2010 Audited Consolidated Annual Financial Statements of Toronto Hydro Corporation

Date:	March 14, 2011
To:	Executive Committee
From:	Deputy City Manager and Chief Financial Officer

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Disclosure of Financial Results:

Section 6.6 of the Toronto Hydro Shareholder Direction requires the Corporation to deliver its audited consolidated annual financial statements to the Shareholder within 120 days of its fiscal year end. These documents are included as Appendix 'A' to this report and are filed with the City Clerk's office, posted on the internet on the Toronto Hydro Corporation website (www.torontohydro.com) and via the SEDAR website for Canadian public securities documents.

The consolidated statements are public documents upon their release. The corporation's unconsolidated statements (relating to its subsidiary companies and the holding company) remain confidential.

The *Business Corporations Act*, Ontario ("OBCA") (s.94) requires that an annual meeting of shareholders be called no later than 15 months after the last preceding annual meeting. The last annual general meeting of the Corporation was held at the Council meeting of July 6, 7 and 8, 2010 (Executive Committee Report No. EX45.2).

2010 Financial Results

For the fiscal year ended December 31, 2010, the Corporation generated a consolidated net income of $66.1 million as compared with $42.1 million for 2009 for a nominal year over year change in net income of $24.0 million ($66.1 million vs. $42.1 million).

The increase in Net Revenues is due to a combination of Ontario Energy Board (OEB) approval of revenue for 2010 (7.5% increase over 2009) and higher consumption.

The increase in Operating Expenses is primarily the result of increased hiring as part of the workforce renewal strategy and general wage increases and contingencies recognized for various legal proceedings.

The table below summarizes the changes in net income for 2010 compared with 2009.

Toronto Hydro Corporation
Change in Consolidated Net Income 2010 vs. 2009 ($'s million)

	2010	2009	Change
Net Revenues	549.4	504.3	45.1
Operating Expenses	(223.3)	(208.8)	(14.5)
Depreciation and Amortization	(169.4)	(163.0)	(6.4)
Provision for Payment-In Lieu of Corporate Tax (PIL)	(25.6)	(19.7)	(5.9)
Net Interest Expense	(71.2)	(70.6)	(0.6)
Add: Gain on Disposals of Property, Plant & Equipment	3.8	0.9	2.9
Change in Fair Value of Investments [1]	2.4	(1.0)	3.4
Total Net Income	66.1	42.1	24.0

1. Non-bank-sponsored Asset Backed Commercial Paper ("ABCP") notes.

During fiscal 2010, the City received Shareholder dividend payments totalling $25.0 million compared with 2009 dividends of $25.2 million.

This is consistent with the City's Shareholder Direction which requires the corporation to pay dividends to the City equal to the greater of $25 million or 50% of net income, paid in arrears once the Financial Statements have been finalized.

Total assets are increasing as Toronto Hydro continues to focus on and execute a significantly expanded infrastructure renewal program that is expected to increase the rate base and increase earnings in the future.

Selected consolidated results of Toronto Hydro Corporation are as follows:

Selected Consolidated Results of Toronto Hydro Corporation ($ millions)		
	Year ended Dec 31, 2010	Year ended Dec 31, 2009
	Actual	Actual
Shareholder's Equity	$1,039.4	$998.3
Total Assets	$3,368.9	$3,059.2
Cash at end of period	$330.2	$211.4
Debt	$1,409.8	$1,210.6
Dividends to City	$25.0	$25.2

The change in cash position at year end is primarily due to strong operating cash-flow (approx. $90 million), an increase in debt (approx. $200 million) to fund infrastructure investments, offset in part by higher Capital Expenditures for 2010 (approx. $142 million increase over 2009).

Subsequent Event

To the end of 2010 and in accordance with the Shareholder Direction the Corporation has paid dividends to the City totalling $25 million.

On March 11, 2011 the Board of Directors declared dividends of $8.1 million payable March 18, 2011, bringing total dividends paid and attributable to the 2010 calendar year to $33.1 million or 50% of Audited Net Income for the year ended December 31, 2010 (of $66.1 million).

