission Rate*. The retail transmission rate represents a pass through of wholesale costs incurred by distributors in respect of the transmission of electricity from generating stations to local areas. Retail transmission rates are regulated by the OEB.

[iv] *Wholesale Market Service Charge*. The wholesale market service charge represents a pass through of various wholesale market support costs. Retail rates for the recovery of wholesale market service charges are regulated by the OEB.

3. ELECTRICITY DISTRIBUTION RATES

On May 15, 2008, the OEB issued its decision regarding LDC’s electricity distribution rates application for 2008 and 2009. In its decision, the OEB approved LDC’s 2008 base distribution revenue requirement and rate base of $473,000,000 and $1,968,900,000, respectively. As part of the decision, the deemed debt to equity structure of LDC was modified to 62.5% debt and 37.5% equity for 2008 and to 60.0% debt and 40.0% equity for 2009 and thereafter.

In its decision on LDC’s electricity distribution rates for 2008 and 2009, the OEB ordered that 100% of the net after-tax gains on the sale of certain LDC properties should be deducted from the revenue requirement recovered through distribution rates. The OEB deemed this amount to be $10,300,000 [the "deemed amount"]. On June 16, 2008, LDC filed an appeal with the Divisional Court of Ontario [the "Divisional Court"] seeking to overturn the gain on sale aspects of the OEB decision and also sought and obtained a stay order with respect to the deduction of the deemed amount from the revenue requirement recovered through rates. On April 30, 2009, the Divisional Court denied the appeal by LDC. LDC filed a motion with the Court of Appeal for leave to appeal that decision of the Divisional Court. The requested leave was denied on September 14, 2009.

LDC filed a notice of clarification with the OEB with respect to the timing and the quantum of the expected reduction in distribution revenue. LDC's position is that the reduction in distribution revenue should be done after the deemed properties are sold and for the related actual net after-tax gain. In the event the OEB does not concur with LDC's position and orders an immediate reduction in distribution revenue, the Corporation would have to reduce its distribution revenue by the deemed amount less the net after-tax gain of the deemed properties already sold. At December 31, 2009, the reduction in distribution revenue would be approximately $8,100,000. Further to the notice of clarification filed by LDC in the fourth quarter of 2009, the OEB indicated that it intends to provide a final ruling on this issue as part of LDC's electricity distribution rates decision for 2010.

On February 24, 2009, the OEB issued the allowed return on equity ["ROE"] for LDC for the 2009 rate year. The percentage was set at 8.01%. In addition to the ROE, the OEB also set LDC's 2009 distribution revenue requirement and rate base at $482,500,000 and $2,035,000,000, respectively.

On August 28, 2009, LDC filed a rate application with the OEB seeking approval of the distribution revenue requirement and corresponding rates for the rate year May 1, 2010.

On December 11, 2009, the OEB issued revised cost of capital guidelines which would set the initial allowed ROE for LDC for 2010 at 9.75%. The ROE formula will be adjusted to reflect the forecast long Canada Bond Yield and A-rated Canadian Utility bonds spreads when this data is released by the OEB on or about the beginning of March 2010. LDC will adjust its distribution rates to reflect the new guidelines as part of its rate finalization process for 2010 distribution rates.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

a) Basis of consolidation

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

b) Regulation

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

Regulatory Assets and Liabilities

Effective January 1, 2009, the Corporation adopted amended Canadian Institute of Chartered Accountants ["CICA"] Handbook Section 1100 – "Generally Accepted Accounting Principles" ["Handbook Section 1100"], Handbook Section 3465 – "Income Taxes" ["Handbook Section 3465"], and Accounting Guideline 19 "Disclosures by Entities Subject to Rate Regulation". These amended sections and guidance established new standards and removed a temporary exemption in Handbook Section 1100 pertaining to the application of that section to the recognition and measurement of assets and liabilities arising from rate regulation. The new standards require the recognition of future income tax liabilities and assets in accordance with Handbook Section 3465 as well as a separate regulatory asset or liability balance for the amount of future income taxes expected to be included in future rates and recovered from or paid to customers, and retain existing requirements to disclose the effects of rate regulation. The revised standards are effective for interim and annual financial statements for the fiscal years beginning on or after January 1, 2009.

Following the removal of the temporary exemption for rate-regulated operations included in Handbook Section 1100, the Corporation developed accounting policies for its assets and liabilities arising from rate regulation using professional judgment and other sources issued by bodies authorized to issue accounting standards in other jurisdictions. Upon final assessment and in accordance with Handbook Section 1100, the Corporation has determined that its assets and liabilities arising from rate-regulated activities qualify for recognition under Canadian GAAP and this recognition is consistent with U.S. Financial Accounting Standards Board Accounting Standards Codification 980 – "Regulated Operations". Accordingly, the removal of the temporary exemption had no effect on the Corporation's results of operations as of December 31, 2009.

Handbook Section 3465 as amended requires the recognition of future income tax assets and liabilities and related regulatory liabilities and assets for the amount of future income taxes expected to be refunded to, or recovered from, customers in future electricity rates, applied on a retrospective basis without prior period restatement. The implementation of these standards did not impact the Corporation's earnings or cash flows. As at December 31, 2009, LDC has recorded a future income tax asset of $250,948,000, and a corresponding regulatory liability of $250,948,000 *[note 9]*.

Payments in lieu of corporate taxes ["PILs"]

The Corporation and its subsidiaries are exempt from tax under the *Income Tax Act* (Canada) ["ITA"], the *Corporations Tax Act* (Ontario) and the *Taxation Act, 2007* (Ontario), if not less than 90% of the capital of the Corporation is owned by the City and not more than 10% of the income of the Corporation and each of its subsidiaries is derived from activities carried on outside the municipal geographical boundaries of the City.

The Corporation and each of its subsidiaries is a Municipal Electricity Utility ["MEU"] for purposes of the PILs regime contained in the *Electricity Act, 1998*. The *Electricity Act, 1998* provides that a MEU that is exempt from tax under the ITA, the *Corporations Tax Act* (Ontario) and the *Taxation Act, 2007* (Ontario) is required to make, for each taxation year, a PILs to the Ontario Electricity Financial Corporation in an amount equal to the tax that it would be liable to pay under the ITA and the *Taxation Act, 2007* (Ontario) (for years ending after 2008) or the *Corporations Tax Act* (Ontario) (for years ending prior to 2009) if it were not exempt from tax.

The PILs regime came into effect on October 1, 2001, at which time the Corporation and each of its subsidiaries were deemed to have commenced a new taxation year for purposes of determining the respective liabilities for PILs.

The differences between the financial statement carrying value and tax basis of assets and liabilities were accounted for by the Corporation as follows:

[a] in the case of the Corporation's unregulated businesses, the liability method of accounting was applied in accordance with recommendations of the CICA; and

[b] in the case of the Corporation's regulated electricity distribution business, until December 31, 2008, the taxes payable method of accounting was applied. Effective January 1, 2009, the Corporation's regulated business began using the liability method of accounting following the new recommendations from the CICA and the OEB.

Under the liability method, current income taxes payable are recorded based on taxable income. Future income taxes arise from temporary differences in the accounting and tax basis of assets and liabilities. Future tax assets and liabilities are provided based on substantively enacted tax rates that will be in effect when the differences are expected to reverse.

Under the taxes payable method, no provisions were made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes became payable, it was expected that they would be included in the rates approved by the OEB and recovered from the customers of the regulated business at that time.

Contributions in aid of construction

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

Allowance for funds used during construction

The AP Handbook provides for the inclusion of an Allowance for Funds Used During Construction ["AFUDC"] when capitalizing construction-in-progress assets, until such time as the asset is substantially complete. A concurrent credit of the same amount is made to the interest expense account 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. AFUDC is included in property, plant and equipment and construction-in-progress for financial reporting purposes, charged to operations through depreciation 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) Inventories

Effective January 1, 2008, the Corporation adopted CICA Handbook Section 3031 – "Inventories" ["Handbook Section 3031"] which is based on the International Accounting Standards Board's International Accounting

[all tabular amounts in thousands of dollars]

Standard 2 and replaced existing CICA Handbook Section 3030. Under this new standard, inventories are required to be measured at the lower of cost and net realizable value and any items considered to be major future components of property, plant and equipment are to be transferred to property, plant and equipment. The new standard also provides updated guidance on the appropriate methods of determining cost and the impact of any write-downs to net realizable value. The implementation of this standard did not have any impact on the Corporation's results of operations.

Inventories consist primarily of maintenance and construction materials. The Corporation has retrospectively reclassified all major future components of its electricity distribution system infrastructure from inventory to property, plant and equipment. Once capitalized, these items are not depreciated until they are put into service. Inventories are carried at the lower of cost and net realizable value, with cost determined on an average cost basis net of a provision for obsolescence.

e) Investments

Investments include the replacement notes received on January 21, 2009 in connection with the restructuring of the Asset Backed Commercial Paper ["ABCP"] notes impacted by the liquidity issues that arose in August 2007. These investments are classified as long-term investments on the consolidated balance sheet. Following the receipt of the replacement notes, the Corporation changed the classification of its investments from "Investments Held to Maturity" to "Investments Held for Trading". This change was related to the underlying nature of the replacement notes and follows the guidance issued by the Accounting Standards Board of Canada ["AcSB"]. The investments are measured at fair value at each period end with changes in fair value included in the consolidated statements of income in the period in which they arise *[note 8]*.

f) Property, plant and equipment and depreciation

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. Gains or losses at retirement or disposition of such assets are credited or charged to "Other" in the consolidated statements of income.

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.

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

Buildings	2.0%
Stations	2.5% to 6.7%
Distribution lines	2.5% to 25.0%
Transformers	3.3% to 4.0%
Meters	2.9% to 6.7%
Other capital assets	4.0% to 20.0%
Communications	10.0% to 20.0%
Computer hardware	20.0% to 25.0%
Rolling stock	12.5% to 33.3%
Equipment and tools	10.0%

[all tabular amounts in thousands of dollars]

Construction in progress includes assets not currently in use which are not depreciated.

g) Intangible assets

Effective January 1, 2009, the Corporation retrospectively adopted CICA Handbook Section 3064 - "Goodwill and Intangible Assets" ["Handbook Section 3064"]. Handbook Section 3064 replaces Handbook Section 3062 – "Goodwill and Other Intangible Assets" ["Handbook Section 3062"] and provides extensive guidance on recognition, measurement and disclosure of intangible assets.

The Corporation evaluated existing intangible assets as at January 1, 2009 to determine whether the intangible assets recognized under previous Handbook Section 3062 met the definition, recognition, and measurement criteria of an intangible asset in accordance with Handbook Section 3064. The assets included land rights or easements, computer software, and capital contributions. As a result, the Corporation identified $1,985,000 of expenditures that no longer met the definition of intangible assets under Handbook Section 3064 and these expenditures were removed from intangible assets and transferred to a regulatory asset account for future recovery. The Corporation's decision to record these expenditures to regulatory assets is based on the fact that the expenditures have already been approved for recovery by the OEB in prior regulatory proceedings. In the absence of rate regulation, these expenditures would have been recorded to opening retained earnings.

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

Computer software	20.0%
Capital contributions	4.0%

Software in development includes assets not currently in use which are not amortized.

h) Deferred debt issue costs

Debt issue costs arising from the Corporation's debenture offerings are recorded against the principal amount of the "Debentures". The debentures are accreted back to their face value using the effective interest rate method over the remaining period to maturity.

i) Workplace Safety and Insurance Act

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

j) Revenue recognition

LDC

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

In May 2007, LDC entered into CDM agreements with the Ontario Power Authority ["OPA"] for the period from 2007 to 2010. The revenues and costs associated with these programs are accounted for using the net basis of accounting, while any performance fees are recognized as the related CDM programs are delivered.

Revenues from Lost Revenue Adjustment Mechanism ["LRAM"] and Shared Savings Mechanism ["SSM"] are recognized as related programs are delivered and measurable.

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

TH Energy

Revenues from the delivery of street lighting and expressway lighting services are recorded as services are rendered.

Other revenues, which includes energy efficiency products and services revenues are accounted for under the percentage of completion method, with revenues recognized proportionately with the degree of completion of the services under contract. Losses on contracts are fully recognized when they become evident.

k) Financial instruments

At inception, all financial instruments which meet the definition of a financial asset or financial liability are to be recorded at fair value, unless fair value cannot be reliably determined. Gains and losses related to the measurement of financial instruments are reported in the consolidated statements of income. Subsequent measurement of each financial instrument will depend on the 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	Investments Held-to-Maturity
Accounts receivable and unbilled revenue	Loans and Receivables
Investments	Investments Held-for-Trading
Accounts payable and accrued liabilities	Other Financial Liabilities
Customers' advance deposits	Other Financial Liabilities
Debentures	Other Financial Liabilities
Promissory note payable to the City	Other Financial Liabilities

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 sheet:

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

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

- Investments, comprised of the replacement notes received on January 21, 2009 in connection with the restructuring of the ABCP notes, are classified as "Investments Held-for-Trading". Prior to receiving the replacement notes, the Investments were classified as "Investments Held-to-Maturity". The notes are measured at fair value at each period end with changes in fair value included in the consolidated statements of income in the period in which they arise. Estimated fair value has been determined using valuation techniques that incorporate discounted future cash flows reflecting market conditions and other factors that a market participant would consider *[note 8]*.

- Accounts payable and accrued liabilities are classified as "Other Financial Liabilities" and are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.

- Customers' advance deposits are classified as "Other Financial Liabilities" and are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of the current portion, and the discounted long-term portion approximates the carrying value, taking into account interest accrued on the outstanding balance.

- The debentures and the promissory note payable to the City are classified as "Other Financial Liabilities" and are initially measured at their fair value. The carrying amounts of the debentures and the promissory note payable to the City are carried at amortized cost, based on an initial fair value as determined at the time using quoted market price for similar debt instruments. The fair value of the debentures and the promissory note payable to the City is calculated by discounting the related cash flows at the estimated yield to maturity of similar debt instruments *[note 19]*. While the Corporation has the option to redeem some or all of the debentures at their discretion, this option has no value and has not been recorded in the consolidated financial statements.

Effective January 1, 2008, the Corporation adopted CICA Handbook Sections 3862 – "Financial Instruments – Disclosures" ["Handbook Section 3862"] and 3863 – "Financial Instruments – Presentation", which establish the requirement of disclosure of risks associated with both recognized and unrecognized financial instruments and the management of those risks. The adoption of these standards did not have any impact on the Corporation's results of operations or financial position *[note 19]*.

In January 2009, the CICA issued Emerging Issues Committee Abstract 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" ["EIC-173"], effective for interim and annual financial statements ending on or after January 2009. EIC-173 provides further information on the determination of the fair value of financial assets and financial liabilities under Handbook Section 3855 – "Financial Instruments – Recognition and Measurement" ["Handbook Section 3855"]. It states that an entity's own credit and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this standard did not have any impact on the Corporation's results of operations or financial position.

In June 2009, the CICA amended Handbook Section 3862 to include additional disclosure requirements with respect to fair value measurements of financial instruments and to enhance liquidity risk disclosure requirements.

Handbook Section 3862 establishes a fair value hierarchy which includes three levels of inputs that may be used to measure fair value:

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

The Corporation adopted these amendments effective for the fiscal year ended December 31, 2009. Comparative information is not required in the first year of application *[note 19]*.

In August 2009, the CICA amended Handbook Section 3855 to add guidance concerning the assessment of embedded derivatives upon reclassification of a financial asset out of the assets held-for-trading category. These amendments apply prospectively to reclassifications made on or after July 1, 2009. Earlier adoption is permitted. The application of these amendments did not have any impact on the Corporation's results of operations or financial position.

In August 2009, the CICA amended Handbook Section 3025 – "Impaired Loans" to include held-to-maturity investments and to conform the definition of a loan to that in amended Handbook Section 3855. These amendments apply to annual financial statements relating to fiscal years beginning on or after November 1, 2008. The Corporation adopted these amendments effective for the fiscal year ended December 31, 2009. The application of these amendments did not have any impact on the Corporation's results of operations or financial position.

l) Capital disclosures

Effective January 1, 2008, the Corporation adopted CICA Handbook Section 1535 – "Capital Disclosures" which requires disclosure of the Corporation's objectives, policies and processes for managing capital as well as its compliance with any external capital requirements *[note 18]*. The implementation of this standard did not have any impact on the Corporation's results of operations or financial position.

m) Employee future benefits

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 the Province of Ontario for employees of municipalities, local boards and school boards in Ontario. Both participating employers and employees are required to make plan contributions based on participating employees' contributory earnings. The Corporation recognizes the expense related to this plan as contributions are made.

