



CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2011



Consolidated Financial Statements

DECEMBER 31, 2011

Contents	Page
Management's Report	1
Independent Auditors' Report	2
Consolidated Balance Sheets	3
Consolidated Statements of Income	4
Consolidated Statements of Retained Earnings	4
Consolidated Statements of Cash Flows	5
Notes to Consolidated Financial Statements	6

MANAGEMENT'S REPORT

The accompanying Consolidated Financial Statements have been prepared by management of Toronto Hydro Corporation (the "Corporation"), who are responsible for the integrity, consistency and reliability of the information presented. The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles and applicable securities legislation.

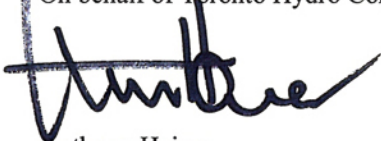
The preparation of the Consolidated Financial Statements necessarily involves the use of estimates and assumptions based on management's judgments, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. Estimates and assumptions are based on historical experience, current conditions and various other assumptions believed to be reasonable in the circumstances, with critical analysis of the significant accounting policies followed by the Corporation as described in Note 3 to the Consolidated Financial Statements. The preparation of the Consolidated Financial Statements includes information regarding the estimated impact of future events and transactions. Actual results in the future may differ materially from the present assessment of this information because future events and circumstances may not occur as expected. The Consolidated Financial Statements have been prepared within reasonable limits of materiality in light of information available up to March 2, 2012.

In meeting its responsibility for the reliability of financial information, management maintains and relies on a comprehensive system of internal control and internal audit, which is designed to provide reasonable assurance that the financial information is relevant, reliable and accurate, and that the Corporation's assets are safeguarded and transactions are properly authorized and executed. The system includes formal policies and procedures and appropriate delegation of authority and segregation of responsibilities within the organization. An internal audit function evaluates the effectiveness of these internal controls consistent with its annual audit plan and reports its findings to management and the Audit Committee of the Corporation, as required.

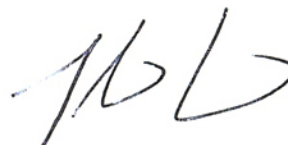
The Consolidated Financial Statements have been examined by KPMG LLP, independent external auditors appointed by the Corporation's shareholder. The external auditors' responsibility is to express their opinion on whether the Consolidated Financial Statements are fairly presented in accordance with generally accepted accounting principles in Canada. The attached Independent Auditors' Report outlines the scope of their examination and their opinion.

The Board of Directors, through its Audit Committee, is responsible for overseeing management in the performance of its financial reporting and internal controls. The Audit Committee is composed of independent directors and meets periodically with management, the internal auditors and the external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each group has properly discharged its respective responsibility and to review the Consolidated Financial Statements before recommending approval by the Board of Directors. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholder, the appointment of the external auditors. The external auditors have direct and full access to the Audit Committee, with and without the presence of management, to discuss their audit and their findings as to the integrity of the financial reporting and the effectiveness of the system of internal controls.

On behalf of Toronto Hydro Corporation's management:

A handwritten signature in black ink, appearing to read "Anthony Haines".

Anthony Haines
President and Chief Executive Officer

A handwritten signature in black ink, appearing to read "Jean-Sebastien Couillard".

Jean-Sebastien Couillard
Chief Financial Officer



KPMG LLP
Chartered Accountants
Bay Adelaide Centre
333 Bay Street Suite 4600
Toronto ON M5H 2S5

Telephone (416) 777-8500
Fax (416) 777-8818
Internet www.kpmg.ca

INDEPENDENT AUDITORS' REPORT

To the Shareholder of Toronto Hydro Corporation

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

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

Other matter

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

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

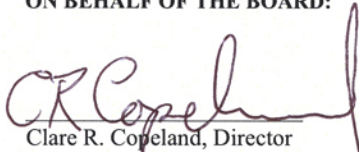
March 2, 2012

CONSOLIDATED BALANCE SHEETS

[in thousands of dollars]