CONTACT

Len Brittain, Director, Corporate Finance Division
Tel: (416) 392-5380; Fax: (416) 397-4555; E-mail: lbrittai@toronto.ca

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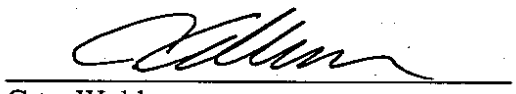

Cam Weldon
Deputy City Manager and Chief Financial Officer

ATTACHMENT:

Appendix A - 2010 Audited Consolidated Financial Statements of Toronto Hydro Corporation

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CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010

Appendix A

toronto hydro corporation

Consolidated Financial Statements
DECEMBER 31, 2010

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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 11, 2011.

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 Ernst & Young LLP, independent external auditors appointed by the Corporation's Board of Directors. 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:

Anthony Haines
President and Chief Executive Officer

Jean-Sebastien Couillard
Chief Financial Officer

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 sheets as at December 31, 2010 and 2009 and the consolidated statements of income, retained earnings and cash flows for the years then ended, and 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 audits. We conducted our audits 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 the auditors' 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, the auditors 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 in our audits 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 financial position of **Toronto Hydro Corporation** as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Canada,
March 11, 2011.

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CONSOLIDATED BALANCE SHEETS

[In thousands of dollars]

As at December 31	2010 $	2009 $
ASSETS		
Current		
Cash and cash equivalents	330,151	211,370
Accounts receivable, net of allowance for doubtful accounts *[note 15[b]]*	168,988	150,795
Unbilled revenue *[note 15[b]]*	287,893	295,647
Payments in lieu of corporate taxes receivable	6,729	15,932
Inventories *[note 4]*	7,501	6,224
Prepaid expenses	4,048	3,331
Total current assets	805,310	683,299
Property, plant and equipment, net *[note 5]*	2,128,777	1,919,954
Intangible assets, net *[note 6]*	85,996	73,829
Regulatory assets *[note 8]*	85,113	68,193
Other assets	7,518	7,615
Future income tax assets *[note 17]*	256,147	253,149
Investments *[note 7]*	-	47,930
Assets held for sale	-	5,258
Total assets	3,368,861	3,059,227
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current		
Accounts payable and accrued liabilities *[note 15[b]]*	373,543	318,317
Other liabilities *[note 10]*	20,367	19,474
Deferred revenue	1,418	421
Debentures *[note 11]*	245,057	-
Total current liabilities	640,385	338,212
Long-term liabilities		
Debentures *[note 11]*	1,164,780	720,475
Promissory note payable *[notes 11 and 19]*	-	490,115
Post-employment benefits *[note 12]*	169,897	161,348
Regulatory liabilities *[note 8]*	303,953	308,575
Asset retirement obligations *[note 13]*	5,005	7,552
Customers' advance deposits	45,462	34,696
Total long-term liabilities	1,689,097	1,722,761
Total liabilities	2,329,482	2,060,973
Commitments and contingencies *[notes 20, 21 and 24]*		
Shareholder's equity		
Share capital *[note 18]*	567,817	567,817
Retained earnings	471,562	430,437
Total shareholder's equity	1,039,379	998,254
Total liabilities and shareholder's equity	3,368,861	3,059,227

ON BEHALF OF THE BOARD:

Clare R. Copeland, Director

Brian Chu, Director

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

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CONSOLIDATED STATEMENTS OF INCOME

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

Year ended December 31	2010 $	2009 $
Revenues	2,611,671	2,457,923
Costs		
Purchased power and other	2,062,269	1,953,657
Operating expenses	223,326	208,834
Depreciation and amortization	169,408	162,970
	2,455,003	2,325,461
Income before the following:	156,668	132,462
Interest income	2,627	3,207
Interest income (expense)		
Long-term debt	(74,505)	(73,061)
Other interest	728	(697)
Change in fair value of investments *[note 7]*	2,420	(1,049)
Gain on disposals of property, plant and equipment *[note 5]*	3,767	1,013
Income before provision for payments in lieu of corporate taxes	91,705	61,875
Provision for payments in lieu of corporate taxes *[note 17]*	25,580	19,742
Net income	66,125	42,133
Basic and fully diluted net income per share *[note 22]*	66,125	42,133