Employee future benefits other than pension

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

The accrued benefit obligations and current service costs are calculated using the projected benefit method prorated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. The excess of the net actuarial gains (losses) over 10% of the accrued benefit obligation is amortized into expense over the average remaining service period of active employees to full eligibility. The effects of a curtailment gain or loss are recognized in income in the year of the event giving rise to the curtailment. The effects of a settlement gain or loss are recognized in the period in which a settlement occurs.

n) Asset retirement obligations

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

o) Customers' advance deposits

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

p) Use of estimates

The preparation of the Corporation’s consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the year. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Minister of Energy, the Minister of Finance, or the Minister of Revenue.

q) Future Accounting Pronouncements

International Financial Reporting Standards ["IFRS"]

On February 13, 2008, the AcSB confirmed that publicly accountable enterprises will be required to adopt IFRS in place of Canadian GAAP for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. A limited number of converged or IFRS-based standards will be incorporated into Canadian GAAP prior to 2011, with the remaining standards to be adopted at the change over date. The Corporation has an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its consolidated financial statements. Although the impact of the adoption of IFRS on the Corporation's financial position and results of operations is not yet reasonably determinable or estimable, the Corporation does expect a significant increase in financial statement disclosure requirements resulting from the adoption of IFRS, and is designing the systems and related processes changes, which will be required in order to provide the additional information required to make these disclosures.

Consolidated Financial Statements and Non-controlling Interests

In January 2009, the CICA issued Handbook Section 1601 – "Consolidated Financial Statements" ["Handbook Section 1601"]. This section along with the new Handbook Section 1602 – "Non-controlling Interests" ["Handbook Section 1602"] replace Handbook Section 1600 – "Consolidated Financial Statements" and establish standards for the preparation of consolidated financial statements. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted as of the beginning of a fiscal year. The Corporation has determined that these standards will have no impact on the classification or valuation of its consolidated financial statements.

Financial Instruments – Recognition and Measurement

In June 2009, the CICA amended Handbook Section 3855 to clarify when an embedded prepayment option is separated from its host debt instrument for accounting purposes. This amendment applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. This section has also been amended to clarify the application of the effective interest method after a debt instrument has been impaired. This amendment applies retrospectively to financial statements for fiscal years beginning on or after January 1, 2010. The Corporation expects these amendments will have no impact on its results of operations and financial position.

Comprehensive Revaluation of Assets and Liabilities

In August 2009, the CICA amended Handbook Section 1625 – "Comprehensive Revaluation of Assets and Liabilities" to be consistent with Handbook Section 1582 – "Business Combinations", Handbook Section 1601 and Handbook Section 1602, which were issued in January 2009. The amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year. The Corporation expects these amendments will have no impact on its results of operations and financial position.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2009

5. INVENTORIES

Inventories consist of the following:

	2009 $	2008 $
Consumables, tools and other maintenance items	**1,870**	1,478
Fuses	**1,783**	1,014
Vehicle parts and supplies	**407**	436
Other	**2,284**	2,235
Less: Allowance for provisions	**(120)**	(94)
	6,224	5,069

6. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consist of the following:

	2009			2008		
	Cost $	**Accumulated depreciation $**	**Net book value $**	**Cost $**	**Accumulated depreciation $**	**Net book value $**
Land	**4,048**	**—**	**4,048**	4,073	—	4,073
Buildings	**146,163**	**53,476**	**92,687**	151,029	50,717	100,312
Stations	**253,659**	**120,201**	**133,458**	242,557	113,315	129,242
Distribution lines	**2,449,630**	**1,291,104**	**1,158,526**	2,324,813	1,197,962	1,126,851
Transformers	**567,573**	**321,140**	**246,433**	542,176	301,446	240,730
Meters	**204,425**	**105,829**	**98,596**	199,127	97,145	101,982
Other capital assets	**53,269**	**29,935**	**23,334**	65,612	38,413	27,199
Communications	**23,860**	**18,994**	**4,866**	29,351	23,381	5,970
Computer hardware	**33,136**	**27,380**	**5,756**	49,299	40,055	9,244
Rolling stock	**68,043**	**42,650**	**25,393**	59,209	41,749	17,460
Equipment and tools	**37,154**	**28,011**	**9,143**	35,827	26,579	9,248
Construction in progress	**117,714**	**—**	**117,714**	81,295	—	81,295
	3,958,674	**2,038,720**	**1,919,954**	3,784,368	1,930,762	1,853,606

For the year ended December 31, 2009, AFUDC in the amount of $2,752,000 [2008 - $2,016,000] was capitalized to property, plant and equipment and credited to interest expense.

At December 31, 2009, net book value of stranded meters related to the deployment of smart meters amounting to $25,347,000 [December 31, 2008 - $25,866,000] is included in property, plant and equipment. In the absence of rate regulation, property, plant and equipment would have been $25,347,000 lower at December 31, 2009 [December 31, 2008 - $25,866,000].

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

7. INTANGIBLE ASSETS, NET

Intangible assets consist of the following:

	2009			2008		
	Cost $	**Accumulated amortization $**	**Net book value $**	**Cost $**	**Accumulated amortization $**	**Net book value $**
Land rights	**—**	**—**	**—**	1,720	242	1,478
Computer software	**145,074**	**113,163**	**31,911**	151,804	111,895	39,909
Capital contributions	**2,043**	**443**	**1,600**	2,043	361	1,682
Software in development	**40,318**	**—**	**40,318**	23,632	—	23,632
	187,435	**113,606**	**73,829**	179,199	112,498	66,701

During the year ended December 31, 2009, the Corporation acquired $14,055,000 intangible assets subject to amortization [2008 - $20,889,000] and acquired $17,101,000 intangible assets not subject to amortization [2008 - $4,900,000].

8. INVESTMENTS

The Corporation held $88,000,000 of third-party ABCP notes impacted by the liquidity crisis that arose in the Canadian market in August 2007. At the time the Corporation purchased each of these notes, they were rated R1(High) by DBRS Limited ["DBRS"], the highest credit rating issued for commercial paper. Following the liquidity crisis, a group representing banks, asset providers and major investors [the "Montreal Committee"] was formed to oversee the restructuring of the impacted ABCP notes.

On January 12, 2009, the Ontario Superior Court approved the restructuring plan proposed by the Montreal Committee and supported by the noteholders of the Canadian third-party ABCP market. On January 21, 2009, the amended restructuring plan was completed and the Corporation received its replacement notes. The replacement notes received have an aggregate principal amount of $87,700,000.

The distribution by class is listed below:

Master Asset Vehicle II	Amount Received $	Percent of Total
Class A-1	36,900,000	42.1%
Class A-2	34,500,000	39.3%
Class B	6,300,000	7.2%
Class C	2,400,000	2.7%
Ineligible Asset Tracking notes	7,600,000	8.7%

Of the $87,700,000, $80,100,000 includes a combination of leveraged collateralized debt, synthetic assets and traditional securitized assets which is represented by senior Class A-1 and Class A-2 and subordinated Class B and Class C long-term restructured notes, and $7,600,000 is represented by assets that have an exposure to U.S. mortgages and sub-prime mortgages, which has been replaced by Ineligible Asset Tracking [“IAT”] notes.

At the time of issuance, DBRS assigned an “A” credit rating to the Class A-1 and A-2 notes; the Class B, C and IAT notes were unrated. On August 11, 2009, DBRS downgraded the rating of the Class A-2 notes from A to BBB (low).

According to the Eighteenth and Nineteenth Reports of the Monitor, the “legal final maturity” of the restructured notes is July 15, 2056. However, the expected repayment date for the restructured Class A-1 and Class A-2 notes is January 22, 2017. Based on the information contained in the above-mentioned reports, there is no obligation to pay interest on the notes before 2019 and no legal requirement to pay principal until 2056.

As part of the implementation of the restructuring plan, the Corporation re-measured its investments in ABCP notes prior to the exchange. This valuation considered new information available at that date and reflected current market conditions. As a result of this valuation, the Corporation increased the fair value of its investment in ABCP notes from $52,908,000 at December 31, 2008 to $56,524,000 at January 20, 2009. The increase in fair value reflected the expected payment to the Corporation of its share of cash accumulated in the conduit trusts from August 2007 to January 2009. The increase in fair value was recorded as income in the first quarter of 2009, under change in fair value of investments.

On January 23, 2009, the Corporation received $2,712,000 representing the first instalment of its share of the accumulated cash in the conduit trusts up to August 31, 2008. On May 15, 2009, the Corporation received a further $1,217,000 representing the second instalment of its share of accumulated cash in the conduit trusts from September 2008 through January 20, 2009. These balances reduced the value of the investments.

Following the receipt of the new notes, the Corporation changed the classification of these investments from “Investments Held-To-Maturity” to “Investments Held-For-Trading”. This change was mainly related to the underlying nature of the new notes and follows the guidance issued by the AcSB on February 2, 2009. The new notes are measured at fair value at each period end with changes in fair value included in the consolidated statements of income in the period in which they arise.

In the fourth quarter of 2009, the Corporation noticed evidence of the development of a market for these notes. However as at December 31, 2009, this market had not developed to a state that warranted a mark-to-market valuation process. Accordingly, the Corporation continued to use a mark-to-model valuation technique that incorporated available information and market data. The valuation technique used by the Corporation to estimate the fair value of its investments in the restructured notes as at December 31, 2009, incorporated a discounted cash flow model considering the best available public information regarding market conditions, including the ratings assigned by DBRS regarding the Class A-1 and Class A-2 notes, and other factors that a market participant would consider to evaluate such investments. The Corporation may change its valuation methodology to a mark-to-market valuation in the future as a more robust market for these notes develops.

A weighted average interest rate of 1.28% was used to determine the expected interest income on the restructured notes, except for the IAT notes, for which a weighted average interest rate of 1.98% was used. These rates were based on a forecast of 90-day Bankers’ Acceptance [“BA”] rates less 50 basis points from 2010 through 2017; except for the IAT notes for which a discount rate based on forecast 90-day BA rate plus 20 basis points was used.

[all tabular amounts in thousands of dollars]

To derive a net present value of the principal and future cash flows, the restructured notes were discounted using an interest rate spread over forecast BA rates ranging from 340 basis points to 1,600 basis points over a seven-year period. On a weighted average basis, the interest rates used to discount the notes ranged from 4.27% to 16.87%.

The discount rates vary by each of the different replacement long-term notes issued as each is expected to have a different risk profile. The discount rates used to value the notes include a risk premium factor that incorporates current indicative credit default swap spreads, an estimated liquidity premium, and a premium for credit losses.

Based on the assumptions described above, the discounted cash flows resulted in an estimated fair value of the Corporation's investment in the restructured notes of $47,930,000 as at December 31, 2009 as compared to $56,524,000 as at January 20, 2009. The variance was mainly related to the cash received in connection with the Corporation's share of cash accumulated in the conduit trusts and change in interest rates due to changing market conditions including the impact of the credit rating downgrade of the Class A-2 notes in August 2009.

A sensitivity analysis was also conducted to examine the impact of an increase or a decrease in the overall weighted average discount rate. Based on the Corporation's mark-to-model valuation, a variation of 1% (100 basis points) would reduce or increase the estimated fair value of the restructured notes by approximately $3,700,000.

The estimation by the Corporation of the fair value of the restructured notes, as at December 31, 2009, is subject to significant risks and uncertainties, including the timing and amount of future cash flows, market liquidity and the quality of the underlying assets and financial instruments. Accordingly, there can be no assurance that the Corporation's assessment of the estimated fair value of the restructured notes will not change materially in subsequent periods.

The on-going liquidity crisis regarding the investments described above has had no significant impact on the Corporation's operations. The Corporation has sufficient cash to fund all of its ongoing liquidity and capital expenditure requirements and is in compliance with the financial covenants under the terms of its outstanding indebtedness.

9. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

	2009 $	2008 $
Smart meters	**50,669**	25,830
Contact voltage	**9,050**	—
LRAM and SSM	**3,546**	—
Other	**4,928**	383
	68,193	26,213

[all tabular amounts in thousands of dollars]

Regulatory liabilities consist of the following:

	2009 $	2008 $
Future income taxes	**250,948**	—
Settlement variances	**36,615**	57,516
PILs variances	**15,197**	11,712
Regulatory assets recovery account	**3,598**	13,832
Other	**2,217**	456
	308,575	83,516

For the year ended December 31, 2009, LDC recovered approved regulatory assets amounts of $nil through permitted distribution rate adjustments [2008 – $15,381,000]. For the year ended December 31, 2009, LDC disposed of approved regulatory liability amounts of $13,747,000 through permitted distribution rate adjustments [2008 – $9,671,000].

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

[a] Smart Meters

The smart meters regulatory asset account relates to the Province of Ontario's decision to install smart meters throughout Ontario by 2010. LDC launched its project shortly following the Province of Ontario's announcement in 2006. As at December 31, 2009, LDC had installed approximately 631,000 smart meters. In 2008, in connection with this initiative, the OEB approved the disposition of the balances incurred in 2006 and 2007. The OEB also approved the transfer from regulatory assets to property plant and equipment of all capital expenditures incurred in 2006 and 2007. In a separate decision regarding LDC's electricity distribution rates for 2008, the OEB ordered LDC to record all future expenditures and revenues related to smart meters to a regulatory asset account and allowed LDC to keep the net book value of the stranded meters related to the deployment of smart meters in its rate base.

In connection with its smart meter initiatives, the Corporation has incurred costs amounting to $22,833,000 for the year ended December 31, 2009 [2008 - $34,125,000]. As at December 31, 2009, smart meter capital expenditures, net of accumulated depreciation, totalling $51,501,000 have been recorded to regulatory assets [December 31, 2008 - $27,559,000]. These expenditures would otherwise have been recorded as property, plant and equipment and intangible assets under Canadian GAAP for unregulated businesses. In the absence of rate regulation, property, plant and equipment and intangible assets would have been $45,606,000 and $5,895,000 higher as at December 31, 2009 [December 31, 2008 - $27,559,000 and $nil, respectively].

For the year ended December 31, 2009, smart meter operating expenses of $3,048,000 [2008 - $863,000], and smart meter depreciation expense of $3,447,000 [2008 - $1,128,000] were deferred which would have been expensed under Canadian GAAP for unregulated businesses. In the absence of rate regulation, for the year ended December 31, 2009, operating expenses would have been $3,048,000 higher [2008 - $863,000 higher], and depreciation expense would have been $3,447,000 higher [2008 - $1,128,000 higher].

For the year ended December 31, 2009, smart meter customer revenues of $5,741,000 were deferred [2008 - $3,796,000]. In the absence of rate regulation, for the year ended December 31, 2009, revenue would have been $5,741,000 higher [2008 - $3,796,000 higher].

[b] Contact Voltage

On June 30, 2009, LDC filed an application with the OEB seeking recovery of costs incurred for the unexpected impact of the remediation of safety issues on its electricity distribution infrastructure. LDC sought recovery of $14,350,000 by way of fixed term rate riders of three years for the street lighting and unmetered scattered load rate classes, and one year for all other classes. On December 10, 2009, the OEB issued its decision, which provides for the future recovery of $9,050,000 of related expenditures. Accordingly, the Corporation has increased its regulatory assets and reduced its operating expenditures by $9,050,000 for 2009. In the absence of rate regulation, for the year ended December 31, 2009, operating expenses would have been $9,050,000 higher.

[c] Lost Revenue Adjustment Mechanism and Shared Savings Mechanism

Under certain specific rules, the OEB has allowed LDC to receive compensation for the lost revenue and the benefits associated to CDM programs delivered. The LRAM represents the lost revenue from CDM programs and the SSM represents LDC's share of provincial savings related to these programs.

On December 15, 2008, LDC applied to the OEB to recover LRAM and SSM amounts related to CDM programs undertaken in 2007. On September 22, 2009, the OEB approved the recovery by LDC of $2,904,000 for LRAM and $586,000 for SSM programs through rate riders commencing on May 1, 2010 and ending April 30, 2011.

[d] Future income taxes

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

On January 1, 2009, LDC began to account for the differences between its financial statement carrying value and tax basis of assets and liabilities following the liability method in accordance with CICA Handbook Section 3465 *[note 4[b]]*. As at December 31, 2009, LDC has recorded a future income tax asset of $250,948,000, and a corresponding regulatory liability of $250,948,000.

[e] 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 after May 1, 2002. The settlement variances relate primarily to service charges, non-competitive electricity charges, imported power charges and the global adjustment. Accordingly, LDC has deferred these recoveries in accordance with the criteria set out in the AP Handbook.

The balance for settlement variances continues to be calculated and attract carrying charges in accordance with the OEB's direction. For the year ended December 31, 2009, settlement variances of $6,628,000 were disposed through rate adjustments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

[f] PILs variances

As at December 31, 2009, LDC has accumulated a PILs variance amount representing differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in the rate adjustment model totalling an over-recovery of $15,197,000 [December 31, 2008 - $11,712,000].

[g] Regulatory assets recovery account ["RARA"]

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

In its decision regarding the electricity distribution rates of LDC issued on May 15, 2008, the OEB approved the disposition of regulatory liabilities of $18,622,000, consisting of settlement variances of $14,590,000 and pre-market opening line loss variance of $4,032,000, which were transferred to the 2008 RARA in June 2008.

On April 16, 2009, the OEB approved disposition of regulatory liability of $7,582,000, for amounts arising from the extended effectiveness of certain rate riders into the 2008 rate year, which was transferred to the 2009 RARA in April 2009.