As at December 31	2011 \$	2010 \$
ASSETS		
Current		
Cash and cash equivalents	154,256	330,151
Investments	34,002	-
Accounts receivable, net of allowance for doubtful accounts [note 16[b]]	183,272	168,988
Unbilled revenue [note 16[b]]	262,058	287,893
Payments in lieu of corporate taxes receivable	11,312	6,729
Inventories [note 4]	6,891	7,501
Prepaid expenses	4,487	4,048
Total current assets	656,278	805,310
Property, plant and equipment, net [note 5]	2,399,497	2,128,777
Intangible assets, net [note 6]	112,982	85,996
Regulatory assets [note 7]	77,322	85,113
Other assets [note 8]	7,331	7,518
Future income tax assets [note 18]	202,367	225,900
Total assets	3,455,777	3,338,614
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities [note 16[b]]	412,412	373,543
Other liabilities [note 10]	22,290	19,733
Deferred revenue	13,359	1,418
Debentures [note 11]	-	245,057
Total current liabilities	448,061	639,751
Long-term liabilities		
Debentures [note 11]	1,463,514	1,164,780
Post-employment benefits [note 12]	179,541	169,897
Regulatory liabilities [note 7]	210,280	273,706
Other liabilities [note 13]	11,301	634
Asset retirement obligations [note 14]	4,902	5,005
Customers' advance deposits	35,930	45,462
Total long-term liabilities	1,905,468	1,659,484
Total liabilities	2,353,529	2,299,235
Commitments, contingencies and subsequent events [notes 21, 22 and 25]		
Shareholder's equity		
Share capital [note 19]	567,817	567,817
Retained earnings	534,431	471,562
Total shareholder's equity	1,102,248	1,039,379
Total liabilities and shareholder's equity	3,455,777	3,338,614

ON BEHALF OF THE BOARD:



Clare R. Copeland, Director



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	2011 \$	2010 \$
Revenues	2,809,258	2,611,671
Costs		
Purchased power and other	2,238,500	2,062,269
Operating expenses	243,547	223,326
Depreciation and amortization	151,022	169,408
	2,633,069	2,455,003
Income before the following:	176,189	156,668
Net financing charges	(75,324)	(71,150)
Gain on disposals of property, plant and equipment [note 5]	3,885	3,767
Change in fair value of investments	-	2,420
Income before provision for payments in lieu of corporate taxes	104,750	91,705
Provision for payments in lieu of corporate taxes [note 18]	8,818	25,580
Net income	95,932	66,125
Basic and fully diluted net income per share [note 23]	95,932	66,125

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

[in thousands of dollars]

Year ended December 31	2011 \$	2010 \$
Retained earnings, beginning of year	471,562	430,437
Net income	95,932	66,125
Dividends [notes 19 and 20]	(33,063)	(25,000)
Retained earnings, end of year	534,431	471,562

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	2011 \$	2010 \$
OPERATING ACTIVITIES		
Net income	95,932	66,125
Adjustments for non-cash items		
Depreciation and amortization	151,022	169,408
Change in fair value of investments	-	(2,420)
Net change in other assets and liabilities	(1,312)	5,051
Payments in lieu of corporate taxes	(4,583)	9,203
Post-employment benefits	9,644	8,549
Future income taxes <i>[note 18]</i>	(601)	871
Gain on disposals of property, plant and equipment <i>[note 5]</i>	(3,885)	(3,767)
Changes in non-cash working capital balances		
Increase in accounts receivable	(14,284)	(18,193)
Decrease in unbilled revenue	25,835	7,754
Decrease (increase) in inventories	610	(1,277)
Increase in prepaid expenses	(439)	(717)
Increase in accounts payable and accrued liabilities	39,093	40,109
Increase (decrease) in deferred revenue	13,316	(378)
Net cash provided by operating activities	310,348	280,318
INVESTING ACTIVITIES		
Purchase of property, plant and equipment <i>[note 5]</i>	(384,262)	(362,397)
Purchase of intangible assets <i>[note 6]</i>	(52,805)	(28,387)
Purchase of investments	(84,041)	-
Proceeds from investments	50,000	50,350
Net change in regulatory assets and liabilities	(31,725)	(16,011)
Proceeds on disposals of property, plant and equipment	4,974	8,861
Net cash used in investing activities	(497,859)	(347,584)
FINANCING ACTIVITIES		
Dividends paid <i>[notes 19 and 20]</i>	(33,063)	(25,000)
Proceeds from debentures <i>[note 11]</i>	297,950	198,493
Repayment of debentures <i>[note 11]</i>	(245,057)	-
Increase (decrease) in customers' advance deposits	(8,214)	12,554
Net cash provided by financing activities	11,616	186,047
Net increase (decrease) in cash and cash equivalents during the year	(175,895)	118,781
Cash and cash equivalents, beginning of year	330,151	211,370
Cash and cash equivalents, end of year	154,256	330,151
Supplementary cash flow information		
Total interest paid	79,552	71,248
Payments in lieu of corporate taxes	10,299	15,061

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, 2011

1. INCORPORATION

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

The Corporation supervises the operations of, and provides corporate, management services and strategic direction to two subsidiaries incorporated under the OBCA and wholly-owned by the Corporation:

- [i] Toronto Hydro-Electric System Limited [“LDC”] (incorporated June 23, 1999) – distributes electricity to customers located in the City and is subjected to rate regulation. LDC is also engaged in the delivery of Conservation and Demand Management [“CDM”] activities; and
- [ii] Toronto Hydro Energy Services Inc. [“TH Energy”] (incorporated June 23, 1999) – provides street lighting services.