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

[in thousands of dollars]

Year ended December 31	2010 $	2009 $
Retained earnings, beginning of year	430,437	413,474
Net income	66,125	42,133
Dividends *[note 18]*	(25,000)	(25,170)
Retained earnings, end of year	471,562	430,437

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

[in thousands of dollars]

Year ended December 31	2010 $	2009 $
OPERATING ACTIVITIES		
Net income	66,125	42,133
Adjustments for non-cash items		
Depreciation and amortization	169,408	162,970
Change in fair value of investments *[note 7]*	(2,420)	1,049
Net change in other assets and liabilities	5,051	(480)
Payments in lieu of corporate taxes	9,203	8,074
Post-employment benefits	8,549	8,577
Future income taxes *[note 17]*	871	494
Gain on disposals of property, plant and equipment *[note 5]*	(3,767)	(1,013)
Changes in non-cash working capital balances		
Increase in accounts receivable	(18,193)	(19,213)
Decrease (increase) in unbilled revenue	7,754	(29,586)
Increase in inventories	(1,277)	(1,155)
Increase in prepaid expenses	(717)	(828)
Increase in accounts payable and accrued liabilities	40,109	22,588
Decrease in deferred revenue	(378)	(2,853)
Net cash provided by operating activities	280,318	190,757
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(362,397)	(218,149)
Purchase of intangible assets	(28,387)	(31,156)
Proceeds from sale of investments *[note 7]*	50,350	-
Accumulated cash received from conduit trusts *[note 7]*	-	3,929
Net change in regulatory assets and liabilities	(16,011)	(58,743)
Proceeds on disposal of property, plant and equipment *[note 5]*	8,861	1,056
Net cash used in investing activities	(347,584)	(303,063)
FINANCING ACTIVITIES		
Decrease in promissory note payable	-	(245,058)
Dividends paid *[note 18]*	(25,000)	(25,170)
Proceeds from debentures *[note 11]*	198,493	248,399
Increase in customers' advance deposits	12,554	5,013
Net cash provided by (used in) financing activities	186,047	(16,816)
Net increase (decrease) in cash and cash equivalents during the year	118,781	(129,122)
Cash and cash equivalents, beginning of year	211,370	340,492
Cash and cash equivalents, end of year	330,151	211,370
Supplementary cash flow information		
Total interest paid	71,248	72,714
Payments in lieu of corporate taxes	15,061	14,803

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, 2010

1. INCORPORATION

On June 23, 1999, Toronto Hydro Corporation [the "Corporation"] was incorporated under the Business Corporations Act (Ontario) [the "BCA"]. The incorporation was required in accordance with the provincial government's *Electricity Act, 1998*.

The Corporation supervises the operations of, and provides corporate, management services and strategic direction to two principal subsidiaries (each of which is listed below, incorporated under the BCA 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 of Toronto [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) – owns and operates street lighting assets located in the City.

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

2. REGULATION

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

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

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

[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 typically comprise a fixed charge and a usage-based (consumption) charge.

The volume of electricity consumed by LDC's customers during any period is governed by events largely outside LDC's control, principally sustained periods of hot or cold weather which increase the consumption of electricity and sustained periods of moderate weather which decrease the consumption of electricity.

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

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

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

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 electricity distribution rates are typically effective from May 1 to April 30 of the following year. Accordingly, for the first four months of 2010, distribution revenue was based on the rates approved for 2009. Distribution revenue for the period from May 1, 2010 to December 31, 2010 was based on the distribution rates approved in 2010.