10. OTHER ASSETS

Other assets consist of the following:

	2009 $	2008 $
Prepaid leases	**7,456**	7,544
Other	**159**	318
	7,615	7,862

11. ASSETS HELD FOR SALE

In November 2009, the Corporation committed to a plan to sell a building and related land owned by TH Energy. An active program to locate a buyer and other actions required to complete the sale plan have been initiated and the property has been actively marketed for sale. Accordingly, an amount of $5,258,000 has been transferred from property, plant and equipment to assets held for sale as at December 31, 2009. The balance is measured at the lower of the carrying amount or fair value less cost to sell. The Corporation does not record depreciation on assets classified as held for sale.

[all tabular amounts in thousands of dollars]

12. BANK INDEBTEDNESS AND LETTERS OF CREDIT

The Corporation has a Revolving Credit Facility with a syndicate of Canadian banks [the "Revolving Credit Facility"] expiring on May 3, 2010. Under the terms of the Revolving Credit Facility, the Corporation may borrow up to $500,000,000, of which:

[a] $500,000,000 less the amount utilized under [b] is available for working capital and LDC capital expenditure purposes in the form of prime rate loans in Canadian dollars and BAs; and

[b] up to $175,000,000 is available in the form of letters of credit to support the prudential requirements of LDC and TH Energy and general credit requirements of the Corporation and its subsidiaries.

The Revolving Credit Facility contains a negative pledge, customary covenants and events of default.

At December 31, 2009, $45,176,000 [December 31, 2008 - $45,078,000] had been utilized under the Revolving Credit Facility in the form of letters of credit primarily to support the prudential requirements of LDC with the Independent Electricity System Operator. At December 31, 2009, no amounts had been drawn for working capital purposes [December 31, 2008 - $nil].

The Corporation also has a bilateral demand line of credit for $20,000,000 with a Canadian chartered bank. The line of credit bears interest at the bank's prime rate. At December 31, 2009, no amounts had been drawn on the line of credit [December 31, 2008 - $nil].

13. CURRENT PORTION OF OTHER LIABILITIES

Current portion of other liabilities consists of the following:

	2009 **$**	**2008** **$**
Current portion of obligations under capital leases *[note 24]*	**218**	199
Customers' advance deposits	**17,002**	16,402
Other	**781**	781
	18,001	17,382

[all tabular amounts in thousands of dollars]

14. LONG-TERM DEBT

Long-term debt consists of the following:

	2009 $	2008 $
Senior unsecured debentures		
Series 1 - 6.11% due May 7, 2013	**223,406**	223,001
Series 2 - 5.15% due November 14, 2017	**248,653**	248,520
Series 3 - 4.49% due November 12, 2019	**248,416**	—
Promissory note payable to the City	**490,115**	735,173
	1,210,590	1,206,694
Less: Current portion of promissory note payable to the City	**—**	245,058
Long-term debt	**1,210,590**	961,636
Comprising:		
Debentures	**720,475**	471,521
Promissory note payable to the City	**490,115**	490,115

All long-term debt of the Corporation ranks equally.

a) Senior unsecured debentures

On May 7, 2003, the Corporation issued $225,000,000 10-year senior unsecured debentures [“Series 1”]. The Series 1 debentures bear interest at the rate of 6.11% per annum, payable semi-annually in arrears in equal instalments on May 7 and November 7 of each year. The Series 1 debentures mature on May 7, 2013.

On November 14, 2007, the Corporation issued $250,000,000 10-year senior unsecured debentures [“Series 2”]. The Series 2 debentures bear interest at the rate of 5.15% per annum, payable semi-annually in arrears in equal instalments on May 14 and November 14 of each year. The Series 2 debentures mature on November 14, 2017.

On November 12, 2009, the Corporation issued $250,000,000 10-year senior unsecured debentures [“Series 3”]. The Series 3 debentures bear interest at the rate of 4.49% per annum, payable semi-annually in arrears in equal instalments on May 12 and November 12 of each year. The Series 3 debentures mature on November 12, 2019.

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 but 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 have the benefit of certain covenants which, subject to certain exceptions, restrict the ability of the Corporation and LDC to create security interests, incur additional indebtedness not ranking *pari passu* or dispose of all or substantially all of their assets.

b) Promissory note payable to the City

On July 1, 1999, LDC issued a promissory note to the City ["Initial Note"] in the principal amount of $947,000,000 in partial consideration for the assets in respect of the electricity distribution system transferred by the Toronto Hydro-Electric Commission and the City to LDC effective July 1, 1999. The Initial Note was non-interest bearing until December 31, 1999 and interest bearing thereafter at the rate of 6% per annum. Pursuant to the Transfer By-law, the principal amount of the Initial Note was adjusted effective January 1, 2000 to $980,231,000 to reflect the deemed debt to equity structure of LDC permitted by the OEB. At the same time, the Initial Note was replaced by a promissory note ["Replacement Note"] issued by LDC, which was interest bearing at the rate of 6.8% per annum. At December 31, 2002, the Replacement Note was payable on the earlier of demand and December 31, 2003.

Concurrent with the closing of the Series 1 unsecured debentures on May 7, 2003, the City transferred the Replacement Note to the Corporation in consideration for the issuance by the Corporation to the City of a new promissory note in the principal amount of $980,231,000 [the "City Note"].

On September 5, 2006, the Corporation announced that it and the City had amended and restated the City Note effective May 1, 2006 by fixing the interest rate at 6.11% and establishing an agreed repayment schedule. The Corporation is required to pay the principal amount of the note as follows: $245,058,000 on the last business day before each of December 31, 2007, December 31, 2009, December 31, 2011 and on May 6, 2013. On December 31, 2007, the Corporation made the first scheduled payment of $245,058,000 to the City in accordance with the terms of the City Note. On December 31, 2009, the Corporation made the second scheduled payment of $245,058,000 to the City in accordance with the terms of the City Note. Accordingly, the remainder of the principal amount outstanding under the City Note is classified as a long-term liability. Interest is calculated and payable quarterly in arrears on the last business day of March, June, September and December of each year.

15. EMPLOYEE FUTURE BENEFITS

Pension

For the year ended December 31, 2009, the Corporation's OMERS current service pension costs were $11,348,000 [2008 - $11,116,000].

Employee future benefits other than pension

The Corporation has a number of unfunded benefit plans providing retirement and post-employment benefits (excluding pension) to most of 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 measures its accrued benefits obligation for accounting purposes as at December 31 of each year. The latest actuarial valuation was performed as at January 1, 2007.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2009

[a] Accrued benefit obligation

	2009 $	2008 $
Balance, beginning of year	**128,804**	165,661
Experience loss at beginning of year	**6,393**	—
Current service cost	**4,793**	3,613
Interest cost	**10,240**	9,155
Benefits paid	**(6,891)**	(5,055)
Actuarial (gains) losses	**33,805**	(44,276)
Sale of Toronto Hydro Telecom Inc [“Telecom “]	—	(294)
Balance, end of year	**177,144**	128,804

[b] Reconciliation of the accrued benefit obligation to the balance sheet accrued benefits liability

	2009 $	2008 $
Accrued benefit obligation	**177,144**	128,804
Unamortized net actuarial gains (losses)	**(12,654)**	28,073
Unamortized past service costs	**(3,142)**	(4,106)
Post-employment benefits liability	**161,348**	152,771

[c] Components for net periodic defined benefit costs

	2009 $	2008 $
Current service cost	**4,793**	3,613
Interest cost	**10,240**	9,155
Actuarial (gains) losses	**33,805**	(44,276)
Cost incurred (recovered) in the year	**48,838**	(31,508)
Differences between costs incurred and costs recognized in the year in respect of:		
Actuarial (gain) loss	**(34,334)**	44,318
Past service costs	**964**	964
	(33,370)	45,282
Defined benefit costs recognized	**15,468**	13,774
Capitalized as part of property, plant and equipment	**7,043**	6,093
Charged to operations	**8,425**	7,681

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

[d] Significant assumptions

	2009 %	2008 %
Accrued benefit obligation as of December 31:		
Discount rate	**6.0**	7.5
Rate of compensation increase	**4.0**	4.0
Benefit costs for years ended December 31:		
Discount rate	**7.5**	5.5
Rate of compensation increase	**4.0**	4.0
Assumed health care cost trend rates at December 31:		
Rate of increase in dental costs	**4.0**	4.0

For December 31, 2009, medical costs are assumed to increase at 7.5% [2008 - 8.5%] graded down by 0.5% [2008 - 0.5%] annual decrements to 5.0% [2008 - 5.0%] in 2016 and thereafter.

[e] Sensitivity analysis

Assumed health and dental care cost trend rates have a significant effect on the amounts reported for health and dental care plans. A one-percentage-point change in assumed health and dental care cost trend rates have the following effects for 2009:

	Increase $	Decrease $
Total of current service and interest cost (at 7.5%)	**1,938**	**(1,492)**
Accrued benefit obligation at December 31, 2009 (at 6.0%)	**28,160**	**(21,574)**

Assumed interest rates have a significant effect on the amounts reported for the total accrued benefit obligation and expense. A one-percentage-point change in assumed interest rates would have the following effects for 2009:

	Increase $	Decrease $
Accrued benefit obligation as at December 31, 2009	**(20,024)**	**28,547**
Estimated expense for fiscal 2010	**(314)**	**2,474**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2009

16. OTHER LIABILITIES

Other long-term liabilities consist of the following:

	2009 $	2008 $
Obligations under capital leases *[note 24]*	**447**	397
Other	**1,026**	1,833
	1,473	2,230

17. ASSET RETIREMENT OBLIGATIONS

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

	2009 $	2008 $
Balance, beginning of year	**6,528**	7,523
ARO liabilities settled in the year	**(87)**	(463)
Accretion expense	**291**	405
Revision in estimated cash flows	**820**	(937)
Balance, end of year	**7,552**	6,528

At December 31, 2009, the Corporation estimates the undiscounted amount of cash flows required over the next one to fifty years to settle the ARO is $9,274,000 [December 31, 2008 - $9,244,000]. Discount rates ranging from 1.39% to 6.60% were used to calculate the carrying value of the ARO liabilities. No assets have been legally restricted for settlement of the liability.

18. CAPITAL DISCLOSURES

The Corporation's main objectives when managing capital are to:

- ensure ongoing access to funding to maintain and improve the electricity distribution system of LDC, and to meet any capital needs of its other subsidiary companies should such needs arise;
- ensure compliance with covenants related to its credit facilities, senior unsecured debentures and the City Note;
- maintain an A- credit rating as required under its shareholder direction; and
- align its capital structure for regulated activities of LDC with the debt to equity structure deemed by the OEB.

As at December 31, 2009, the Corporation's definition of capital includes shareholder's equity and long-term debt which includes the current portion of the promissory note payable to the City, and has remained unchanged from December 31, 2008. As at December 31, 2009, shareholder's equity amounts to $998,254,000 [December 31, 2008 – $981,291,000] and long-term debt, including the current portion of the promissory note payable to the City, amounts to $1,210,590,000 [December 31, 2008 – $1,206,694,000]. The Corporation's capital structure as at December 31, 2009 is 55% debt and 45% equity [December 31, 2008 - 55% debt and 45% equity]. There have been no changes in the Corporation's approach to capital management during the year.

[all tabular amounts in thousands of dollars]

As at December 31, 2009, the Corporation is subject to debt agreements that contain various covenants. The Corporation's unsecured debentures and the City Note limit consolidated funded indebtedness to a maximum of 75% of total consolidated capitalization. As at December 31, 2009, consolidated funded indebtedness to consolidated capitalization was 55% [December 31, 2008 – 56%].

The Corporation's Revolving Credit Facility limits the debt to capitalization ratio to a maximum of 75%. As at December 31, 2009, the debt to capitalization ratio was 56% [December 31, 2008 – 56%].

The Corporation's long-term debt agreements also include negative covenants such as limitations on funded indebtedness, limitations on designated subsidiary indebtedness, restrictions on mergers and dispositions of designated subsidiaries, and amendments to the City Note. As at December 31, 2009 and as at December 31, 2008, the Corporation was in compliance with all covenants included in its long-term debt agreements, City Note and short-term Revolving Credit Facility.

19. FINANCIAL INSTRUMENTS

a) Recognition and measurement

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

	2009 $		2008 $	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Cash and cash equivalents	**211,370**	**211,370**	340,492	340,492
Accounts receivable, net of allowance for doubtful accounts	**150,281**	**150,281**	131,582	131,582
Unbilled revenue	**295,647**	**295,647**	266,061	266,061
Investments	**47,930**	**47,930**	52,908	52,908
Accounts payable and accrued liabilities	**316,768**	**316,768**	294,839	294,839
Customers' advance deposits	**51,698**	**51,698**	46,685	46,685
Senior unsecured debentures				
Series 1 – 6.11% due May 7, 2013	**223,406**	**247,967**	223,001	242,522
Series 2 – 5.15% due November 14, 2017	**248,653**	**265,874**	248,520	247,872
Series 3 – 4.49% due November 12, 2019	**248,416**	**249,581**	—	—
Promissory note payable to the City	**490,115**	**529,886**	735,173	770,224

The Corporation's fair value measurements of financial instruments within the fair value hierarchy, as at December 31, 2009 consists of $47,930,000 of investments in Level 3.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

The following table reconciles the Corporation's Level 3 fair value measurements, which includes its investments from January 1 to December 31, 2009:

Fair value measurements using Level 3 inputs	2009 $
Balance, beginning of year	**52,908**
Loss included in net income	**(1,049)**
Settlements[1]	**(3,929)**
Balance, end of year	**47,930**

[1] Settlements relate to share of accumulated cash received from the conduit trusts on the investments.

b) Risk Factors

The following is a discussion of 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. Risks related to the Corporation's investments are discussed in more detail in Investments *[note 8]*.

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

Credit risk

Financial instruments are exposed to credit risk as a result of the risk of the counter-party defaulting on its obligations. The Corporation monitors and limits its exposure to credit risk on a continuous basis. The Corporation provides reserves for credit risks based on the financial condition and short and long-term exposures to counter-parties.

The Corporation's credit risk associated with accounts receivable is primarily related to payments from LDC customers. LDC has approximately 690,000 customers, the majority of which are residential. LDC collects security deposits from customers in accordance with directions provided by the OEB. As at December 31, 2009, LDC held security deposits in the amount of $51,698,000 [December 31, 2008 - $46,685,000].

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

[all tabular amounts in thousands of dollars]

Credit risk associated with accounts receivable is as follows:

	2009 $	2008 $
Total accounts receivable	**162,861**	141,692
Less: Allowance for doubtful accounts	**(12,580)**	(10,110)
Total accounts receivable, net	**150,281**	131,582
Of which:		
Outstanding for not more than 30 days	**128,729**	104,869
Outstanding for more than 30 days but not more than 120 days	**20,796**	21,668
Outstanding for more than 120 days	**13,336**	15,155
Less: Allowance for doubtful accounts	**(12,580)**	(10,110)
Total accounts receivable, net	**150,281**	131,582

Unbilled revenue represents amounts to which the Corporation has a contractual right to receive cash through future billings but are unbilled at period-end. As at December 31, 2009, total unbilled revenue was $295,647,000 [December 31, 2008 - $266,061,000]. Unbilled revenue outstanding is considered current.

At December 31, 2009, there were no significant concentrations of credit risk with respect to any class of financial assets or counterparties with the exception of investments *[note 8]*. 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 in holding certain financial instruments. The Corporation's objective is to minimize net interest expense. 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 on-going basis.

Under the Corporation's Revolving Credit Facility *[note 12]*, the Corporation may obtain short-term borrowings for working capital purposes. These borrowings may expose the Corporation to fluctuations in short-term interest rates (borrowings in the form of prime rate loans in Canadian dollars and BAs and letters of credit). The fee payable for BAs and letters of credit is based on a margin determined by reference to the Corporation's credit rating.

Cash balances, which are not required to meet day-to-day obligations of the Corporation, are either held in account or invested in Canadian money market instruments, with terms of one day to 90 days, exposing the Corporation to fluctuations in short-term interest rates. These fluctuations could impact the level of interest income earned by the Corporation.

[all tabular amounts in thousands of dollars]

Liquidity risk

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 interest expense. 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:

December 31, 2009			
	Due within 1 year $	**Due between 1 year and 5 years $**	**Due after 5 years $**
Financial liabilities			
Accounts payable and accrued liabilities	**316,768**	**—**	**—**
Promissory note payable to the City	**—**	**490,115**	**—**
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**
	316,768	**715,115**	**500,000**

Hedging and Derivative risk

As at December 31, 2009, and as at December 31, 2008, the Corporation has not entered into hedging and derivative financial instruments.

Foreign exchange risk

As at December 31, 2009, the Corporation has limited exposure to the changing values of foreign currencies. While the Corporation purchases goods and services which are payable in U.S. dollars, and purchases U.S. currency to meet the related payables commitments when required, the impact of these transactions is not material to the consolidated financial statements.

20. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
[all tabular amounts in thousands of dollars]

December 31, 2009

21. PAYMENTS IN LIEU OF CORPORATE TAXES

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

Consolidated Statements of income

	2009 $	2008 $
Rate reconciliation		
Income before PILs	**62,555**	51,741
Consolidated Statutory Canadian federal and provincial income tax rate	**33.00%**	33.50%
Expected provision for PILs	**20,643**	17,333
Temporary differences not benefited	**(1,097)**	3,658
Valuation allowance	**1,105**	5,333
Decrease in future tax rates	**374**	—
Change in income tax positions	**(1,256)**	(28,503)
Other	**(27)**	7,924
Provision for PILs	**19,742**	5,745
Effective tax rate	**31.56%**	11.10%
Components of provision for PILs		
Current tax provision	**19,326**	3,881
Future income tax provision related to the origination and reversal of temporary differences	**416**	1,864
Provision for PILs	**19,742**	5,745

Consolidated Balance sheets

Significant components of the Corporation's future income tax assets and liabilities are as follows:

	2009 $	2008 $
Property, plant and equipment and intangible assets	**154,515**	9,910
Regulatory adjustments	**62,737**	—
Post-employment benefits liability	**40,337**	1,921
Other taxable temporary differences	**5,641**	6,886
Non-capital loss carryforwards	**479**	643
Valuation allowance	**(10,560)**	(16,665)
	253,149	2,695

[all tabular amounts in thousands of dollars]

Presented on the consolidated balance sheets as follows:

	2009 $	2008 $
Future income tax assets, long-term	**253,149**	2,809
Future income tax liabilities, long-term	—	(114)
	253,149	2,695

On January 1, 2009, LDC began to account for the differences between its financial statement carrying value and tax basis of assets and liabilities following the liability method in accordance with CICA Handbook Section 3465 *[note 4[b]]*. As at December 31, 2009, LDC has recorded a future income tax asset of $250,948,000 and a corresponding regulatory liability of $250,948,000.

As at December 31, 2009, the Corporation has accumulated tax losses for PILs purposes of approximately $1,916,000 [December 31, 2008 - $2,218,000], which are available to reduce taxable income in future years.

22. SHARE CAPITAL

Share capital consists of the following:

	2009 $	2008 $
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 provided that the Corporation's board of directors would use its best efforts to ensure that the Corporation met certain financial performance standards, including those relating to 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. The dividends are not cumulative and are payable as follows:

[a] $6,000,000 on the last day of each of the first three fiscal quarters in each year;

[b] $7,000,000 on the last day of the fiscal year; and

[c] 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 board of directors of the Corporation approves the Corporation's audited consolidated financial statements for the year.

During 2009, the board of directors of the Corporation declared and paid dividends totalling $25,170,000 [2008 – $116,416,000 to the City, including a $75,000,000 special dividend payment in relation to the sale of all the shares of Telecom in 2008].

23. 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.

For the year ended December 31, 2009, LDC provided electricity to the City in the amount of $109,678,000 [2008 - $107,093,000]. As at December 31, 2009, included in "unbilled revenue" is a balance amounting to $9,679,000 [December 31, 2008 - $9,090,000] receivable from the City related to the provision of electricity for the previous months.

For the year ended December 31, 2009, LDC provided relocation services related to the City in the amount of $886,000 [2008 - $991,000]. As at December 31, 2009, included in LDC's "Accounts receivable, net of allowance for doubtful accounts" is $1,183,000 [December 31, 2008 - $4,098,000] receivable from the City related to relocation services and other construction activities.

For the year ended December 31, 2009, TH Energy provided energy management services, street lighting services and consolidated billing services to the City amounting to $20,964,000 [2008 - $19,853,000]. As at December 31, 2009, included in TH Energy's "Accounts receivable, net of allowance for doubtful accounts" is $5,045,000 [December 31, 2008 - $4,884,000] receivable from the City related to these services.

For the year ended December 31, 2009, LDC purchased road cut and other services of $6,873,000 [2008 - $4,877,000] from the City. As at December 31, 2009, included in "Accounts payable and accrued liabilities" is $5,492,000 [December 31, 2008 - $4,514,000] payable to the City related to services received from the City.

For the year ended December 31, 2009, LDC and TH Energy paid property tax expenses to the City of $6,279,000 [2008 - $6,533,000].

On December 31, 2009, the Corporation made the second scheduled payment of $245,058,000 to the City in accordance with the terms of the City Note. As at December 31, 2009, the outstanding principal amount in respect of the City Note was $490,115,000 [December 31, 2008 - $735,173,000] *[note 14]*. For the year ended December 31, 2009, interest of $44,919,000 [2008 - $44,919,000], on the City Note was paid to the City.

[all tabular amounts in thousands of dollars]

24. LEASE COMMITMENTS

Operating lease obligations

As at December 31, 2009, the future minimum annual lease payments under property operating leases with remaining lease terms from one to five years and thereafter are as follows:

	$
2010	**4,506**
2011	**3,952**
2012	**983**
2013	**74**
2014	**80**
Thereafter	**1,574**
Total minimum lease payments	**11,169**

Capital lease obligations

As at December 31, 2009, the future minimum annual lease payments under capital leases with remaining lease terms from one to five years and thereafter are as follows:

	$
2010	**240**
2011	**217**
2012	**135**
2013	**87**
2014 and thereafter	**43**
Total amount of future minimum lease payments	**722**
Less interest	**57**
	665
Current portion *[note 13]*	**218**
Long-term portion *[note 16]*	**447**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

25. CONTINGENCIES

a) Legal Proceedings

Late Payment Charges Class Action

On April 22, 2004, in a decision in a class action commenced against The Consumers' Gas Company Limited [now Enbridge Gas Distribution Inc., hereinafter referred to as "Enbridge"], the Supreme Court of Canada [the "Supreme Court"] ruled that Enbridge was required to repay the portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. Although the claim related to charges collected by Enbridge after the enactment of section 347 of the *Criminal Code* in 1981, the Supreme Court limited recovery to charges collected after the action was initiated in 1994. The Supreme Court remitted the matter back to the Ontario Superior Court of Justice for a determination of the plaintiffs' damages. The parties reached a settlement of this class action. The Ontario Superior Court of Justice has approved this settlement.

On February 4, 2008, the OEB, in response to an application filed by Enbridge, ruled that all of Enbridge's costs related to settlement of the class action lawsuit, including legal costs, settlement costs and interest, are recoverable from ratepayers. The representative plaintiff in the class action lawsuit has made a petition to the Lieutenant Governor in Council ["Cabinet"] under subsection 34(1) of the *Ontario Energy Board Act, 1998*, Schedule B for an order that the matter be submitted back to the OEB for reconsideration. The Cabinet dismissed the petition.

LDC was not a party to the Enbridge class action. It is, however, subject to the two class actions described below in which the issues are analogous.

The first is an action commenced in April 1994 against a predecessor of LDC and other Ontario MEUs under the *Class Proceedings Act, 1992* (Ontario) seeking $500,000,000 in restitution for late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is at a preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and the classes have not been certified. After the release by the Supreme Court of its 2004 decision in the Enbridge case, the plaintiffs in this proposed class action indicated their intention to proceed with the litigation.

The second is an action commenced in November 1998 against a predecessor of LDC under the *Class Proceedings Act, 1992* (Ontario) seeking $64,000,000 in restitution for late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is also at a preliminary stage. Pleadings have closed and examinations for discovery have been conducted but, as in the first action, the classes have not been certified.

The claims made against LDC and the definitions of the plaintiff classes are identical in both actions. As a result, any damages payable by LDC in the first action would reduce the damages payable by LDC in the second action, and vice versa.

The determination of whether the late payment charges collected by LDC from its customers were in excess of the interest limit stipulated in section 347 of the *Criminal Code* is fact specific in each circumstance. Also, decisions of the OEB are fact specific in each circumstance and the decision of the OEB in respect of Enbridge's application for recovery of costs related to the settlement is not necessarily determinative of the outcome of any similar application which LDC may make to the OEB in the future.

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 has been filed, and a certification order issued. Affidavits of Documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

Another action was commenced against LDC in February 2009 in the Ontario Superior Court of Justice seeking damages in the amount of $20,000,000 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 has been filed, and a certification order issued. Affidavits of Documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

By order of the court, these two actions, together with a third smaller non-class action commenced in April 2009 involving the same incident, will be tried at the same time or consecutively. Consequently, documentary discovery and examinations for discovery will be joined for all three actions.

3650 Kingston Road

An action was commenced against LDC in March 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 and explosion in the electrical room at 3650 Kingston Road on March 19, 2009. This action is at a preliminary stage. A statement of claim has been served on LDC but a statement of defence has not been filed. The proceedings of other parties to the action have revealed that the damages are likely to have been caused by a party other than LDC and LDC is making a motion to have LDC dismissed from the action. While it is not possible at this time to state conclusively, it is unlikely that LDC will be found liable for damages. If damages were awarded against LDC, LDC would make a claim under its liability insurance which LDC believes would cover such damages. Accordingly, this action is not likely to have a material effect on the financial performance of the Corporation.

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. This action is at a preliminary stage. A third party claim has been served on LDC but a statement of defence to the third party claim has not been filed. Accordingly, given the preliminary status of this action, it is not possible at this time to reasonably quantify the effect, if any, of this action on the financial performance of the

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

Another third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice seeking damages in the amount of $30,000,000 as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. This action is at a preliminary stage. A third party claim has been served on LDC and a statement of defence to the third party claim has not been filed. Accordingly, given the preliminary status of this action, it is not possible at this time 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

In 2009, the OEB commenced its review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for all MEUs. The current proceeding is expected to provide direction regarding the interpretation of the rules issued by the OEB. The outcome of this proceeding could have a material impact on the financial position of the Corporation.

c) Payments in Lieu of Additional Municipal and School Taxes

The Ministry of Revenue has issued assessments in respect of payments in lieu of additional municipal and school taxes under s.92 of the *Electricity Act, 1998* that are in excess of the amounts LDC believes are payable. The dispute arose as a result of inaccurate information incorporated into Ontario Regulation 224/00, correction of which has been requested by LDC.

The balance assessed by the Ministry of Revenue above the balance accrued by the Corporation amounts to $8,660,000 as at December 31, 2009. The Corporation has been proactive with the Ministry of Revenue and the Ministry of Finance to resolve this issue. However, there can be no assurance that the Corporation will not have to pay the full assessed balance in the future.

26. NET INCOME PER SHARE

The weighted daily average number of shares outstanding was 1,000 as at December 31, 2009 and 2008, for the purpose of determining basic and fully diluted net income per share from continuing and discontinued operations. Basic and fully diluted net income per share from continuing and discontinued operations were determined by dividing the net income for the year by the weighted daily average number of shares outstanding.

27. DISCONTINUED OPERATIONS

On July 31, 2008, the Corporation sold all the shares of Telecom to Cogeco Cable Canada Inc. for cash consideration of $200,000,000. In connection with this transaction, the Corporation recorded a net gain of $118,673,000 in the third quarter of 2008, and recorded an unfavourable post-closing adjustment of $1,905,000 for the year ended December 31, 2009. The results of operations and financial position of Telecom have been segregated and presented as discontinued operations in the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

On April 30, 2009, EBT Express, an equal partnership between the Corporation's wholly owned subsidiary 1455948 Ontario Inc. and OPG EBT Holdco Inc., sold its interest in The SPi Group ["SPi"] to ERTH Corporation for cash consideration of approximately $5,200,000 subject to post-closing adjustments and transaction costs. The Corporation's share of the sale proceeds from this transaction as it relates to 1455948 Ontario Inc. was approximately $2,600,000. In connection with this transaction and other activities related to this business, the Corporation recorded a net gain of $1,220,000 in the second quarter of 2009. The results of operations and financial position of SPi have been segregated and presented as discontinued operations in the consolidated financial statements.

Current assets from discontinued operations relate to SPi and amount to $514,000 as at December 31, 2009 [December 31, 2008 - $nil]. Current liabilities from discontinued operations relate to Telecom and amounts to $1,549,000, as at December 31, 2009 [December 31, 2008 - $890,000].

For the years ended December 31, 2009 and December 31, 2008, the following revenues and expenses of SPi and Telecom have been reclassified from continuing operations to discontinued operations:

	2009 $	2008 $
Revenues	**850**	2,606
Costs		
Operating expenses	**971**	2,043
Depreciation and amortization	**101**	188
Other	**(2)**	(22)
	(220)	397
Provision for (recovery of) PILs	**13**	(48)
Minority interest	**(78)**	148
Income (loss) from discontinued operations - SPi	**(155)**	297
Income (loss) from discontinued operations - Telecom	**(1,905)**	4,046
Gain on sale of SPi – net of tax	**1,380**	—
Gain on sale of Telecom – net of tax	**—**	118,673
Income (loss) from discontinued operations - net of tax	**(680)**	123,016

28. SEGMENT REPORTING

The designation of the segments has been based on a combination of the regulatory status and the nature of products and services provided. The Corporation has two reportable segments:

[a] Electricity Distribution
The regulated business which consists of the electricity distribution business and conservation activities including OPA contracts of LDC; and

[b] Non-regulated
The non-regulated business of TH Energy consists primarily of the delivery of street lighting and expressway lighting services and energy efficiency products and services.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

Segment information is as follows:

	2009 $	2008 $
Electricity distribution		
Revenues	**2,438,907**	2,349,547
Purchased power and other	**1,946,812**	1,869,557
Operating expenses	**195,460**	182,363
Depreciation and amortization	**155,468**	149,019
Income before interest and provision for PILs	**141,167**	148,608
Interest income	**1,257**	8,897
Interest expense	**70,181**	72,402
Provision for PILs	**21,242**	8,969
Income from continuing operations	**51,001**	76,134
Non-regulated		
Revenues	**22,827**	32,135
Purchased power and other	**6,845**	14,761
Operating expenses	**15,492**	21,154
Depreciation and amortization	**7,502**	7,140
Loss before interest, change in fair value of investments and recovery of PILs	**(7,012)**	(10,920)
Interest income	**1,950**	3,431
Interest expense	**3,577**	2,352
Change in fair value of investments	**(1,049)**	(22,033)
Recovery of PILs	**(1,500)**	(3,224)
Loss from continuing operations	**(8,188)**	(28,650)
Intersegment eliminations		
Revenues	**(63)**	(1,598)
Purchased power and other	—	(22)
Operating expenses	**(63)**	(88)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2009

	2009 $	2008 $
Total		
Revenues	**2,461,671**	2,380,084
Purchased power and other	**1,953,657**	1,884,296
Operating expenses	**210,889**	203,429
Depreciation and amortization	**162,970**	156,159
Income before interest, change in fair value of investments and provision for PILs	**134,155**	136,200
Interest income	**3,207**	12,328
Interest expense	**73,758**	74,754
Change in fair value of investments	**(1,049)**	(22,033)
Provision for PILs	**19,742**	5,745
Income from continuing operations	**42,813**	45,996

	2009 $	2008 $
Expenditures on property, plant and equipment and intangible assets		
Electricity distribution	**241,686**	205,712
Non-regulated	**7,619**	8,869
Total	**249,305**	214,581

	2009 $	2008 $
Assets		
Electricity distribution	**2,819,230**	2,506,141
Non-regulated	**268,781**	300,071
Intersegment eliminations	**(29,298)**	(26,400)
Discontinued operations	**514**	—
Total	**3,059,227**	2,779,812

All revenues, costs and assets, as the case may be, are earned, incurred or held in Canada.

29. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2009 consolidated financial statements.

30. SUBSEQUENT EVENTS

a) Late Payment Charges Class Action

On January 15, 2010, a conditional settlement was reached for both actions pursuant to which the defendants would pay the amount of $17,000,000 plus costs and taxes in settlement of all claims. The amount paid by each MEU will be its proportionate share of the settlement amount based on its percentage of distribution service revenue over the period for which it has exposure for repayment of late payment penalties exceeding the interest rate limit in the *Criminal Code*. While the amounts have not yet been determined, it is anticipated that LDC's share of the settlement amount will be in the range of $7,500,000 to $9,500,000. The settlement is conditional upon a sufficient number of MEUs participating so as to collect the full amount of the settlement funds payable to the plaintiffs. It is also conditional upon court approval. All the MEUs involved in the settlement, including LDC, will request an order from the OEB allowing for the future recovery from customers of all costs related to the proposed settlement. LDC has not accrued any liabilities in relation to this proposed settlement. There is no guarantee that the OEB will allow for total or partial recovery of such costs in the future. The outcome of the OEB decision in this regard could have an adverse material impact on the consolidated results of operations and financial position of the Corporation in the future.

b) 2010 Electricity Distribution Rates

On February 4, 2010, the OEB tentatively accepted a settlement proposal agreed to by LDC and various intervening parties. The settlement proposal captured a majority of issues, and provides for a 2010 capital budget of $350,000,000 with a variance account to capture up to an additional $27,800,000 of capital expenditures and operations, maintenance and administration expenditures of $204,100,000. The settlement proposal did not settle issues relating to cost of capital (including applicability of new ROE guidelines to LDC), suite metering, and distributed generation, which are subject to a decision by the OEB in the first quarter of 2010. The final disposition of these matters could have a material impact on the final settlement.

c) Street Lighting Activities

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

On February 11, 2010, the OEB issued its decision in regards to these applications. In its decision, the OEB agreed, that under certain conditions, the treatment of certain types of street lighting assets as regulated assets is justified. The OEB ordered the Corporation to provide a detailed valuation of the street lighting assets and to perform an operational review to determine which assets could become regulated assets. The Corporation is currently evaluating the impact of this decision on its regulated and unregulated businesses and whether to transfer the street lighting assets to LDC.

d) Dividends

On March 5, 2010, the board of directors of the Corporation declared dividends in the amount of $6,000,000 with respect to the first quarter of 2010, payable to the City on March 31, 2010.