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

2. REGULATION

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

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

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

a) Electricity Distribution Rates

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

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

LDC filed evidence supporting its position for electricity distribution rates to be set under the cost of service framework as part of its 2012-2014 Rate Application. In particular, LDC provided evidence that it cannot adequately manage its resources and financial needs under the incentive regulation mechanism framework. The OEB established a process by which a portion of LDC’s evidence was tested during an oral hearing held in November 2011 [note 25[b]].

b) Street Lighting Activities

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

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

On August 3, 2011, the OEB issued its final decision allowing the transfer of a portion of the street lighting assets to the new wholly-owned legal entity, and for LDC to amalgamate with the new legal entity [note 25[a]].

c) Conservation and Demand Management Activities

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

Effective January 1, 2011, LDC entered into an agreement with the Ontario Power Authority ["OPA"] to deliver CDM programs in the amount of approximately \$50,000,000 extending from January 1, 2011 to December 31, 2014. As at December 31, 2011, LDC received approximately \$19,875,000 from the OPA for the delivery of CDM programs. All programs to be delivered are fully funded and paid in advance by the OPA. These programs are expected to support the achievement of the mandatory CDM targets described above.

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

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

d) Contact Voltage

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The 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"], are presented in Canadian dollars 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

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

Contributions in aid of construction

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

Allowance for funds used during construction

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

c) Cash and cash equivalents

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

d) Investments

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

e) Inventories

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

f) Property, plant and equipment

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

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

	<u>2011</u>	<u>2010</u>
Distribution lines	1.7% to 5.0%	2.5% to 25.0%
Transformers	3.3% to 5.0%	3.3% to 4.0%
Stations	2.5% to 10.0%	2.5% to 6.7%
Meters	2.5% to 6.7%	2.9% to 6.7%
Buildings	1.3% to 5.0%	2.0%
Rolling stock	12.5% to 25.0%	12.5% to 33.3%
Other capital assets	4.0% to 20.0%	4.0% to 20.0%
Assets under capital lease	14.3% to 25.0%	25.0%
Equipment and tools	10.0% to 16.7%	10.0% to 16.7%
Computer hardware	16.7% to 25.0%	20.0% to 25.0%
Communications	10.0% to 20.0%	10.0% to 20.0%

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

g) Intangible assets

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

j) Revenue recognition

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

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

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
Investments	Investments Held to Maturity
Accounts receivable and unbilled revenue	Loans and Receivables
Accounts payable and accrued liabilities	Other Financial Liabilities
Obligations under capital lease	Other Financial Liabilities
Customers' advance deposits	Other Financial Liabilities
Debentures	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.
- Investments are classified as "Investments Held to Maturity" and are measured at amortized cost, which, upon initial recognition, is considered equivalent to fair value. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Accounts receivable and unbilled revenue are classified as "Loans and Receivables" and are measured at amortized cost, which, upon initial recognition, are considered equivalent to fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Accounts payable and accrued liabilities are classified as "Other Financial Liabilities" and are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

l) Fair value measurements

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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 the current service costs are calculated using the projected benefit method prorated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. The excess of the net actuarial gains or losses over 10% of the accrued benefit obligation is amortized into expense over the average remaining service period of active 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 removal and handling costs for contamination in distribution equipment in service and in storage and for the future environmental remediation of certain properties. Initially, the liability is measured at present value and the amount of the liability is added to the carrying amount of the related asset. In subsequent periods, the asset is depreciated and the liability is adjusted quarterly for the discount applied upon initial recognition of the liability ["accretion expense"] and for changes in the underlying assumptions. The liability is recognized when the asset retirement obligation ["ARO"] is incurred and when the fair value is determined.

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 net financing charges. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

p) Payments in lieu of corporate taxes

The Corporation is exempt from tax under the *Income Tax Act* (Canada) ["ITA"] if not less than 90% of the capital of the Corporation is owned by the City and not more than 10% of the income of the Corporation is derived from activities carried on outside the municipal geographical boundaries of the City. In addition, the Corporation's subsidiaries are also exempt from tax under the ITA provided that all of their capital is owned by the Corporation and not more than 10% of their respective income is from activities carried on outside the municipal geographical boundaries of the City. A corporation exempt from tax under the ITA is also exempt from tax under the *Taxation Act, 2007* (Ontario) ["TA"] and the *Corporations Tax Act* (Ontario) ["CTA"].