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

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

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

December 31, 2010

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

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

On April 9, 2010, the OEB issued its final decision regarding electricity distribution rates of LDC for the 2010 rate year beginning May 1, 2010 and ending April 30, 2011. The decision rendered by the OEB was aligned with the settlement proposal accepted by LDC and other parties with regard to the major components of the revenue requirements such as operating expenditures, capital expenditures and load forecast. The decision provided for capital expenditures of $350,000,000 with an additional $27,800,000 allowed to cover expenditures related to Transit City and operating expenses of $204,100,000. The OEB also increased the ROE of LDC from 8.01% in 2009 to 9.85% for 2010, as it transitioned to the new ROE formula guidelines issued in December 2009. Finally, the OEB ordered LDC to reduce its revenue requirement by $10,300,000 to reflect the expected gains on sale related to some designated surplus properties. This reduction was related to the OEB's 2008 decision with regard to LDC's distribution rates for which LDC had filed a notice of clarification in September 2009. Accordingly, after giving effect to all the aspects of the 2010 OEB decision, the distribution revenue requirement and rate base of LDC were set at $518,700,000 and $2,140,700,000, respectively.

On August 23, 2010, LDC filed a rate application with the OEB seeking approval of revenue requirements and corresponding rates for the 2011 rate year commencing on May 1, 2011 and ending on April 30, 2012. The requested distribution revenue requirement and rate base for this period are $578,400,000 and $2,346,300,000, respectively.

b) Contact Voltage

On December 10, 2009, the OEB issued its initial decision in regard to 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 its final decision, following further review of the costs incurred by LDC in connection with the contact voltage remediation activities. In its decision, the OEB deemed the balance allowable for recovery at $5,296,000. 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.

c) Street Lighting Activities

On June 15, 2009, the Corporation filed an application with the OEB seeking an electricity distribution license for a new wholly-owned legal entity to which the Corporation 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 assets could become regulated assets *[note 24[a]]*.

d) Green Energy and Green Economy Act

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

On March 31, 2010, the Minister of Energy and Infrastructure of Ontario, under the guidance of sections 27.1 and 27.2 of the *Ontario Energy Board Act, 1998*, directed the OEB to establish CDM targets to be met by electricity distributors. Accordingly, on November 12, 2010, the OEB amended LDC's distribution license to incorporate the implementation of regulations under the Green Energy Act. The amendments require LDC, as a condition of its license, to achieve 1,304 Gigawatt-Hour of energy savings and 286 Megawatt of summer peak demand savings, over the period beginning January 1, 2011 through December 31, 2014.

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"], and reflect the significant accounting policies summarized below:

a) Basis of consolidation

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

b) Regulation

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2010

Regulatory Assets and Liabilities

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

Handbook Section 1100 directs the Corporation to adopt accounting policies that are developed through the exercise of professional judgment and other sources issued by bodies authorized to issue accounting standards in other jurisdictions. These assets and liabilities can be recognized for rate-setting and financial reporting purposes only if the OEB directs the relevant regulatory treatment or if future OEB direction is judged to be probable. In the event that the disposition of these balances was no longer deemed to be probable, the balances would be recorded in the consolidated statements of income. 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. In accordance with Handbook Section 1100, the Corporation has determined that its assets and liabilities arising from rate-regulated activities qualify for recognition under Canadian GAAP and this recognition is consistent with U.S. Financial Accounting Standards Board Accounting Standards Codification 980 – "Regulated Operations". Accordingly, the removal of the temporary exemption had no effect on the Corporation's results of operations for the year ended December 31, 2010.

Handbook Section 3465 as amended requires the recognition of future income tax assets and liabilities and related regulatory liabilities and assets for the amount of future income taxes expected to be refunded to, or recovered from, customers in future electricity rates, applied on a retrospective basis without prior period restatement. The implementation of these standards did not impact the Corporation's earnings or cash flows. As at December 31, 2010, LDC has recorded a future income tax asset of $254,817,000 and a corresponding regulatory liability of $254,817,000 *[note 8]*.