ANNEX C
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

TORONTO HYDRO CORPORATION

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE YEAR ENDED
DECEMBER 31, 2009**

The following discussion and analysis should be read in conjunction with the audited consolidated financial statements and accompanying notes of Toronto Hydro Corporation (the "Corporation") as at and for the year ended December 31, 2009 (the "Consolidated Financial Statements"). The Consolidated Financial Statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), including accounting principles prescribed by the Ontario Energy Board (the "OEB"), and are presented in Canadian dollars.

Business of Toronto Hydro

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

- *Toronto Hydro-Electric System Limited* ("LDC") - which distributes electricity and engages in Conservation and Demand Management ("CDM") activities; and

- *Toronto Hydro Energy Services Inc.* ("TH Energy") - which provides street lighting services.

The principal business of the Corporation and its subsidiaries is the distribution of electricity by LDC. LDC owns and operates an electricity distribution system, which delivers electricity to approximately 690,000 customers located in the City of Toronto (the "City"). LDC is the largest municipal electricity distribution company in Canada and distributes approximately 18% of the electricity consumed in Ontario. The business of LDC is regulated by the OEB which has broad powers relating to licensing, standards of conduct and service and the regulation of rates charged by LDC and other electricity distributors in Ontario.

The sole shareholder of the Corporation is the City.

Electricity Distribution – Industry Overview

In April 1999, the government of Ontario initiated a restructuring of Ontario's electricity industry. The restructuring was intended, among other things, to facilitate competition in the generation and sale of electricity, to protect the interests of consumers with respect to prices and the reliability and quality of electricity service and to promote economic efficiency in the generation, transmission and distribution of electricity.

On May 1, 2002, the Province opened Ontario's wholesale and retail markets to competition by providing generators, retailers and consumers with open access to Ontario's transmission and distribution network ("Open Access").

Since the commencement of Open Access, 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 OEB.

The OEB has regulatory oversight of electricity matters in the Province of Ontario. The *Ontario Energy Board Act, 1998* sets out the OEB's authority to issue a distribution licence which must be obtained by owners or operators of a 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 fulfil obligations to connect and service customers.

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

- *Distribution Rate* – The distribution rate is designed to recover the costs incurred by LDC in delivering electricity to customers and the OEB-allowed rate of return. Distribution rates are regulated by the OEB and typically comprise a fixed charge and a usage-based (consumption) charge.

  The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control (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).

- *Electricity Price and Related Regulated Adjustments* – The electricity price and related regulated adjustments represent a pass through of the commodity cost of electricity.

- *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.

- *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.

The Corporation and its subsidiaries are exempt from tax under the *Income Tax Act* (Canada), the *Corporations Tax Act* (Ontario) and the *Taxation Act, 2007* (Ontario), if not less than 90% of the capital of the Corporation is owned by the City and not more than 10% of the income of the Corporation and each of its subsidiaries is derived from activities carried on outside the municipal geographical boundaries of the City.

The Corporation and each of its subsidiaries is a Municipal Electricity Utility ("MEU") for purposes of the Payment In Lieu of Corporate Taxes ("PILs") regime contained in the *Electricity Act, 1998*. The *Electricity Act, 1998* provides that a MEU that is exempt from tax under the *Income Tax Act* (Canada), the *Corporations Tax Act* (Ontario) and the *Taxation Act, 2007* (Ontario) is required to make, for each taxation year, a PILs to the Ontario Electricity Financial Corporation in an amount equal to the tax that it would be liable to pay under 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) if it were not exempt from tax.

On May 14, 2009, the *Green Energy and Green Economy Act, 2009* (Ontario) (the "Green Energy Act") received Royal Assent from the Province of Ontario. The Green Energy Act, among other things, permits electricity distribution companies to own renewable energy generation facilities; obligates electricity distribution companies to provide priority connection access for renewable energy generation facilities; empowers the OEB to set CDM targets for electricity distribution companies as a condition of license; and requires electricity distribution companies to accommodate the development and implementation of a smart grid in relation to their systems. The legislation was largely enabling and provided that much of the implementation detail would be defined in subsequent regulations. The Corporation expects that the full implementation of the Act will affect the manner and framework under which many of its business operations are currently conducted.

Selected Consolidated Financial Data

The selected consolidated financial data presented below should be read in conjunction with the Consolidated Financial Statements.

Years ended December 31, (in thousands of dollars except for per share amounts)	2009 $	2008 $	Change $	Change %	2007 $
Revenues	2,461,671	2,380,084	81,587	3.4	2,351,486
Costs					
Purchased power and other	1,953,657	1,884,296	69,361	3.7	1,853,874
Operating expenses	210,889	203,429	7,460	3.7	190,404
Depreciation and amortization	162,970	156,159	6,811	4.4	143,983
	2,327,516	2,243,884	83,632	3.7	2,188,261
Income before interest, change in fair value of investments, other and provision for PILs	134,155	136,200	(2,045)	(1.5)	163,225
Interest income	3,207	12,328	(9,121)	(74.0)	13,949
Interest expense					
Long-term debt	(73,061)	(71,542)	(1,519)	(2.1)	(75,312)
Other interest	(697)	(3,212)	2,515	(78.3)	1,403
Change in fair value of investments	(1,049)	(22,033)	20,984	95.2	(13,059)
Other	-	-	-	-	1,674
Income before provision for PILs	62,555	51,741	10,814	20.9	91,880
Provision for PILs	19,742	5,745	13,997	243.6	37,802
Income from continuing operations	42,813	45,996	(3,183)	(6.9)	54,078
Income (loss) from discontinued operations – net of tax[(1)]	(680)	123,016	(123,696)	(100.6)	28,753
Net income	42,133	169,012	(126,879)	(75.1)	82,831
Basic and fully diluted net income per share from continuing operations	42,813	45,996	(3,183)	(6.9)	54,078
Basic and fully diluted net income (loss) per share from discontinued operations	(680)	123,016	(123,696)	(100.6)	28,753
Basic and fully diluted net income per share	42,133	169,012	(126,879)	(75.1)	82,831

Notes:

(1) Consists of discontinued operations for Toronto Hydro Telecom Inc. (“Telecom”) and The SPi Group (“SPi”). See note 27 to the Consolidated Financial Statements.

As at December 31, (in thousands of dollars)	2009 $	2008 $
Consolidated Balance Sheet Data		
Total assets	3,059,227	2,779,812
Current liabilities[(1)]	336,739	561,443
Long-term liabilities	1,724,234	1,237,078
Total liabilities	2,060,973	1,798,521
Shareholder’s equity	998,254	981,291
Total liabilities and shareholder’s equity	3,059,227	2,779,812

Note:

(1) Amounts include current liabilities from discontinued operations regarding Telecom and SPi. See note 27 to the Consolidated Financial Statements.

Results of Operations – 2009 compared to 2008

Net Income

Net income was $42.1 million in 2009 compared to $169.0 million in 2008. The decrease in net income was primarily due to lower income from discontinued operations in 2009 relating to the sale of Telecom in 2008 (see “Discontinued Operations” below) ($123.7 million), higher provision for PILs in 2009 ($14.0 million), higher net interest expense ($8.2 million), higher operating expenses ($7.5 million), and higher depreciation expense ($6.8 million). These unfavourable variances were partially offset by a lower reduction in the fair value of investments in 2009 compared to 2008 due to changes in market conditions ($21.0 million) and higher net revenues ($12.2 million).

Net Revenues

Net revenues (revenues minus the cost of purchased power and other) were $508.0 million in 2009 compared to $495.8 million in 2008. The increase was primarily due to increased net revenues at LDC ($12.1 million).

At LDC, the increase in net revenues was primarily due to increased distribution revenue. The increase in distribution revenue was mainly related to higher distribution rates for 2009 ($20.3 million). The increase in distribution rates was approved by the OEB in 2008 and provides for increases in maintenance program expenditures and capital expenditures of LDC. This favourable variance was partially offset by lower consumption in 2009 (25,223 GWh in 2009 compared to 26,037 GWh in 2008) ($6.8 million), mainly due to a higher impact from the general slow down in the economy in 2009 and mild weather conditions for 2009.

Expenses

Operating expenses were $210.9 million in 2009 compared to $203.4 million in 2008. The increase in operating expenses was primarily due to higher payroll costs at LDC mainly from the hiring of new apprentices in the electrical trades and annual general wage increases ($7.0 million) and unexpected emergency operating expenditures incurred by LDC to ensure the safety of its electricity distribution infrastructure. During the month of February 2009, LDC suspended all non-emergency maintenance and capital programs and mobilized its workforce to inspect the connections of its infrastructure to the street lights and other unmetered assets. The overall operating costs related to this initiative were approximately $14.4 million and were comprised primarily of internal labour costs and external scanning and remediation costs. Of this amount, $9.1 million has been approved for future recovery by the OEB and transferred from operating expenses to regulatory assets following the decision rendered on December 10, 2009 (see “Corporate Developments – Contact Voltage” below). Accordingly, in connection with this issue, the Corporation incurred $5.3 million of unexpected operating expenditures in 2009. These unfavourable variances were partially offset by lower costs at TH Energy related to decreased activities in energy management services ($3.8 million).

Depreciation and amortization expense was $163.0 million in 2009 compared to $156.2 million in 2008. The increase in depreciation and amortization expense was primarily due to increased investments in the electricity distribution assets of LDC. Since 2007, LDC has significantly increased its capital expenditures through its strategy of modernizing the electricity infrastructure. This strategy was presented to the OEB in 2008 and related incremental funding was approved in distribution rates for 2008 and 2009.

Net Interest Expense

Net interest expense was $70.6 million in 2009 compared to $62.4 million in 2008. The increase in net interest expense was primarily due to lower interest income.

Change in Fair Value of Investments

Change in fair value of investments was $1.0 million in 2009 compared to $22.0 million in 2008. The decrease in the change in fair value of investments was primarily due to deteriorating market conditions in 2008 reflected in the mark-to-model valuation performed on the Asset Backed Commercial Paper (“ABCP”) notes. In each valuation, the Corporation considered the impact of its share of cash in the conduit trusts and the changes in prevailing market conditions impacting the value of the investments including the impact of the credit rating downgrade of the Class A-2 notes in August 2009 (see “Investments” below).

Provision for PILs

Provision for PILs was $19.7 million in 2009 compared to $5.7 million in 2008. The increase in the provision for PILs was primarily due to the favourable impact in 2008 of the settlement of the Ministry of Revenue PILs audits for 2001 and 2002 and higher earnings before tax in 2009, partially offset by lower temporary and permanent differences in LDC in 2009.

Discontinued Operations

Loss from discontinued operations, net of tax, was $0.7 million in 2009 compared to income from discontinued operations, net of tax, of $123.0 million in 2008. The decrease in income from discontinued operations, net of tax, was primarily due to the sale of Telecom in 2008.

On July 31, 2008, the Corporation sold all of the shares of Telecom to Cogeco Cable Canada Inc. for cash consideration of $200.0 million. In connection with this transaction, the Corporation recorded a net gain of $118.7 million in the third quarter of 2008, and recorded an unfavourable post-closing adjustment of $1.9 million for the year ended December 31, 2009. The results of operations and financial position of Telecom have been segregated and presented as discontinued operations in the Consolidated Financial Statements.

On April 30, 2009, EBT Express, an equal partnership between the Corporation’s wholly owned subsidiary 1455948 Ontario Inc. and OPG EBT Holdco Inc., sold its interest in SPi to ERTH Corporation for cash consideration of approximately $5.2 million subject to post-closing adjustments and transaction costs. The Corporation’s share of the sale proceeds from this transaction as it relates to 1455948 Ontario Inc. was approximately $2.6 million. In connection with this transaction and other activities related to this business, the Corporation recorded a net gain of $1.2 million in the second quarter of 2009. The results of operations and financial position of SPi have been segregated and presented as discontinued operations in the Consolidated Financial Statements.

See note 27 to the Consolidated Financial Statements.

Results of Operations – 2008 compared to 2007

Net income was $169.0 million in 2008 compared to $82.8 million in 2007. The increase in net income was primarily due to higher contribution from discontinued operations in 2008 ($94.3 million) related to the sale of Telecom (see "Discontinued Operations" above) and a favourable variance in provision for PILs mainly from the settlement of disputes with the Ministry of Revenue ($32.1 million). These favourable variances were partially offset by higher operating expenses ($13.0 million), higher depreciation expense ($12.2 million), higher impairment on investments recorded in 2008 ($9.0 million), higher net interest expense ($2.4 million), and lower gains on disposition of property, plant and equipment ($1.7 million). For further details, see the Corporation's 2008 Management's Discussion and Analysis as filed on the System for Electronic Document Analysis and Retrieval ("SEDAR") website at www.sedar.com.

Summary of Quarterly Results

The tables below present unaudited quarterly consolidated financial information of the Corporation for 2009 and 2008 and reflect discontinued operations. See note 27 to the Consolidated Financial Statements.

2009 quarter ended,
(in thousands of dollars)

	December 31 $	September 30 $	June 30 $	March 31 $
Revenues	634,041	639,692	575,771	612,167
Costs	597,108	602,167	541,051	587,190
Income from continuing operations	9,398	11,826	14,621	6,968
Net income..	8,941	11,831	14,375	6,986

2008 quarter ended,
(in thousands of dollars)

	December 31 $	September 30 $	June 30 $	March 31 $
Revenues	586,608	633,236	568,354	591,886
Costs	555,502	588,766	533,758	565,858
Income from continuing operations	4,688	11,029	9,654	20,625
Net income..	4,820	126,623	15,077	22,492

Liquidity and Capital Resources

Sources of Liquidity and Capital Resources

The Corporation's primary sources of liquidity and capital resources are cash provided by operating activities, bank financing, interest income and borrowings from debt capital markets. The Corporation's liquidity and capital resource requirements are mainly for capital expenditures to maintain and improve the electricity distribution system of LDC, purchased power expense, interest expense and prudential requirements.

The Corporation does not believe that equity contributions from the City, its sole shareholder, will constitute a source of capital. In addition, the Corporation is not aware of any plans or decisions by the City to permit the Corporation to sell equity to the public or to other investors.

Liquidity and Capital Resources
Year Ended December 31,
(in thousands of dollars)

	2009 $	2008 $
Cash and cash equivalents, beginning of year	340,492	216,002
Net cash provided by operating activities	192,451	266,466
Net cash used in investing activities	(304,119)	(197,864)
Net cash used in financing activities	(16,816)	(112,722)
Net cash provided by (used in) discontinued operations [1]	(638)	168,610
Cash and cash equivalents, end of year	211,370	340,492

Note:

(1) Consists of discontinued operations for Telecom and SPi. See note 27 to the Consolidated Financial Statements.

Net Cash Provided by Operating Activities

Net cash provided by operating activities was $192.5 million in 2009 compared to $266.5 million in 2008. The decrease in net cash provided by operating activities was primarily due to a variance in the aggregate of accounts receivable and unbilled revenue due to higher energy prices at the end of 2009 and the timing of billing and collection activities at LDC and TH Energy ($79.7 million), a non-cash variance in the fair value of investments ($21.0 million), and lower income from continuing operations ($3.2 million). The decrease was partially offset by timing variances and higher energy prices in electricity payables at LDC ($15.1 million), a variance in PILs receivable ($9.9 million), and increased depreciation and amortization ($6.8 million).

Net Cash Used in Investing Activities

Net cash used in investing activities was $304.1 million in 2009 compared to $197.9 million in 2008. The increase in net cash used in investing activities was primarily due to a reduction of regulatory liabilities ($41.1 million) primarily related to the payment to customers of prior periods' retail settlement variance account balances arising from the variances in transmission and other market administration charges regulated by the OEB, an increase in regulatory assets ($34.3 million) mainly from the deployment of smart meters, and an increase in capital expenditures ($34.7 million). These variances were partially offset by the accumulated cash in conduits trusts received by the Corporation in 2009 ($3.9 million) (see "Liquidity and Capital Resources – Investments" below).

The increase in capital expenditures at LDC for 2009 amounted to $36.0 million and was primarily due to the increased investment in electricity distribution assets in connection with LDCs infrastructure renewal program approved by the OEB in 2008, higher technology asset purchases related to system upgrades, and higher fleet purchases including the purchase of new energy efficient vehicles.