The Corporation and each of its subsidiaries are Municipal Electricity Utilities ["MEUs"] for purposes of the PILs regime contained in the Electricity Act. The Electricity Act provides that a MEU that is exempt from tax under the ITA, the CTA and the TA is required to make, for each taxation year, a PILs payment to the Ontario Electricity

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

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

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

r) Future Accounting Pronouncements

Adoption of New Accounting Standards

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

The Corporation’s IFRS conversion project was proceeding as planned to meet the January 1, 2011 conversion date. In the absence of a definitive plan to consider the issuance of a RRA standard by the IASB, the Corporation decided to evaluate the option of adopting United States [“US”] GAAP effective January 1, 2012 as an alternative to IFRS. The Corporation’s current application of Canadian GAAP for RRA is generally consistent with US GAAP. Under US GAAP, the Corporation’s financial reporting is expected to be more comparable with its current Canadian

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

GAAP results than it would be under IFRS and is expected to facilitate comparability with other large North American utilities.

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

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

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

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

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

4. INVENTORIES

Inventories consist of the following:

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

5. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consist of the following:

	2011			2010		
	Cost \$	Accumulated depreciation \$	Net book value \$	Cost \$	Accumulated depreciation \$	Net book value \$
Land	16,761	—	16,761	9,560	—	9,560
Distribution lines	2,850,401	1,441,333	1,409,068	2,608,555	1,384,876	1,223,679
Transformers	652,102	360,398	291,704	609,702	341,706	267,996
Stations	277,905	137,246	140,659	259,337	128,254	131,083
Meters	238,459	124,117	114,342	214,859	114,808	100,051
Buildings	154,932	62,403	92,529	151,543	55,609	95,934
Rolling stock	78,016	43,154	34,862	73,749	43,208	30,541
Other capital assets	68,802	44,108	24,694	59,049	35,462	23,587
Assets under capital lease	14,269	1,251	13,018	886	351	535
Equipment and tools	44,208	31,785	12,423	41,604	29,732	11,872
Computer hardware	44,625	35,602	9,023	40,634	31,228	9,406
Communications	31,537	23,912	7,625	26,818	21,013	5,805
Construction in progress	232,789	—	232,789	218,728	—	218,728
	4,704,806	2,305,309	2,399,497	4,315,024	2,186,247	2,128,777

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

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

For the year ended December 31, 2011, the Corporation recognized a gain of \$3,885,000 [2010 - \$3,767,000] on disposals of surplus properties, of which \$1,375,000 [2010 - \$2,750,000] relates to surplus properties for which the OEB reduced electricity distribution rates in 2010. LDC began recognizing the actual gain realized on the sale of these properties over a one-year period from May 1, 2010 to mirror the actual timing of the reduction in 2010 electricity distribution rates.

For the year ended December 31, 2011, the Corporation recorded depreciation expense of \$125,210,000 [2010 - \$153,189,000] of which \$1,177,000 [2010 - \$204,000] related to assets under capital lease.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

6. INTANGIBLE ASSETS, NET

Intangible assets consist of the following:

	2011			2010		
	Cost \$	Accumulated amortization \$	Net book value \$	Cost \$	Accumulated amortization \$	Net book value \$
Computer software	222,598	154,186	68,412	172,709	129,301	43,408
Contributions	14,059	1,440	12,619	2,043	524	1,519
Software in development	3,582	—	3,582	39,191	—	39,191
Contributions for work in progress	28,369	—	28,369	1,878	—	1,878
	268,608	155,626	112,982	215,821	129,825	85,996

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

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

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

For the year ended December 31, 2011, the Corporation recorded amortization expense on intangible assets of \$25,812,000 [2010 - \$16,219,000].

7. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

Regulatory liabilities consist of the following:

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

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

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

a) Smart Meters

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

b) Late Payment Penalties Settlement

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

c) IFRS Conversion Project

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

d) Settlement Variances

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

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

e) Special Purpose Charge Variance

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

f) Future Income Taxes

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

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

g) Regulatory Assets Recovery Account

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

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

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

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

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

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

h) PILs Variances

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

8. OTHER ASSETS

Other assets consist of the following:

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

9. CREDIT FACILITIES

On May 3, 2011, the Corporation extended its revolving credit facility ["Revolving Credit Facility"] for an additional term, expiring on May 3, 2013. Under the terms of the Revolving Credit Facility, the Corporation may borrow up to \$400,000,000, of which:

- [i] \$400,000,000 less the amount utilized under [ii] is available for working capital and LDC capital expenditure purposes in the form of prime rate loans in Canadian dollars and Bankers' Acceptance ["BAs"]; and
- [ii] up to \$140,000,000 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 fee payable for BAs and letters of credit is based on a margin determined by reference to the Corporation's credit rating. The Revolving Credit Facility contains a negative pledge, customary covenants and events of default.