Contributions in aid of construction

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

Allowance for funds used during construction

The AP Handbook provides for the inclusion of an Allowance for Funds Used During Construction ["AFUDC"] when capitalizing construction-in-progress assets, until such time as the asset is substantially complete. A concurrent credit of the same amount is made to the interest expense account when the allowance is capitalized. The interest rate for capitalization is prescribed by the OEB and modified on a periodic basis and is applied to the

balance of the construction-in-progress assets on a simple interest basis. AFUDC is included in property, plant and equipment, intangible assets, and construction-in-progress for financial reporting purposes, charged to operations through depreciation and amortization expense over the service life of the related assets and recovered through future revenue.

c) Cash and cash equivalents

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

d) 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.

e) Investments

Investments consisted solely of the replacement notes received on January 21, 2009 in connection with the restructuring of the Asset Backed Commercial Paper ["ABCP"] notes impacted by the liquidity issues that arose in August 2007. The Corporation classifies its investments as "Investments Held for Trading". The investments are measured at fair value at each period end with changes in fair value included in the consolidated statements of income in the period in which they arise. On October 8, 2010, the Corporation sold all of its investments for cash consideration of $50,350,000 *[note 7]*.

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.

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

Buildings	2.0%
Stations	2.5% to 6.7%
Distribution lines	2.5% to 25.0%
Transformers	3.3% to 4.0%
Meters	2.9% to 6.7%
Other capital assets	4.0% to 20.0%
Communications	10.0% to 20.0%
Computer hardware	20.0% to 25.0%
Rolling stock	12.5% to 33.3%
Equipment and tools	10.0% to 16.7%

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

g) Intangible assets

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

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

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

Computer software	20.0%
Capital contributions	4.0%

Software in development and capital 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.

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i) Workplace Safety and Insurance Act

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

j) Revenue recognition

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
Accounts receivable and unbilled revenue	Loans and Receivables
Investments	Investments Held for Trading
Accounts payable and accrued liabilities	Other Financial Liabilities
Customers' advance deposits	Other Financial Liabilities
Debentures	Other Financial Liabilities
Promissory note payable to the City	Other Financial Liabilities

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

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

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- Investments are classified as "Investments Held for Trading". The investments are measured at fair value at each period end with changes in fair value included in the consolidated statements of income in the period in which they arise. On October 8, 2010, the Corporation sold all of its investments for cash consideration of $50,350,000 *[note 7]*.
- Accounts payable and accrued liabilities are classified as "Other Financial Liabilities" and are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of these instruments.
- Customers' advance deposits are classified as "Other Financial Liabilities" and are initially measured at their fair value. Subsequent measurements are recorded at amortized cost using the effective interest rate method. The carrying amounts approximate fair value because of the short maturity of the current portion, and the discounted long-term portion approximates the carrying value, taking into account interest accrued on the outstanding balance.
- The debentures and the promissory note payable to the City are classified as "Other Financial Liabilities" and are initially measured at their fair value. The carrying amounts of the debentures and the promissory note payable to the City are carried at amortized cost, based on an initial fair value as determined at the time using quoted market price for similar debt instruments. The fair value of the debentures and the promissory note payable to the City is calculated by discounting the related cash flows at the estimated yield to maturity of similar debt instruments *[note 15]*. 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. On April 1, 2010, the promissory note payable to the City was monetized and cancelled *[note 11[b]]*.

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

In June 2009, the CICA amended Handbook Section 3862 – "Financial Instruments – Disclosures" ["Handbook Section 3862"] to include additional disclosure requirements with respect to fair value measurements of financial instruments and to enhance liquidity risk disclosure requirements. Handbook Section 3862 establishes a fair value hierarchy which includes three levels of inputs that may be used to measure fair value:

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

The Corporation adopted these amendments effective for the fiscal year ended December 31, 2009 *[note 15]*.

In June 2009, the CICA amended Handbook Section 3855 to clarify the application of the effective interest method after a debt instrument has been impaired. This amendment applies retrospectively to financial statements for fiscal years beginning on or after January 1, 2010. The adoption of this amendment did not have any impact on the Corporation's results of operations or financial position.