The following table summarizes the Corporation's capital expenditures for the years indicated.

Year Ended December 31, (in thousands of dollars)	2009 $	2008 $
Capital Expenditures from Continuing Operations		
LDC		
Distribution system	183,479	160,256
Technology assets	38,159	30,316
Other [(1)]	20,048	15,140
	241,686	205,712
TH Energy	7,619	8,869
Total capital expenditures	249,305	214,581

Notes:

(1) Consists of leasehold improvements, vehicles, other work-related equipment, furniture and office equipment.

Net Cash Used In Financing Activities

Net cash used in financing activities was $16.8 million in 2009 compared to $112.7 million in 2008. The decrease in net cash used in financing activities was primarily due to decreased dividends paid to the City of Toronto in 2009 compared to 2008 and higher reimbursement of customer deposits in 2009 in compliance with OEB rules and regulations.

Revolving Credit Facility

The Corporation is a party to a revolving credit facility pursuant to which the Corporation may borrow up to $500.0 million, of which up to $175.0 million is available in the form of letters of credit. As at December 31, 2009, no borrowings for working capital were outstanding and letters of credit in the amount of $45.2 million had been issued primarily to support the prudential requirements of LDC with the IESO. (See note 12 to the Consolidated Financial Statements).

Prudential Requirements and Third Party Credit Support

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 $500.0 million.

Investments

The Corporation held $88.0 million of third-party ABCP notes impacted by the liquidity crisis that arose in the Canadian market in August 2007. At the time the Corporation purchased each of these notes, they were rated R1(High) by DBRS Limited ("DBRS"), the highest credit rating issued for commercial paper. Following the liquidity crisis, a group representing banks, asset providers and major investors (the "Montreal Committee") was formed to oversee the restructuring of the impacted ABCP notes.

On January 12, 2009, the Ontario Superior Court approved the restructuring plan proposed by the Montreal Committee and supported by the noteholders of the Canadian third-party ABCP market. On January 21, 2009, the amended restructuring plan was completed and the Corporation received its replacement notes. The replacement notes received have an aggregate principal amount of $87.7 million. The distribution by class is listed below:

Master Asset Vehicle II	Amount Received	Percent of Total
Class A-1	$36.9 million	42.1%
Class A-2	$34.5 million	39.3%
Class B	$6.3 million	7.2%
Class C	$2.4 million	2.7%
Ineligible Asset Tracking notes	$7.6 million	8.7%

Of the $87.7 million, $80.1 million includes a combination of leveraged collateralized debt, synthetic assets and traditional securitized assets which is represented by senior Class A-1 and Class A-2 and subordinated Class B and Class C long-term restructured notes, and $7.6 million is represented by assets that have an exposure to U.S. mortgages and sub-prime mortgages, which has been replaced by Ineligible Asset Tracking ("IAT") notes.

At the time of issuance, DBRS assigned an "A" credit rating to the Class A-1 and A-2 notes; the Class B, C and IAT notes were unrated. On August 11, 2009, DBRS downgraded the rating of the Class A-2 notes from A to BBB (low).

According to the Eighteenth and Nineteenth Reports of the Monitor, the "legal final maturity" of the restructured notes is July 15, 2056. However, the expected repayment date for the restructured Class A-1 and Class A-2 notes is January 22, 2017. Based on the information contained in the above-mentioned reports, there is no obligation to pay interest on the notes before 2019 and no legal requirement to pay principal until 2056.

As part of the implementation of the restructuring plan, the Corporation re-measured its investments in ABCP notes prior to the exchange. This valuation considered new information available at that date and reflected current market conditions. As a result of this valuation, the Corporation increased the fair value of its investment in ABCP notes from $52.9 million at December 31, 2008 to $56.5 million at January 20, 2009. The increase in fair value reflected the expected payment to the Corporation of its share of cash accumulated in the conduit trusts from August 2007 to January 2009. The increase in fair value was recorded as income in the first quarter of 2009, under change in fair value of investments.

On January 23, 2009, the Corporation received $2.7 million representing the first instalment of its share of the accumulated cash in the conduit trusts up to August 31, 2008. On May 15, 2009, the Corporation received a further $1.2 million representing the second instalment of its share of accumulated cash in the conduit trusts from September 2008 through January 20, 2009. These balances reduced the value of the investments.

Following the receipt of the new notes, the Corporation changed the classification of these investments from "Investments Held-To-Maturity" to "Investments Held-For-Trading". This change was mainly related to the underlying nature of the new notes and follows the guidance issued by the Accounting Standards Board of Canada ("AcSB") on February 2, 2009. The new notes are measured at fair value at each period end with changes in fair value included in the consolidated statements of income in the period in which they arise.

In the fourth quarter of 2009, the Corporation noticed evidence of the development of a market for these notes. However as at December 31, 2009, this market had not developed to a state that warranted a mark-to-market valuation process. Accordingly, the Corporation continued to use a mark-to-model valuation technique that incorporated available information and market data. The valuation technique used by the Corporation to estimate the fair value of its investments in the restructured notes as at December 31, 2009, incorporated a discounted cash flow model considering the best available public information regarding market conditions, including the ratings assigned by DBRS regarding the Class A-1 and Class A-2 notes, and other factors that a market participant would consider to evaluate such investments. The Corporation may change its valuation methodology to a mark-to-market valuation in the future as a more robust market for these notes develops.

A weighted average interest rate of 1.28% was used to determine the expected interest income on the restructured notes, except for the IAT notes, for which a weighted average interest rate of 1.98% was used. These rates were based on a forecast of 90-day Bankers' Acceptance ("BA") rates less 50 basis points from 2010 through 2017, except for the IAT notes for which a discount rate based on forecast 90-day BA rate plus 20 basis points was used. To derive a net present value of the principal and future cash flows, the restructured notes were discounted using an interest rate spread over forecast BA rates ranging from 340 basis points to 1,600 basis points over a seven-year period. On a weighted average basis, the interest rates used to discount the notes ranged from 4.27% to 16.87%.

The discount rates vary by each of the different replacement long-term notes issued as each is expected to have a different risk profile. The discount rates used to value the notes include a risk premium factor that incorporates current indicative credit default swap spreads, an estimated liquidity premium, and a premium for credit losses.

Based on the assumptions described above, the discounted cash flows resulted in an estimated fair value of the Corporation's investment in the restructured notes of $47.9 million as at December 31, 2009 as compared to $56.5 million as at January 20, 2009. The variance was mainly related to the cash received in connection with the Corporation's share of cash accumulated in the conduit trust and the change in interest rates due to changing market conditions including the impact of the credit rating downgrade of the Class A-2 notes in August 2009.

A sensitivity analysis was also conducted to examine the impact of an increase or a decrease in the overall weighted average discount rate. Based on the Corporation's mark-to-model valuation, a variation of 1% (100 basis points) would reduce or increase the estimated fair value of the restructured notes by approximately $3.7 million.

The estimation by the Corporation of the fair value of the restructured notes, as at December 31, 2009 is subject to significant risks and uncertainties, including the timing and amount of future cash flows, market liquidity and the quality of the underlying assets and financial instruments. Accordingly, there can be no assurance that the Corporation's assessment of the estimated fair value of the restructured notes will not change materially in subsequent periods.

The on-going liquidity crisis regarding the investments described above has had no significant impact on the Corporation's operations. The Corporation has sufficient cash to fund all of its ongoing liquidity and capital expenditure requirements and is in compliance with the financial covenants under the terms of its outstanding indebtedness.

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 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 million or 50% of the Corporation's consolidated net income for the year. The dividends are not cumulative and are payable as follows:

- $6 million on the last business day of each of the first three fiscal quarters during the year;
- $7 million on the last business day of the fiscal year; and

- the amount, if any, by which 50% of the Corporation's net income for the year exceeds $25 million, within ten calendar days after the board of directors of the Corporation approved the Corporation's Consolidated Financial Statements for the year.

The board of directors of the Corporation declared and paid dividends totalling $25.2 million in 2009 and $116.4 million in 2008 to the City. The 2008 dividend payments included a special dividend of $75.0 million paid on December 31, 2008, in relation to the sale of all the shares of Telecom.

On March 5, 2010, the board of directors of the Corporation declared dividends in the amount of $6.0 million with respect to the first quarter of 2010, payable to the City on March 31, 2010.

Credit Rating

As at December 31, 2009, the Corporation and the Corporation's Debentures were rated "A"(high) by DBRS and "A" by Standard & Poor's ("S&P").

Corporate Developments

Medium-Term Note Program

On November 12, 2009, the Corporation issued $250.0 million in 10-year senior unsecured debentures ("Series 3") which bear interest at the rate of 4.49% per annum and are payable semi-annually in arrears in equal installments on May 12 and November 12 of each year. The Series 3 debentures mature on November 12, 2019, and contain covenants which, subject to certain exceptions, restrict the ability of the Corporation and LDC to create security interests, incur additional indebtedness not ranking *pari passu* or dispose of all or substantially all of their assets. The net proceeds of this issuance were used principally to repay $245.1 million of indebtedness outstanding to the City under the terms of the Corporation's promissory note with the City (the "Amended and Restated City Note") on December 31, 2009.

Management Change

On August 17, 2009, David O'Brien announced his retirement as President and Chief Executive Officer of the Corporation effective September 30, 2009. The Board appointed Anthony Haines as President and Chief Executive Officer of the Corporation effective October 1, 2009. Mr. Haines is also the President of LDC.

Distribution Rates for LDC

The continuing restructuring of Ontario's electricity industry and other regulatory developments, including current and possible future consultations between the OEB and interested stakeholders, may affect the distribution rates and other permitted recoveries in the future.

On May 15, 2008, the OEB issued its decision regarding LDC's electricity distribution rates application for 2008 and 2009. In its decision, the OEB approved LDC's 2008 base distribution revenue requirement and rate base of $473.0 million and $1,968.9 million, respectively. As part of the decision, the deemed debt to equity structure of LDC was modified to 62.5% debt and 37.5% equity for 2008, and to 60.0% debt and 40.0% equity for 2009 and thereafter.

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

LDC filed a notice of clarification with the OEB with respect to the timing and the quantum of the expected reduction in distribution revenue. LDC's position is that the reduction in distribution revenue should be done after the deemed properties are sold and for the related actual net after-tax gain. In the event the OEB does not concur with LDC's position and orders an immediate reduction in distribution revenue, the Corporation would have to reduce its distribution revenue by the deemed amount less the net after-tax gain of the deemed properties already sold. At December 31, 2009, the reduction in distribution revenue would be approximately $8.1 million. Further to the notice of clarification filed by LDC in the fourth quarter of 2009, the OEB indicated that it intends to provide a final ruling on this issue as part of LDC's electricity distribution rates decision for 2010.

On February 24, 2009, the OEB issued the allowed return on equity ("ROE") for LDC for the 2009 rate year. The percentage was set at 8.01%. In addition to the ROE, the OEB also set LDC's 2009 distribution revenue requirement and rate base at $482.5 million and $2,035.0 million, respectively.

On August 28, 2009, LDC filed a rate application with the OEB seeking approval of the distribution revenue requirement and corresponding rates for the rate year May 1, 2010.

On December 11, 2009, the OEB issued revised cost of capital guidelines which set the initial allowed ROE for LDC for 2010 at 9.75%. The ROE formula will be adjusted to reflect the forecast long Canada Bond yield and A-rated Canadian Utility bond spreads when this data is released by the OEB on or about the beginning of March 2010. LDC will adjust its distribution rates to reflect the new guidelines as part of its rate finalization process for 2010 distribution rates.

On February 4, 2010, the OEB tentatively accepted a settlement proposal agreed to by LDC and various intervening parties. The settlement proposal captures a majority of issues, and provides for a 2010 capital budget of $350.0 million with a variance account to capture up to an additional $27.8 million of capital expenditures and operations, maintenance, and administration expenditures of $204.1 million. The settlement proposal does not settle issues relating to cost of capital (including applicability of new ROE guidelines to LDC), suite metering, and distributed generation, which are subject to a decision by the OEB in the first quarter of 2010. The final disposition of these matters could have a material impact on the final settlement.

Smart Meters

In support of the Province of Ontario's decision to install smart meters throughout Ontario by 2010, LDC launched its smart meter project in 2006. The project objective is to install smart meters and the supporting infrastructure by the end of 2010 for all residential and commercial customers. LDC had installed approximately 631,000 smart meters as at December 31, 2009.

In 2008, in connection with this initiative, the OEB approved the disposition of the balances incurred in 2006 and 2007. The OEB also approved the transfer from regulatory assets to property, plant and equipment of all capital expenditures incurred in 2006 and 2007. In a separate decision regarding LDC's electricity distribution rates for 2008, the OEB ordered LDC to record all future expenditures and revenues related to smart meters to a regulatory asset account and allowed LDC to keep the net book value of the stranded meters related to the deployment of smart meters in its rate base.

Lost Revenue Adjustment Mechanism ("LRAM") and Shared Savings Mechanism ("SSM")

Under certain specific rules, the OEB has allowed LDC to receive compensation for the lost revenue and the benefits associated to CDM programs delivered. The LRAM represents the lost revenue from CDM programs and the SSM represents LDC's share of provincial savings related to these programs.

On September 22, 2009, the OEB approved the recovery by LDC of $3.5 million in relation to LRAM and SSM expenditures related to CDM programs delivered in 2007. The recovery will be done through rate riders commencing on May 1, 2010 and ending April 30, 2011.

CDM Agreements

In May 2007, LDC entered into agreements with the Ontario Power Authority ("OPA") to deliver OPA-funded CDM programs in the amount of approximately $60.0 million during the years from 2007 to 2010. All programs are fully funded by the OPA with any advance payments recorded on the consolidated balance sheet as a deferred liability.

Since the launch of these programs in 2007, LDC has spent a total of $60.4 million on OPA programs ($20.7 million in 2007, $10.0 million in 2008 and $29.7 million in 2009) and recognized $11.1 million in margin related to such programs ($6.2 million in 2007, $1.9 million in 2008 and $3.0 million in 2009).

Street Lighting Activities

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

On February 11, 2010, the OEB issued its decision in regards to these applications. In its decision, the OEB agreed, that under certain conditions, the treatment of certain types of street lighting assets as regulated assets is justified. The OEB ordered the Corporation to provide a detailed valuation of the street lighting assets and to perform an operational review to determine which assets could become regulated assets. The Corporation is currently evaluating the impact of this decision on its regulated and unregulated businesses and whether to transfer the street lighting assets to LDC.

Contact Voltage

On June 30, 2009, LDC filed an application with the OEB seeking recovery of costs incurred for the unexpected impact of the remediation of safety issues on its electricity distribution infrastructure. LDC sought recovery of $14.4 million by way of fixed term rate riders of three years for the street lighting and unmetered scattered load rate classes, and one year for all other classes. On December 10, 2009, the OEB issued its decision, which provides for the future recovery of $9.1 million of related expenditures. Accordingly, the Corporation has increased its regulatory assets and reduced its operating expenditures by $9.1 million for 2009.

OEB PILs Proceeding

In 2009, the OEB commenced its review of the PILs variances accumulated in regulatory variance accounts for the period from October 1, 2001 to April 30, 2006 for all MEUs. The current proceeding is expected to provide direction regarding the interpretation of the rules issued by the OEB. The outcome of this proceeding could have a material impact on the financial position of the Corporation.

Payments in Lieu of Additional Municipal and School Taxes

The Ministry of Revenue has issued assessments in respect of payments in lieu of additional municipal and school taxes under s.92 of the *Electricity Act, 1998* that are in excess of the amounts LDC believes are payable. The dispute arose as a result of inaccurate information incorporated into Ontario Regulation 224/00, correction of which has been requested by LDC.

The balance assessed by the Ministry of Revenue above the balance accrued by the Corporation amounts to $8.7 million as at December 31, 2009. The Corporation has been proactive with the Ministry of Revenue and the Ministry of Finance to resolve this issue. However, there can be no assurance that the Corporation will not have to pay the full assessed balance in the future.

Legal Proceedings

Late Payment Charges Class Action

On April 22, 2004, in a decision in a class action commenced against The Consumers' Gas Company Limited (now Enbridge Gas Distribution Inc., hereinafter referred to as "Enbridge"), the Supreme Court of Canada (the "Supreme Court") ruled that Enbridge was required to repay the portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. Although the claim related to charges collected by Enbridge after the enactment of section 347 of the *Criminal Code* in 1981, the Supreme Court limited recovery to charges collected after the action was initiated in 1994. The Supreme Court remitted the matter back to the Ontario Superior Court of Justice for a determination of the plaintiffs' damages. The parties reached a settlement of this class action. The Ontario Superior Court of Justice has approved this settlement.