As at December 31, 2011, no amounts had been drawn under the Corporation's Revolving Credit Facility [December 31, 2010 - \$nil]. As at December 31, 2011, no amounts had been drawn for working capital purposes [December 31, 2010 - \$nil].

Additionally, the Corporation is a party to a bilateral facility for \$50,000,000 for the purpose of issuing letters of credit mainly to support LDC's prudential requirements with the IESO. As at December 31, 2011, \$45,077,000 had been drawn on the bilateral facility [December 31, 2010 - \$46,077,000].

10. CURRENT PORTION OF OTHER LIABILITIES

Current portion of other liabilities consist of the following:

	2011 \$	2010 \$
Customers' advance deposits	20,108	18,790
Obligations under capital lease <i>[note 21]</i>	1,871	182
Other	311	761
	22,290	19,733

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

11. DEBENTURES

Debentures consist of the following:

	2011 \$	2010 \$
Senior unsecured debentures		
Series 1 – 6.11% due May 7, 2013	224,298	223,838
Series 2 – 5.15% due November 14, 2017	248,941	248,793
Series 3 – 4.49% due November 12, 2019	248,682	248,546
Series 4 – 6.11% due December 30, 2011	—	245,057
Series 5 – 6.11% due May 6, 2013	245,057	245,057
Series 6 – 5.54% due May 21, 2040	198,566	198,546
Series 7 – 3.54% due November 18, 2021	297,970	—
Total debentures	1,463,514	1,409,837
Less: Current portion of debentures	—	245,057
Long-term portion of debentures	1,463,514	1,164,780

All debentures of the Corporation rank equally.

On May 7, 2003, the Corporation issued \$225,000,000 in 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 in 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 in 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.

On April 1, 2010, the Corporation issued \$245,057,000 senior unsecured debentures [“Series 4”]. The Series 4 debentures bear interest at the rate of 6.11% per annum, payable semi-annually in arrears in equal instalments on June 30 and December 30 of each year and on the maturity date. The Series 4 debentures matured on December 30, 2011.

On April 1, 2010, the Corporation issued \$245,057,000 senior unsecured debentures [“Series 5”]. The Series 5 debentures bear interest at the rate of 6.11% per annum, payable semi-annually in arrears in equal instalments on May 6 and November 6 of each year and on the maturity date. The Series 5 debentures mature on May 6, 2013.

On May 20, 2010, the Corporation issued \$200,000,000 in 30-year senior unsecured debentures [“Series 6”]. The Series 6 debentures bear interest at the rate of 5.54% per annum, payable semi-annually in arrears in equal instalments on May 21 and November 21 of each year. The Series 6 debentures mature on May 21, 2040.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

On November 18, 2011, the Corporation issued \$300,000,000 in 10-year senior unsecured debentures [“Series 7”]. The Series 7 debentures bear interest at the rate of 3.54% per annum, payable semi-annually in arrears in equal instalments on May 18 and November 18 of each year. The Series 7 debentures mature on November 18, 2021.

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 contain certain covenants which, subject to certain exceptions, restrict the ability of the Corporation and LDC to create security interests, incur additional indebtedness or dispose of all or substantially all of their assets.

12. EMPLOYEE FUTURE BENEFITS

Pension

For the year ended December 31, 2011, the Corporation’s OMERS current service pension costs were \$14,115,000 [2010 - \$12,024,000]. For the year ended December 31, 2011, OMERS contribution rates were 7.4% up to the year’s maximum pensionable earnings [“YMPE”] and 10.7% over YMPE for normal retirement age [“NRA”] of 65 [December 31, 2010 - 6.4% up to YMPE and 9.7% over YMPE for NRA of 65].

Employee future benefits other than pension

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, 2010.

a) Accrued benefit obligation

	2011 \$	2010 \$
Balance, beginning of year	200,027	177,144
Experience loss at beginning of year	—	8,013
Current service cost	3,908	3,485
Interest cost	11,507	11,102
Benefits paid	(7,495)	(7,197)
Actuarial losses	36,379	7,480
Balance, end of year	244,326	200,027

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

	2011 \$	2010 \$
Accrued benefit obligation	244,326	200,027
Unamortized net actuarial losses	(63,698)	(27,952)
Unamortized past service costs	(1,087)	(2,178)
Post-employment benefits liability	179,541	169,897

c) Components for net periodic defined benefit costs

	2011 \$	2010 \$
Current service cost	3,908	3,485
Interest cost	11,507	11,102
Actuarial losses	36,379	15,493
Cost incurred in the year	51,794	30,080
Differences between costs incurred and costs recognized in the year in respect of:		
Actuarial gains	(35,746)	(15,298)
Past service costs	1,091	964
	(34,655)	(14,334)
Defined benefit costs recognized	17,139	15,746
Capitalized as part of property, plant and equipment	6,758	7,388
Charged to operations	10,381	8,358