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

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

l) Capital disclosures

The Corporation discloses objectives, policies and processes for managing capital as well as its compliance with any external capital requirements *[note 14]*.

m) Employee future benefits

Pension plan

The Corporation provides a pension plan for its full-time employees through the Ontario Municipal Employees Retirement System ["OMERS"]. OMERS is a multi-employer, contributory, defined benefit pension plan established in 1962 by the Province of Ontario for employees of municipalities, local boards and school boards in Ontario. Both participating employers and employees are required to make plan contributions based on participating employees' contributory earnings. The Corporation recognizes the expense related to this plan as contributions are made.

Employee future benefits other than pension

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

The accrued benefit obligations and 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

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10% of the accrued benefit obligation is amortized into expense over the average remaining service period of active employees to full eligibility. The effects of a curtailment gain or loss are recognized in income in the year of the event giving rise to the curtailment. The effects of a settlement gain or loss are recognized in the period in which a settlement occurs.

n) Asset retirement obligations

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

o) Customers' advance deposits

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

p) Payments in lieu of corporate taxes

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

The Corporation and each of its subsidiaries are Municipal Electricity Utilities ["MEUs"] for purposes of the payments in lieu of corporate taxes ["PILs"] regime contained in the *Electricity Act, 1998*. The *Electricity Act, 1998* provides that a MEU that is exempt from tax under the ITA and the *Taxation Act, 2007* (Ontario) is required to make, for each taxation year, a PILs payment to the Ontario Electricity Financial Corporation in an amount equal to the tax that it would be liable to pay under the ITA and the *Taxation Act, 2007* (Ontario) 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 following the recommendations of the CICA and the OEB. Under the liability method, current income taxes payable are recorded based on taxable income. Future income taxes arise from temporary differences in the accounting and tax basis of assets and liabilities. Future tax assets and liabilities are provided based on substantively enacted tax rates that will be in effect when the differences are expected to reverse.

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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 judgments 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 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, the Ministry of Finance, or the Ministry of Revenue.

r) *Future Accounting Pronouncements*

International Financial Reporting Standards

On February 13, 2008, the Canadian Accounting Standards Board ["AcSB"] confirmed that publicly accountable enterprises will be 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. A limited number of converged or IFRS-based standards will be incorporated into Canadian GAAP, with the remaining standards to be adopted at the change over date.

The Corporation has an internal initiative to govern the conversion process and is currently in the process of evaluating the potential impact of the conversion to IFRS on its consolidated financial statements. The Corporation believes that the impact on its financial statements could be material.

On September 10, 2010, the AcSB granted an optional one year deferral for IFRS adoption for entities subject to rate regulation. This decision came in light of the uncertainty created by the International Accounting Standards Board ["IASB"] in regard to the rate-regulated project which is assessing the potential recognition of regulatory assets and regulatory liabilities under IFRS. Subsequently, the Canadian Securities Administrators announced that entities subject to rate regulation may defer the adoption of IFRS for up to one year, consistent with the one year deferral granted by the AcSB.

Given the continued uncertainty around the timing, scope and eventual adoption of a rate-regulated accounting ["RRA"] standard under IFRS and the potential material impact of RRA on the Corporation's financial statements, the Corporation has decided to elect the optional one year deferral of its adoption of IFRS. Accordingly, the Corporation will continue to prepare its consolidated financial statements in accordance with Canadian GAAP accounting standards in Part V of the CICA Handbook for 2011.

As a result of these developments related to RRA under IFRS and the uncertainty regarding the impact of IFRS on the OEB electricity distribution rates application process, the Corporation cannot reasonably quantify the full impact that adopting IFRS would have on its future financial position and results of operations. Although the Corporation has completed a detailed assessment of the accounting and disclosure differences between Canadian GAAP and IFRS, in light of the one-year deferral, this assessment will be revisited due to changes to standards during this

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period. The Corporation will continue to actively monitor IASB developments with respect to RRA and non-RRA IFRS developments and their potential impacts.

Consolidated Financial Statements and Non-controlling Interests

In January 2009, the CICA issued Handbook Section 1601 – "Consolidated Financial Statements" ["Handbook Section 1601"]. This section along with the new CICA Handbook Section 1602 – "Non-controlling Interests" ["Handbook Section 1602"] replaces Handbook Section 1600 – "Consolidated Financial Statements" and establishes standards for the preparation of consolidated financial statements. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Corporation has determined that these standards will have no impact on its results of operations or financial position.