On February 4, 2008, the OEB, in response to an application filed by Enbridge, ruled that all of Enbridge's costs related to settlement of the class action lawsuit, including legal costs, settlement costs and interest, are recoverable from ratepayers. The representative plaintiff in the class action lawsuit has made a petition to the Lieutenant Governor in Council ("Cabinet") under subsection 34(1) of the *Ontario Energy Board Act, 1998*, Schedule B for an order that the matter be submitted back to the OEB for reconsideration. The Cabinet dismissed the petition.

LDC was not a party to the Enbridge class action. It is, however, subject to the two class actions described below in which the issues are analogous.

The first is an action commenced in April 1994 against a predecessor of LDC and other Ontario MEUs under the *Class Proceedings Act*, *1992* (Ontario) seeking $500.0 million in restitution for late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is at a preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and the classes have not been certified. After the release by the Supreme Court of its 2004 decision in the Enbridge case, the plaintiffs in this proposed class action indicated their intention to proceed with the litigation.

The second is an action commenced in November 1998 against a predecessor of LDC under the *Class Proceedings Act*, *1992* (Ontario) seeking $64.0 million in restitution for late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. This action is also at a preliminary stage. Pleadings have closed and examinations for discovery have been conducted but, as in the first action, the classes have not been certified.

The claims made against LDC and the definitions of the plaintiff classes are identical in both actions. As a result, any damages payable by LDC in the first action would reduce the damages payable by LDC in the second action, and vice versa.

The determination of whether the late payment charges collected by LDC from its customers were in excess of the interest limit stipulated in section 347 of the *Criminal Code* is fact specific in each circumstance. Also, decisions of the OEB are fact specific in each circumstance and the decision of the OEB in respect of Enbridge's application for recovery of costs related to the settlement is not necessarily determinative of the outcome of any similar application which LDC may make to the OEB in the future.

On January 15, 2010, a conditional settlement was reached for both actions pursuant to which the defendants would pay the amount of $17.0 million plus costs and taxes in settlement of all claims. The amount paid by each MEU will be its proportionate share of the settlement amount based on its percentage of distribution service revenue over the period for which it has exposure for repayment of late payment penalties exceeding the interest rate limit in the *Criminal Code*. While the amounts have not yet been determined, it is anticipated that LDC's share of the settlement amount will be in the range of $7.5 million to $9.5 million. The settlement is conditional upon a sufficient number of MEUs participating so as to collect the full amount of the settlement funds payable to the plaintiffs. It is also conditional upon court approval. All the MEUs involved in the settlement, including LDC, will request an order from the OEB allowing for the future recovery from customers of all costs related to the proposed settlement. LDC has not accrued any liabilities in relation to this proposed settlement. There is no guarantee that the OEB will allow for total or partial recovery of such costs in the future. The outcome of the OEB decision in this regard could have an adverse material impact on the consolidated results of operations and financial position of the Corporation in the future.

2 Secord Avenue

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the *Class Proceedings Act*, *1992* (Ontario) seeking damages in the amount of $30.0 million as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence has been filed, and a certification order issued. Affidavits of Documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

Another action was commenced against LDC in February 2009 in the Ontario Superior Court of Justice seeking damages in the amount of $20.0 million as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence has been filed, and a certification order issued. Affidavits of Documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

By order of the court, these two actions, together with a third smaller non-class action commenced in April 2009 involving the same incident, will be tried at the same time or consecutively. Consequently, documentary discovery and examinations for discovery will be joined for all three actions.

3650 Kingston Road

An action was commenced against LDC in March 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of $30.0 million as compensation for damages allegedly suffered as a result of a fire and explosion in the electrical room at 3650 Kingston Road on March 19, 2009. This action is at a preliminary stage. A statement of claim has been served on LDC but a statement of defence has not been filed. The proceedings of other parties to the action have revealed that the damages are likely to have been caused by a party other than LDC and LDC is making a motion to have LDC dismissed from the action. While it is not possible at this time to state conclusively, it is unlikely that LDC will be found liable for damages. If damages were awarded against LDC, LDC would make a claim under its liability insurance which LDC believes would cover such damages. Accordingly, this action is not likely to have a material effect on the financial performance of the Corporation.

2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of $30.0 million as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. This action is at a preliminary stage. A third party claim has been served on LDC but a statement of defence to the third party claim has not been filed. Accordingly, given the preliminary status of this action, it is not possible at this time to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

Another third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice seeking damages in the amount of $30.0 million as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. This action is at a preliminary stage. A third party claim has been served on LDC and a statement of defence to the third party claim has not been filed. Accordingly, given the preliminary status of this action, it is not possible at this time 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.

Share Capital

The authorized capital of the Corporation consists of an unlimited number of common shares of which 1,000 common shares are issued and outstanding as at the date hereof.

Transactions with Related Parties

The City is the sole shareholder of the Corporation. Subsidiaries of the Corporation provide certain services to the City at commercial and regulated rates, including electricity, street lighting and maintenance services. In addition, the City and its agencies have entered into energy management contracts with TH Energy. All transactions with the City are conducted at prevailing market prices and normal trade terms. Additional information with respect to related party transactions between the Corporation and its subsidiaries, as applicable, and the City is set out below.

LDC provided electricity to the City in the amount of $109.7 million at prevailing market prices and normal trade terms in 2009, compared to $107.1 million in 2008. Included in “Unbilled Revenue”, as at December 31, 2009, is a balance amounting to $9.7 million receivable from the City related to the provision of electricity for the previous months, compared to $9.1 million as at December 31, 2008.

LDC provided relocation services related to the City in the amount of $0.9 million in 2009, compared to $1.0 million in 2008. Included in LDC’s “Accounts receivable, net of allowance for doubtful accounts”, as at December 31, 2009, is $1.2 million receivable from the City related to relocation services and other construction activities, compared to $4.1 million as at December 31, 2008.

TH Energy provided energy management services, street lighting services and consolidated billing services to the City amounting to $21.0 million in 2009, compared to $19.9 million in 2008. Included in TH Energy’s “Accounts receivable, net of allowance for doubtful accounts”, as at December 31, 2009, is $5.0 million receivable from the City related to these services, compared to $4.9 million as at December 31, 2008.

LDC purchased road cut and other services of $6.9 million from the City in 2009, compared to $4.9 million in 2008. Included in LDC’s “Accounts payable and Accrued liabilities”, as at December 31, 2009, is $5.5 million payable to the City related to services received from the City, compared to $4.5 million as at December 31, 2008.

LDC and TH Energy paid property tax expenses to the City of $6.3 million in 2009, compared to $6.5 million in 2008.

On December 31, 2009, the Corporation made the second scheduled payment of $245.1 million to the City in accordance with the terms of the Amended and Restated City Note. At December 31, 2009, the outstanding principal amount in respect of the Amended and Restated City Note was $490.1 million, compared to $735.2 million as at December 31, 2008. The remaining principal amount outstanding under the Amended and Restated City Note is classified as a long-term liability. The Corporation paid to the City interest of $44.9 million on the Amended and Restated City Note in each of 2009 and 2008.

See note 14 and note 23 to the Consolidated Financial Statements.

Risk Factors

The financial performance of the Corporation is subject to a variety of risks including those described below:

Regulatory Developments

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

- the OEB may not set a lower recovery for LDC's cost of capital;
- the full cost of providing service to distribution customers will be permitted to be recovered through distribution rates;
- the OEB will not permit competitors to provide distribution services in a distributor's licensed area, or loads within LDC's service area to become electrically served by a means other than through LDC's system;

- the OEB will allow recovery for revenue lost as a consequence of the emergence and adoption of new technologies such as distributed generation, or unanticipated effects of conservation and demand management;
- parts of LDC's services will not be separated from LDC and opened to competition; or
- regulatory or other changes will not be made to the PILs regime.

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

Condition of Distribution Assets

LDC’s ability to continue to maintain and operate the distribution system reliably and safely in the future will depend on, among other things, the OEB allowing recovery of costs in respect of LDC's maintenance program and capital expenditure requirements for distribution plant refurbishment and replacement.

Information Technology Infrastructure

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

Electricity Consumption

LDC's distribution rates typically comprise a fixed charge and a usage-based (consumption) charge. The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control (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). Accordingly, there can be no assurance that LDC will earn the revenue requirement approved by the OEB.

Market and Credit Risk

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

LDC is also exposed to fluctuations in interest rates as its regulated rate of return is derived using a formulaic approach, which is based in part on a forecast of long-term Government of Canada bond yields coupled with an equity risk premium. LDC estimates that a 1% (100 basis points) reduction in long-term Government of Canada bond yields, used in determining its regulated rate of return would reduce LDC’s net income by approximately $4.3 million.

The Corporation is also exposed to fluctuation in interest rates for the valuation of its post-employment benefit obligations. The Corporation estimates that a 1% (100 basis points) increase in the discount rate used to value these obligations would decrease the accrued benefit obligation, as at December 31, 2009, by $20.0 million, and a 1% (100 basis points) decrease in the discount rate would increase the accrued benefit obligation, as at December 31, 2009, by $28.5 million.

Additional Debt Financing

The Corporation expects to borrow to repay the Amended and Restated City Note when required to do so under the terms of the Amended and Restated City Note; and to finance the renewal of LDC's electricity infrastructure. The Corporation's ability to arrange sufficient and cost-effective debt financing could be adversely affected by a number of factors, including financial market conditions, the regulatory environment in Ontario, the Corporation's results of operations and financial condition, the ratings assigned to the Corporation and its debt securities by credit rating agencies, the current timing of debt maturities and general economic conditions.

Work Force Renewal

Over the next nine years, approximately 600 LDC employees will be eligible for retirement. This number represents approximately 40% of LDC's workforce (with a significant number of potential retirements occurring in supervisory trades and technical positions). Accordingly, LDC will be required to attract and retain skilled employees. There can be no assurance that LDC will be able to attract and retain the required workforce.

Natural and Other Unexpected Occurrences

The facilities of LDC are exposed to the effects of natural and other unexpected occurrences. Although LDC's facilities are constructed, operated and maintained to withstand severe weather conditions, there can be no assurance that they will successfully do so in all circumstances. For example, an ice storm in January 1998 caused significant damage to transmission and distribution facilities in Ontario, Québec and the north-eastern United States. Any major damage to LDC's facilities could result in lost revenues and repair costs that are substantial in amount. If it sustained a large uninsured loss caused by natural or other unexpected occurrences, LDC could apply to the OEB for the recovery of the loss. There can be no assurance that the OEB would approve, in whole or in part, such an application.

Insurance

Although the Corporation maintains insurance, there can be no assurance that the Corporation will be able to obtain or maintain adequate insurance in the future at rates it considers reasonable or that insurance will continue to be available. Further, there can be no assurance that available insurance will cover all losses or liabilities that might arise in the conduct of the Corporation's business. The Corporation self-insures against certain risks (e.g., business interruption and physical damage to certain automobiles). The occurrence of a significant uninsured claim or a claim in excess of the insurance coverage limits maintained by the Corporation could have a material adverse effect on the Consolidated Financial Statements.

Environmental Regulation

LDC is subject to Canadian federal, provincial and municipal environmental regulation. Failure to comply with environmental regulation could subject LDC to fines and other penalties. In addition, releases of hazardous substances now or in the past on or from properties owned, leased, occupied or used by LDC, or as a result of LDC's operations could lead to governmental orders requiring investigation, control and/or remediation of releases. The presence or release of hazardous substances could also lead to claims by third parties for harm as a result of the existence of these substances.

Changes in environmental regulation or enforcement may impose material additional costs on LDC. In addition, new approvals or permits or renewals of existing approvals and permits may require environmental assessment and/or result in the imposition of conditions which may result in significant compliance costs. The process for obtaining environmental permits and approvals, including any necessary environmental assessment, can be lengthy, contentious and expensive.

Investments

At December 31, 2009, the Corporation held long-term investments in connection with the restructuring of the ABCP market. The notes have an aggregate principal amount of $87.7 million.

The estimation by the Corporation of the fair value of its investments is subject to significant risks and uncertainties, including the timing and amount of future cash flows, market liquidity and the quality of the underlying assets and financial instruments. Accordingly, there can be no assurance that the Corporation's assessment of the estimated fair value of its long term investments will not change materially in subsequent periods.

Credit Rating

Should the Corporation's credit rating from both of its credit rating agencies falls below “A”(minus) (S&P) and “A”(low) (DBRS), LDC may be required to post additional collateral with the IESO.

Labour Relations

The Corporation’s ability to operate successfully in the restructured electricity industry in Ontario will depend in part on its ability to make changes to existing work practices and procedures to adapt to changing circumstances. The Corporation’s ability to make these changes will depend in part on its ability to develop plans and approaches that are acceptable to its labour unions. There can be no assurance that the Corporation will be able to secure the support of its labour unions in this regard.

Relationship with the City

The City owns all of the outstanding shares of the Corporation and has the power to determine the composition of the board of directors of the Corporation and influence major business and corporate decisions, including its financing programs and dividend payments. A conflict may arise between the City's role as the sole shareholder and major debt holder of the Corporation and its role as the administrator of the City budget and other matters for the residents of the City. The City may decide to sell all or part of the Corporation. In this event, depending on the nature of the transaction, the Corporation's credit ratings may be negatively affected.

Real Property Rights

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

LDC Competition

In the past, there had been one electricity distributor in each region of Ontario. Under the current regulatory regime, a person must obtain a licence from the OEB in order to own and operate a distribution system. LDC has the right to distribute electricity in the City. Although the distribution licence specifies the area in which the distributor is authorized to distribute electricity, unless otherwise provided, the licence does not provide exclusive distribution rights for such area.

The Corporation believes that the complexities and potential inefficiencies that would be created by having multiple electricity distributors authorized to serve a single area are likely to result in the continuation of the practice of having a single electricity distributor authorized to serve a single area. In addition, the Corporation believes that there are significant barriers to entry with respect to the business of electricity distribution in Ontario, including the cost of maintaining a distribution system, OEB regulation of distribution rates and the level of regulatory compliance required to operate a distribution system. However, the Corporation recognizes that more than one distribution licence could be issued for the same area and there is a possibility that in the future some business functions or activities could be separated from LDC and made open to competition from non-regulated business entities, or that defined geographical areas within LDC's service area may be electrically supplied by a means other than through LDC's system.

Considerations Related to Current Economic Conditions

Electricity Consumption

The current economic downturn could lead to lower overall electricity consumption, particularly in the commercial customer segments, which is estimated to be the most sensitive to economic changes. Lower electricity consumption from commercial customers may negatively impact LDC’s revenue. On an annual basis, a decrease of 1% in electricity consumption would reduce net revenue by approximately $3.3 million.

Interest Rates

Changes in interest rates will impact the calculation of LDC’s revenue requirements filed with the OEB. The first component impacted by interest rates is the ROE. Under the OEB’s revised Cost of Capital formula, the approved adjustment formula for calculating ROE will increase or decrease by 50% of the change between the current Long Canada Bond Forecast and the risk free rate established at 4.25% and 50% of the change between the market-quoted Canadian A-rated utility bond spread and the initial spread set at 1.415%. The Corporation estimates that a 1% (100 basis points) decrease in the forecast long-term Government of Canada bond yield, with no corresponding decrease in the A-rated utility spread used in the current OEB formula to determine LDC's ROE would reduce net income by approximately $4.3 million at LDC's current rate base level.

The second component of revenue requirement which would be impacted by interest rates is the recovery of financing costs. The difference between actual interest rates on new debt issuances and those approved by the OEB may negatively impact the Corporation's results of operations.

Debt Financing

Cash generated from operations, after the payment of expected dividends, will not be sufficient to repay existing indebtedness, fund capital expenditures and meet other obligations. The Corporation relies on debt financing through a Medium-Term Note Program or its revolving credit facility to repay existing indebtedness and fund capital expenditures. However, given the recent and on-going turmoil on financial markets, there can be no assurance that the Corporation will be able to arrange long-term debt financing, nor renew short-term financing facilities with similar terms in the future.

Critical Accounting Estimates

The preparation of the Corporation's Consolidated Financial Statements in accordance with Canadian GAAP requires estimates and assumptions which affect the reported amounts of assets, liabilities, revenues and costs, and related disclosures of commitments and contingencies. The estimates are based on judgements 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 judgements about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Actual results may differ from these estimates and judgements under different assumptions or conditions.

The following critical accounting estimates involve the more significant estimates and judgements used in the preparation of the Consolidated Financial Statements:

Regulatory Assets and Liabilities

Regulatory assets as at December 31, 2009, amounted to $68.2 million and primarily relate to the deferral of smart meters expenditures incurred in 2008 and 2009. Regulatory liabilities as at December 31, 2009, amounted to $308.6 million and primarily relate to PILs variances and settlement variances. These assets and liabilities can be recognized for rate-setting and financial reporting purposes only if the OEB directs the relevant regulatory treatment or if future OEB direction is judged to be probable. In the event that the disposition of these balances was no longer deemed to be probable, the balances would be recorded in the consolidated statements of income.