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

d) Significant assumptions

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

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

e) Sensitivity analysis

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

	Increase \$	Decrease \$
Total of current service and interest cost (at 5.8%)	2,733	(1,880)
Accrued benefit obligation as at December 31, 2011 (at 4.8%)	36,933	(28,417)

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

	Increase \$	Decrease \$
Accrued benefit obligation as at December 31, 2011	(33,098)	42,923
Estimated expense for fiscal 2012	(3,030)	3,449

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

13. OTHER LIABILITIES

Other long-term liabilities consist of the following:

	2011 \$	2010 \$
Obligations under capital lease <i>[note 21]</i>	11,301	369
Other	—	265
	11,301	634

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

14. ASSET RETIREMENT OBLIGATIONS

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

	2011 \$	2010 \$
Balance, beginning of year	5,005	7,552
ARO liabilities settled in the year	(688)	(2,290)
Accretion expense	173	194
Revision in estimated cash flows	412	(451)
Balance, end of year	4,902	5,005

As at December 31, 2011, the Corporation estimates the undiscounted amount of cash flows required over the next one to 45 years to settle the ARO liabilities is \$5,811,000 [December 31, 2010 - \$6,560,000]. Discount rates ranging from 1.39% to 6.60% [December 31, 2010 - 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.

15. CAPITAL DISCLOSURES

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

- ensure ongoing access to funding to maintain and refurbish the electricity distribution system of LDC;
- ensure compliance with covenants related to its credit facilities and senior unsecured debentures;
- maintain at least an A- credit rating as required under its shareholder direction; and
- align its capital structure for regulated activities of LDC with the deemed debt to equity structure set by the OEB.

As at December 31, 2011, the Corporation's definition of capital includes long-term debt and obligations under capital lease, including the current portion thereof, and shareholder's equity, and has remained unchanged from

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

December 31, 2010. As at December 31, 2011, shareholder's equity amounted to \$1,102,248,000 [December 31, 2010 - \$1,039,379,000] and long-term debt, including the current portion thereof, amounted to \$1,476,686,000 [December 31, 2010 - \$1,409,837,000]. The Corporation's capital structure as at December 31, 2011 was 57% debt and 43% equity [December 31, 2010 - 58% debt and 42% equity]. There were no changes in the Corporation's approach to capital management during the year.

As at December 31, 2011, the Corporation is subject to debt agreements that contain various covenants. The Corporation's unsecured debentures limit consolidated funded indebtedness to a maximum of 75% of total consolidated capitalization. As at December 31, 2011, the consolidated funded indebtedness to consolidated capitalization ratio was 57% [December 31, 2010 - 57%].

The Corporation's Revolving Credit Facility limits the debt to capitalization ratio to a maximum of 75%. As at December 31, 2011, the debt to capitalization ratio was 58% [December 31, 2010 - 58%].

The Corporation's long-term debt agreements also include negative covenants such as limitations on funded indebtedness, limitations on designated subsidiary indebtedness, and restrictions on mergers and dispositions of designated subsidiaries. As at December 31, 2011 and as at December 31, 2010, the Corporation was in compliance with all covenants included in its long-term debt agreements and short-term Revolving Credit Facility.

16. FINANCIAL INSTRUMENTS

a) Recognition and measurement

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

	2011		2010	
	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	154,256	154,256	330,151	330,151
Investments	34,002	34,002	—	—
Accounts receivable, net of allowance for doubtful accounts	183,272	183,272	168,988	168,988
Unbilled revenue	262,058	262,058	287,893	287,893
Accounts payable and accrued liabilities	412,412	412,412	373,543	373,543
Obligations under capital lease	13,172	13,172	505	505
Customers' advance deposits	56,038	56,038	64,252	64,252
Senior unsecured debentures				
Series 1 – 6.11% due May 7, 2013	224,298	238,359	223,838	245,310
Series 2 – 5.15% due November 14, 2017	248,941	284,126	248,793	273,725
Series 3 – 4.49% due November 12, 2019	248,682	275,575	248,546	259,777
Series 4 – 6.11% due December 30, 2011	—	—	245,057	255,199
Series 5 – 6.11% due May 6, 2013	245,057	259,578	245,057	267,177
Series 6 – 5.54% due May 21, 2040	198,566	245,096	198,546	217,188
Series 7 – 3.54% due November 18, 2021	297,970	306,696	—	—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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.