Financial Instruments – Recognition and Measurement

In June 2009, the CICA amended Handbook Section 3855 to clarify when an embedded prepayment option is separated from its host debt instrument for accounting purposes. This amendment applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Corporation has determined that this amendment will have no impact on its results of operations or financial position.

Comprehensive Revaluation of Assets and Liabilities

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

4. INVENTORIES

Inventories consist of the following:

	2010 $	2009 $
Consumables, tools and other maintenance items	2,077	1,870
Fuses	1,731	1,783
Drums and reels	1,092	384
Other	2,601	2,187
	7,501	6,224

For the year ended December 31, 2010, the Corporation recognized operating expenses of $4,727,000, related to inventory used to service electrical distribution assets [2009 - $5,282,000].

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5. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consist of the following:

	2010			2009		
	Cost $	Accumulated depreciation $	Net book value $	Cost $	Accumulated depreciation $	Net book value $
Land	9,560	—	9,560	4,048	—	4,048
Buildings	151,543	55,609	95,934	146,163	53,476	92,687
Stations	259,337	128,254	131,083	253,659	120,201	133,458
Distribution lines	2,608,555	1,384,876	1,223,679	2,449,630	1,291,104	1,158,526
Transformers	609,702	341,706	267,996	567,573	321,140	246,433
Meters	214,859	114,808	100,051	204,425	105,829	98,596
Other capital assets	59,049	35,462	23,587	53,269	29,935	23,334
Communications	26,818	21,013	5,805	23,860	18,994	4,866
Computer hardware	40,634	31,228	9,406	33,136	27,380	5,756
Rolling stock	74,635	43,559	31,076	68,043	42,650	25,393
Equipment and tools	41,604	29,732	11,872	37,154	28,011	9,143
Construction in progress	218,728	—	218,728	117,714	—	117,714
	4,315,024	2,186,247	2,128,777	3,958,674	2,038,720	1,919,954

For the year ended December 31, 2010, AFUDC in the amount of $1,850,000 [2009 - $2,752,000] was capitalized to property, plant and equipment and credited to interest expense.

As at December 31, 2010, the net book value of stranded meters related to the deployment of smart meters amounting to $23,120,000 [December 31, 2009 - $25,347,000] is included in property, plant and equipment. In the absence of rate regulation, property, plant and equipment would have been $23,120,000 lower as at December 31, 2010 [December 31, 2009 - $25,347,000].

For the year ended December 31, 2010, the Corporation recognized a net gain of $3,767,000 on the disposal of various surplus properties, of which, $2,750,000 relates to properties for which the OEB reduced electricity distribution rates in 2010 *[note 2[a]]*. LDC began recognizing the actual gains 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.

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6. INTANGIBLE ASSETS, NET

Intangible assets consist of the following:

	2010			2009		
	Cost $	Accumulated amortization $	Net book value $	Cost $	Accumulated amortization $	Net book value $
Computer software	172,709	129,301	43,408	145,074	113,163	31,911
Capital contributions	2,043	524	1,519	2,043	443	1,600
Software in development	39,191	—	39,191	39,576	—	39,576
Capital contributions for work in progress	1,878	—	1,878	742	—	742
	215,821	129,825	85,996	187,435	113,606	73,829

For the year ended December 31, 2010, the Corporation acquired $27,636,000 of intangible assets subject to amortization [2009 - $14,055,000] and acquired $751,000 of intangible assets not subject to amortization [2009 - $17,101,000].

7. INVESTMENTS

On October 8, 2010, the Corporation sold all of its investments for cash consideration of $50,350,000.

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

On January 12, 2009, the Ontario Superior Court approved the restructuring plan proposed by the Montreal Committee note holders. On January 21, 2009, the amended restructuring plan was completed and the Corporation received its replacement notes. The replacement notes received had an aggregate principal amount of $87,700,000. The expected repayment date of the replacement notes was January 22, 2017 and no legal obligation to pay interest on the replacement notes was provided upon issuance.