Environmental Liabilities

The Corporation recognizes a liability for the future environmental remediation of certain properties and for future removal and handling costs for contamination in distribution equipment in service and in storage. The estimation of such a liability requires that assumptions be made, such as the number of contaminated properties and the extent of contamination, the number of assets and contamination levels of equipment. All factors used in deriving the Corporation's environmental liabilities represents management's best estimates based on planned approach of meeting regulatory requirements. However, it is possible that numbers of contaminated assets, current cost estimates, inflation assumptions and assumed pattern of annual cash flows may differ significantly from the Corporations' assumptions.

Employee Future Benefits

Employee future benefits other than pension provided by the Corporation include medical, dental and life insurance benefits, and accumulated sick leave credits. These plans provide benefits to employees when they are no longer providing active service. The accrued benefit obligations and current service cost are calculated by independent actuaries using the projected benefit method prorated on service and based on assumptions that reflect management's best estimate. The assumptions were determined by management recognizing the recommendations of our actuaries. There could be no assurance that actual employee's future benefits cost will not differ significantly from the estimates calculated using management's assumptions.

Fair Value of Long-Term Investments

The estimation by the Corporation of the fair value of its long-term investments, as at December 31, 2009, is subject to significant risks and uncertainties, including the timing and amount of future cash flows, market liquidity and the quality of the underlying assets and financial instruments. Accordingly, there can be no assurance that the Corporation's assessment of the estimated fair value of its long-term investments will not change materially in subsequent periods.

Revenue Recognition

Revenue from the sale of electricity is recorded on a basis of cyclical billings and also includes unbilled revenue accrued in respect of electricity delivered but not yet billed. The unbilled revenue accrual at the end of each period is based on the difference between the forecast revenue and the actual amounts billed. The development of the revenue forecast requires estimates of customer growth, economic activity and weather conditions. There can be no assurance that actual unbilled revenue estimates will not differ materially from actual revenue for the period.

Significant Accounting Policies

The Consolidated Financial Statements of the Corporation have been prepared in accordance with Canadian GAAP including accounting principles prescribed by the OEB in the handbook "Accounting Procedures Handbook for Electric Distribution Utilities" ("AP Handbook") and are presented in Canadian dollars. In preparing the Consolidated Financial Statements, management makes estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the Consolidated Financial Statements and the reported amounts of revenues and expenses for the periods covered thereby. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Minister of Energy, the Minister of Finance, or the Minister of Revenue. The significant accounting policies of the Corporation are summarized in note 4 to the Consolidated Financial Statements.

Changes in Accounting Standards

Rate-Regulated Operations: Effective January 1, 2009, the Corporation adopted amended Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1100 – "Generally Accepted Accounting Principles" ("Handbook Section 1100"), Handbook Section 3465 – "Income Taxes" ("Handbook Section 3465"), and Accounting Guideline 19 – "Disclosures by Entities Subject to Rate Regulation". These amended sections and guidance established new standards and removed a temporary exemption in Handbook Section 1100 pertaining to the application of that section to the recognition and measurement of assets and liabilities arising from rate regulation. The new standards require the recognition of future income tax liabilities and assets in accordance with Handbook Section 3465 as well as a separate regulatory asset or liability balance for the amount of future income taxes expected to be included in future rates and recovered from or paid to customers, and retain existing requirements to disclose the effects of rate regulation. The revised standards are effective for interim and annual financial statements for the fiscal years beginning on or after January 1, 2009. See note 4 and note 9 to the Consolidated Financial Statements.

Following the removal of the temporary exemption for rate-regulated operations included in Handbook Section 1100, the Corporation developed accounting policies for its assets and liabilities arising from rate regulation using professional judgment and other sources issued by bodies authorized to issue accounting standards in other jurisdictions. Upon final assessment and in accordance with Handbook Section 1100, the Corporation has determined that its assets and liabilities arising from rate-regulated activities qualify for recognition under Canadian GAAP and this recognition is consistent with U.S. Financial Accounting Standards Board Accounting Standards Codification 980 – "Regulated Operations". Accordingly, the removal of the temporary exemption had no effect on the Corporation's results of operations as of December 31, 2009.

Handbook Section 3465 as amended requires the recognition of future income tax assets and liabilities and related regulatory liabilities and assets for the amount of future income taxes expected to be refunded to, or recovered from, customers in future electricity rates, applied on a retrospective basis without prior period restatement. The implementation of these standards did not impact the Corporation's earnings or cash flows. As at December 31, 2009, LDC has recorded a future income tax asset of $250.9 million and a corresponding regulatory liability of $250.9 million. See note 4 and note 9 to the Consolidated Financial Statements.

Goodwill and Intangible Assets: Effective January 1, 2009, the Corporation retrospectively adopted CICA Handbook Section 3064 – "Goodwill and Intangible Assets" ("Handbook Section 3064"). Handbook Section 3064 replaces Handbook Section 3062 – "Goodwill and Other Intangible Assets" ("Handbook Section 3062") and provides extensive guidance on recognition, measurement and disclosure of intangible assets.

The Corporation evaluated existing intangible assets as at January 1, 2009 to determine whether the intangible assets recognized under previous Handbook Section 3062 met the definition, recognition, and measurement criteria of an intangible asset in accordance with Handbook Section 3064. The assets included land rights or easements, computer software, and capital contributions. As a result, the Corporation identified $2.0 million of expenditures that no longer met the definition of intangible assets under Handbook Section 3064. As a result, these expenditures were removed from intangible assets and transferred to a regulatory asset account for future recovery. The Corporation's decision to record these expenditures to regulatory assets is based on the fact that the expenditures have already been approved for recovery by the OEB in prior regulatory proceedings. In the absence of rate regulation, these expenditures would have been recorded to opening retained earnings.

Credit Risk and Fair Value of Financial Assets and Financial Liabilities: In January 2009, the CICA issued Emerging Issues Committee Abstract 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" ("EIC-173"), effective for interim and annual financial statements ending on or after January 2009. EIC-173 provides further information on the determination of the fair value of financial assets and financial liabilities under Handbook Section 3855 – "Financial Instruments - Recognition and Measurement" ("Handbook Section 3855"). It states that an entity's own credit and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this standard did not have any impact on the Corporation's results of operations or financial position.

Financial Instruments – Disclosures: In June 2009, the CICA amended Handbook Section 3862 – "Financial Instruments – Disclosures" ("Handbook Section 3862") to include additional disclosure requirements with respect to fair value measurements of financial instruments and to enhance liquidity risk disclosure requirements. Handbook Section 3862 establishes a fair value hierarchy which includes three levels of inputs that may be used to measure fair value:

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

The Corporation adopted these amendments effective for the fiscal year ended December 31, 2009. Comparative information is not required in the first year of application. See note 4 and note 19 to the Consolidated Financial Statements

Financial Instruments – Recognition and Measurement: In August 2009, the CICA amended Handbook Section 3855 to add guidance concerning the assessment of embedded derivatives upon reclassification of a financial asset out of the assets held-for-trading category. These amendments apply prospectively to reclassifications made on or after July 1, 2009. Earlier adoption is permitted. The application of these amendments did not have any impact on the Corporation's results of operations or financial position.

Impaired Loans: In August 2009, the CICA amended Handbook Section 3025 – "Impaired Loans" to include held-to-maturity investments and to conform the definition of a loan to that in amended Handbook Section 3855. These amendments apply to annual financial statements relating to fiscal years beginning on or after November 1, 2008. The Corporation adopted these amendments effective for the fiscal year ended December 31,

2009. The application of these amendments did not have any impact on the Corporation's results of operations or financial position.

Future Accounting Pronouncements

International Financial Reporting Standards ("IFRS"): On February 13, 2008, the AcSB confirmed that publicly accountable enterprises will be required to adopt IFRS in place of Canadian GAAP for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. A limited number of converged or IFRS-based standards will be incorporated into Canadian GAAP prior to 2011, with the remaining standards to be adopted at the change over date. The Corporation has an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its Consolidated Financial Statements. At this time, the impact on the Corporation's future financial position and results of operations is not reasonably determinable or estimable.

The Corporation commenced its IFRS conversion project in 2007 and has established a formal project governance structure. This structure includes a steering committee consisting of senior levels of management from finance, information technology, treasury and operations, among others. Regular progress reports are provided to senior executive management. The Corporation's audit committee receives periodic project updates from senior management and approves all IFRS accounting policies. The Corporation's board of directors receives periodic project updates from senior management.

The Corporation's project consists of 3 phases: (1) awareness and assessment; (2) design; and (3) implementation. The Corporation completed its awareness and initial assessment during the second quarter of 2008, which involved a high level review of the major differences between Canadian GAAP and IFRS. During the initial assessment it was determined that the areas of accounting differences with the highest potential impact to the Corporation are rate regulated accounting, accounting for property, plant and equipment, PILs, employee future benefits, as well as initial adoption of IFRS under the provisions of IFRS 1, *First-Time Adoption of IFRS*. The Corporation next completed a detailed assessment which involved detailed systematic gap analyses of accounting and disclosure differences between Canadian GAAP and IFRS, and conducted an analysis of the available accounting choices to be made to address these differences and options available under IFRS 1. In parallel, a detailed assessment of the impact of the IFRS conversion on the Corporation's systems, processes and controls as well as other business, regulatory and tax impacts was also conducted. During the awareness and assessment phase, the Corporation established a communication plan and a staff-training plan.

The Corporation is currently in the design phase of the project, and is nearing completion thereof. The design phase involves establishing issue-specific working groups in each of the identified risk areas. The working groups have established key milestones which include developing recommendations, analyzing financial system and internal control impacts, developing significant accounting policies, and carrying out ongoing discussions with external auditors, in each area. Based on the outcomes of each working group, the Corporation is determining the projected impacts of adopting IFRS on its financial statements after considering the options available under IFRS 1. Although the impact of the adoption of IFRS on the Corporation's financial position and results of operations is not yet reasonably determinable or estimable, the Corporation expects a significant increase in financial statement disclosure requirements resulting from the adoption of IFRS, and has designed the systems to provide the additional information required to make these disclosures. Furthermore, as a result of the work performed in the design phase, the Corporation has identified and developed new business processes and modifications to existing business processes. The Corporation continues to roll out its communication initiatives during this phase and has begun to execute against the staff-training plan that was established during the awareness and assessment phase, as scheduled in the project plan. Training on the systems and process changes are incorporated as part of the implementation phase.

In conjunction with the design phase of the project, the Corporation commenced work in the implementation phase. The roll-out of the designed changes developed in the design phase takes place during the implementation phase and involves the development of new accounting policies and accounting manuals and the associated training for the finance team, testing the effectiveness of the changes made to systems, a simulation of the financial reporting process, preparation of opening balance sheet on transition date and related reconciliations, assessing the ongoing impacts on the IFRS financial statements and related disclosures. Other activities that take place in this phase might include implementation of possible changes to debt covenants, internal performance measures, contracts and processes, and carrying ongoing discussions with its external auditors.

The Corporation has begun to roll-out business process changes developed in the design phase and training finance and operation teams. Based on these process changes, the Corporation is updating internal control processes and documentation. Changes to accounting policies will result in additional controls and procedures to address reporting on transition date as well as ongoing IFRS reporting requirements. The Corporation is in the process of developing and implementing the related controls and procedures to ensure the integrity of internal controls over financial reporting and disclosure controls and procedures. The updated controls and procedures will be evaluated to ensure that they are operating effectively.

On July 23, 2009, the International Accounting Standards Board ("IASB") issued an Exposure Draft ("ED") proposing accounting requirements for rate-regulated activities. The ED proposes to allow entities with rate-regulated activities to recognize regulatory assets and liabilities on their balance sheets, at their present values, using an expected future cash flow model. Under the ED, expected cash flows would be derived by weighting various potential scenarios by their probabilities of occurrence. The ED also proposes to allow rate-regulated entities a special exception in those otherwise ineligible costs would be capitalized to items of PP&E or intangible assets, if those costs were required to be capitalized by the local regulator for rate-making purposes. The Corporation submitted its comment letter on November 20, 2009. The IASB received an overwhelming number of comment letters in regards to the ED with significant diversity in the comments. The Board held a meeting on February 17, 2010 to discuss the summary analysis of the comments letters received. During this meeting, the IASB directed the IASB Staff to continue its research and analysis on the project and to focus on the key issue of whether regulatory assets and regulatory liabilities exist in accordance with the current *Framework for the Preparation and Presentation of Financial Statements* and whether they are similar to other current IFRSs. The IASB Staff will present their analysis to the IASB in the near term together with an amended timetable for the project. In light of these developments, a final standard is not likely to be issued in 2010. In addition, the IASB tentatively decided that the previously proposed amendment to IFRS 1 be removed from the broader Rate-regulated Activities project, and that it be incorporated as part of the omnibus *Improvements to IFRSs* expected to be issued in April 2010. The proposed amendment to IFRS 1 would allow an entity with operations subject to rate regulation to use its previous GAAP carrying amounts for PP&E and intangible assets as its deemed cost at the date of transition.

If a standard is not available in time for transition, there could be significant volatility in the Corporation's statement of comprehensive income since under current IFRS some or all regulatory assets and liabilities might not be recognized on the balance sheet. The Corporation will continue to monitor the rate-regulated activities project developments for further guidance, and evaluate the impacts on its systems, processes and controls.

In addition to the project on accounting for rate-regulated activities, the IASB has a number of on-going projects on its agenda. As accounting standards, exposure drafts and interpretations change prior to transition, the Corporation will actively monitor these developments and the impact that any resulting IFRS changes may have on its anticipated accounting policies, financial position or results of operations. The Corporation has and will continue to adjust its implementation plan for these changes.

The technical analysis performed to date is based on the IFRS standards in its current form. However, the analysis will be revisited in light of upcoming changes to the standards, including the ED on rate-regulated activities.

On July 28, 2009, the OEB issued its Report of the Board – *Transition to IFRS*, which contains recommendations on how regulatory reporting requirements should change in response to IFRS. The OEB has initiated a second phase in its transition project, which involves amending certain regulatory instruments. The Corporation continues to evaluate the potential impacts of the recommendations contained in the Report of the Board on both the activities of LDC and its IFRS transition plan.

Consolidated Financial Statements and Non-controlling Interests: In January 2009, the CICA issued Handbook Section 1601 – "Consolidated Financial Statements" ("Handbook Section 1601"). This section along with the new Handbook Section 1602 – "Non-controlling Interests" ("Handbook Section 1602"), replace Handbook Section 1600 – "Consolidated Financial Statements" and establish standards for the preparation of consolidated financial statements. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted as of the beginning of a fiscal year. The Corporation has determined that these standards will have no impact on the classification or valuation of its Consolidated Financial Statements.

Financial Instruments – Recognition and Measurement: In June 2009, the CICA amended Handbook Section 3855 to clarify when an embedded prepayment option is separated from its host debt instrument for accounting purposes. This amendment applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. This section has also been amended to clarify the application of the effective interest method after a debt instrument has been impaired. This amendment applies retrospectively to financial statements for fiscal years beginning on or after January 1, 2010. The Corporation expects these amendments will have no impact on its results of operations and financial position.

Comprehensive Revaluation of Assets and Liabilities: In August 2009, the CICA amended Handbook Section 1625 – "Comprehensive Revaluation of Assets and Liabilities" to be consistent with Handbook Section 1582 – "Business Combinations", Handbook Section 1601 and Handbook Section 1602, which were issued in January 2009. The amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year. The Corporation expects these amendments will have no impact on its results of operations and financial position.

Forward-Looking Information

The Corporation includes forward-looking information in the Management's Discussion and Analysis ("MD&A") within the meaning of applicable securities laws in Canada ("forward-looking information"). The purpose of the forward-looking information is to provide management's expectations regarding the Corporation's future results of operations, performance, business prospects and opportunities and may not be appropriate for other purposes. All forward-looking information is given pursuant to the "safe harbour" provisions of applicable Canadian securities legislation. The words "anticipates", "believes", "budgets", "could", "estimates", "expects", "forecasts", "intends", "may", "might", "plans", "projects", "schedule", "should", "will", "would" and similar expressions are often intended to identify forward-looking information, although not all forward-looking information contains these identifying words. The forward-looking information reflects management's current beliefs and is based on information currently available to the Corporation's management.

The forward-looking information in the MD&A includes, but is not limited to, statements regarding LDC's 2009 base distribution revenue, the Corporation's plans to borrow to repay the Amended and Restated City Note, the impact of current economic conditions and financial market volatility on the Corporation's results of operations, performance, business prospects and opportunities, the potential transfer of street lighting activities from TH Energy, the outcome of outstanding proceedings before the OEB, the estimated fair value of the Corporation's investments, the effect of changes in interest rates on future revenue requirements, and the Corporation's conversion to IFRS. The statements that make up the forward-looking information are based on assumptions that include, but are not limited to, the future course of the economy and financial markets, the receipt of applicable regulatory approvals and requested rate orders, the receipt of favourable judgments, the level of interest rates, the Corporation's ability to borrow, the fair market value of the Corporation's investments, and the impact of IFRS on the Corporation's Consolidated Financial Statements.

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

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

Additional Information

Additional information with respect to the Corporation (including its annual information form) is available at www.sedar.com.

Toronto, Canada

March 8, 2010