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

Credit risk

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

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

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

Credit risk associated with accounts receivable is as follows:

	2011 \$	2010 \$
Total accounts receivable	196,259	180,900
Less: Allowance for doubtful accounts	(12,987)	(11,912)
Total accounts receivable, net	183,272	168,988
Of which:		
Outstanding for not more than 30 days	155,274	147,457
Outstanding for more than 30 days but not more than 120 days	24,777	21,635
Outstanding for more than 120 days	16,208	11,808
Less: Allowance for doubtful accounts	(12,987)	(11,912)
Total accounts receivable, net	183,272	168,988

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

	2011 \$	2010 \$
Balance, beginning of year	(11,912)	(12,580)
Provision for doubtful accounts	(10,272)	(6,998)
Write-offs	9,854	9,273
Recoveries	(657)	(1,607)
Balance, end of year	(12,987)	(11,912)

Unbilled revenue represents amounts for which the Corporation has a contractual right to receive cash through future billings but are unbilled at period-end. As at December 31, 2011, total unbilled revenue was \$262,058,000 [December 31, 2010 - \$287,893,000]. Unbilled revenue is considered current.

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

Interest rate risk

The Corporation is exposed to interest rate risk through holding certain financial instruments, and short-term borrowings under the Corporation's Revolving Credit Facility [note 9] which 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 Corporation attempts to minimize interest rate risk by issuing long-term fixed rate debt, and by extending or shortening the term of its short-term money market investments by assessing the monetary policy stance of the Bank of Canada, while ensuring that all payment obligations are met on an ongoing basis.

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

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

The Corporation is also exposed to fluctuations in interest rates for the valuation of its post-employment benefit obligations [note 12[e]].

Liquidity risk

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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, 2011			
	Due within 1 year \$	Due between 1 year and 5 years \$	Due after 5 years \$
Financial liabilities			
Accounts payable and accrued liabilities	412,412	—	—
Obligations under capital lease	1,871	8,042	3,259
Senior unsecured debentures			
Series 1 – 6.11% due May 7, 2013	—	225,000	—
Series 2 – 5.15% due November 14, 2017	—	—	250,000
Series 3 – 4.49% due November 12, 2019	—	—	250,000
Series 5 – 6.11% due May 6, 2013	—	245,057	—
Series 6 – 5.54% due May 21, 2040	—	—	200,000
Series 7 – 3.54% due November 18, 2021	—	—	300,000
Interest payments on debentures	74,905	197,560	359,293
	489,188	675,659	1,362,552

Hedging and Derivative risk

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

Foreign exchange risk

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

17. FINANCIAL GUARANTEES

The City has authorized the Corporation to provide financial assistance to its subsidiaries, and LDC to provide financial assistance to other subsidiaries of the Corporation, in the form of letters of credit and guarantees, for the purpose of enabling them to carry on their businesses up to an aggregate amount of \$500,000,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

18. 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

	2011 \$	2010 \$
Rate reconciliation		
Income before PILs	104,750	91,705
Consolidated Statutory Canadian federal and provincial income tax rate	28.25%	31.00%
Expected provision for PILs	29,592	28,429
Temporary differences not benefited	(16,032)	(1,303)
Other	(4,742)	(1,546)
Provision for PILs	8,818	25,580
Effective tax rate	8.42%	27.89%
Components of provision for PILs		
Current tax provision	9,419	24,709
Future income tax provision related to the origination and reversal of temporary differences	(601)	871
Provision for PILs	8,818	25,580

Consolidated Balance Sheets

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

	2011 \$	2010 \$
Property, plant and equipment and intangible assets	110,161	131,232
Regulatory adjustments	50,109	56,142
Post-employment benefits liability	44,885	42,474
Other taxable temporary differences	6,482	6,583
Capital loss carryforwards	5,147	4,840
Non-capital loss carryforwards	503	509
Valuation allowance	(14,920)	(15,880)
Future income tax assets	202,367	225,900

As at December 31, 2011, the Corporation accumulated non-capital losses for PILs purposes of approximately \$2,011,000 [December 31, 2010 - \$2,037,000], which are available to reduce taxable income in future years. As at December 31, 2011, the Corporation also accumulated taxable capital losses of \$19,698,000 [December 31, 2010 -

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

\$19,359,000] which are available to offset capital gains in future years. If not utilized, \$500,000 of non-capital losses will expire in 2014 and 2015, and \$1,511,000 of non-capital losses will expire in or after 2026.

19. SHARE CAPITAL

Share capital consists of the following:

	2011 \$	2010 \$
Authorized The authorized share capital of the Corporation consists of an unlimited number of common shares		
Issued and outstanding 1,000 common shares	567,817	567,817

Dividends

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

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

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

During 2011, the board of directors of the Corporation declared and paid dividends totalling \$33,063,000 [2010 - \$25,000,000] to the City.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

20. RELATED PARTIES

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

Transactions with Related Parties Summary	2011 \$	2010 \$
Revenues	147,469	147,399
Operating expenses and capital expenditures	30,582	14,068
Net financing charges	—	7,487
Dividends	33,063	25,000

Transactions with Related Parties Summary	2011 \$	2010 \$
Accounts receivable, net of allowance for doubtful accounts	8,412	6,711
Unbilled revenue	8,692	9,830
Other assets	7,279	7,368
Accounts payable and accrued liabilities	25,085	12,164
Customers' advance deposits	8,714	10,953

Revenues represent amounts charged to the City primarily for electricity and street lighting services. Operating expenses and capital expenditures represent amounts charged by the City for purchased road cut repairs, property taxes and other services. Net financing charges represent interest paid to the City on the promissory note which was monetized on April 1, 2010. Dividends represent dividends paid to the City [note 19].

Accounts receivable, net of allowance for doubtful accounts represent receivables from the City primarily for relocation services, sale of electricity and street lighting services. Unbilled revenue represents receivables from the City related to the provision of electricity not yet billed. Other assets represent amounts for prepaid land leases from the City. Accounts payable and accrued liabilities represent amounts payable to the City relating to road cut repairs and other services, as well as funds received from the City for the construction of electricity distribution assets. Customers' advance deposits represent funds received from the City for future expansion projects.

21. COMMITMENTS

Operating lease obligations and future commitments

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

	\$
2012	27,715
2013	23,442
2014	7,492
2015	6,487
2016	6,308
Thereafter	4,755
Total amount of future minimum payments	76,199

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

Capital lease obligations

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

	\$
2012	2,454
2013	2,445
2014	2,404
2015	2,327
2016	2,267
Thereafter	3,380
Total amount of future minimum payments	15,277
Less interest and executory costs	2,105
	13,172
Current portion <i>[note 10]</i>	1,871
Long-term portion <i>[note 13]</i>	11,301

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

22. CONTINGENCIES

a) Legal Proceedings

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

Christian Helm Class Action

On December 6, 2010, a statement of claim in a proposed class action was issued against LDC. The claim seeks general and special damages in the amount of \$100,000,000 for disgorgement of unjust gains allegedly resulting from the receipt of interest on overdue accounts at a rate exceeding 5% per annum in contravention of the *Interest Act* (Canada) ["Interest Act"]. A statement of defence has been filed. Prior to any certification of the action as a class proceeding, cross summary judgment motions were heard in June 2011 to determine whether the Interest Act has been breached [note 25[c]].

2 Secord Avenue

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

2369 Lakeshore Boulevard West

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

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

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

Adamopoulos

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

b) OEB PILs Proceeding

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

c) Payments in Lieu of Additional Municipal and School Taxes

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

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

23. NET INCOME PER SHARE

The weighted daily average number of shares outstanding as at December 31, 2011 was 1,000 [December 31, 2010 - 1,000]. Basic and fully diluted net income per share was determined by dividing the net income for the year by the weighted daily average number of shares outstanding.

24. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

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

25. SUBSEQUENT EVENTS

a) Street Lighting Activities

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

b) Electricity Distribution Rates

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2011

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

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

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

Under the incentive regulation mechanism framework, LDC has to significantly reduce its costs structure, and in particular its operating expenses, in order to meet its financial obligations. Accordingly, in the first quarter of 2012, LDC began implementing a restructuring program aimed at reducing its operating costs in the future. The main component of this restructuring program is a workforce reduction plan targeting both union and management employees. As at March 2, 2012, the costs incurred as a result of the restructuring program amounted to approximately \$19,300,000, which were mainly related to employee severance and buy-out costs.

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

c) Christian Helm Class Action

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

If the settlement does not receive court approval, the decision on the cross summary judgment motions will be released. In this event, if the court finds a breach of the Interest Act, subject to appeals, the proceeding will continue, and LDC will rely on other defences. While LDC believes it has a defence to this claim, there is no guarantee that it will be successful in defending the action and therefore, the outcome of this proceeding could have a material impact on the Corporation's consolidated financial statements and results of operations [note 22[a]].

d) Dividends

On March 2, 2012, the board of directors of the Corporation declared dividends in the amount of \$28,966,000. The dividends are comprised of \$22,966,000 with respect to net income for the year ended December 31, 2011, payable to the City on March 12, 2012, and \$6,000,000 with respect to the first quarter of 2012, payable to the City on March 30, 2012 [note 19].