Prior to their sale, the Corporation valued the investments at fair value on its balance sheets and changes in fair value of investments were recorded to the consolidated statements of income in the period they arose. The fair value of the investments was $47,930,000 as at December 31, 2009 and $50,350,000 as at September 30, 2010. For the year ended December 31, 2010, the Corporation recognized a gain to the consolidated statements of income of $2,420,000 in connection with the sale of these investments. For the year ended December 31, 2009, the Corporation recognized in the consolidated statements of income a reduction in the fair market value of these investments of $1,049,000.

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8. REGULATORY ASSETS AND LIABILITIES

Regulatory assets consist of the following:

	2010 $	2009 $
Smart meters	67,543	50,669
Late payment penalties settlement	7,750	—
IFRS conversion project	6,089	2,943
Special purpose charge variance	3,555	—
Contact voltage	—	9,050
Other	176	5,531
	85,113	68,193

Regulatory liabilities consist of the following:

	2010 $	2009 $
Future income taxes	254,817	250,948
Regulatory assets recovery account	40,275	3,598
PILs variances	5,675	15,197
Settlement variances	2,277	36,615
Other	909	2,217
	303,953	308,575

For the year ended December 31, 2010, LDC disposed of approved net regulatory liabilities amounting to $23,003,000 through permitted distribution rate adjustments [2009 - $13,747,000].

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

a) Smart Meters

The smart meters regulatory asset account relates to the Province of Ontario's decision to install smart meters throughout Ontario. LDC launched its smart meter project shortly following the Province of Ontario's announcement in 2006. As at December 31, 2010, LDC installed approximately 674,000 smart meters. In 2008, in connection with this initiative, the OEB approved the disposition of the balances incurred in 2006 and 2007. The OEB also approved the transfer from regulatory assets to property, plant and equipment of all capital expenditures incurred in 2006 and 2007. In a separate decision regarding LDC's electricity distribution rates for 2008, the OEB ordered LDC to record all future expenditures and revenues related to smart meters to a regulatory asset account and allowed LDC to keep the net book value of the stranded meters related to the deployment of smart meters in its rate base.

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In connection with its smart meter initiatives, the Corporation has incurred costs amounting to $19,799,000 for the year ended December 31, 2010 [2009 - $22,833,000]. As at December 31, 2010, smart meter capital expenditures, net of accumulated depreciation, totalling $65,588,000 have been recorded to regulatory assets [December 31, 2009 - $51,501,000]. 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 $59,416,000 and $6,172,000 higher as at December 31, 2010 [December 31, 2009 - $45,606,000 and $5,895,000, respectively].

For the year ended December 31, 2010, smart meter operating expenses of $3,109,000 [2009 - $3,048,000], and smart meter depreciation expense of $5,357,000 [2009 - $3,447,000] 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, 2010, operating expenses would have been $3,109,000 higher [2009 - $3,048,000 higher], and depreciation expense would have been $5,357,000 higher [2009 - $3,447,000 higher].

For the year ended December 31, 2010, smart meter customer revenues of $5,774,000 were deferred [2009 - $5,741,000]. In the absence of rate regulation, for the year ended December 31, 2010, revenue would have been $5,774,000 higher [2009 - $5,741,000 higher].

b) Late Payment Penalties Settlement

The late payment penalties settlement account relates to the settlement costs accrual associated with the late payment charges class action *[note 21[a] and note 24[d]]*. All of the MEUs involved in the settlement, including LDC, have requested an order from the OEB allowing for the future recovery from customers of all costs related to the settlement. LDC has accrued a liability and a corresponding regulatory asset in the amount of $7,750,000, as at December 31, 2010. In the absence of rate regulation, operating expenses for the year ended December 31, 2010, would have been $7,750,000 higher.

c) IFRS Conversion Project

For year ended December 31, 2010, LDC has incurred $3,108,000 [2009 - $2,927,000] of costs relating to the IFRS conversion project. These costs have been recorded to regulatory assets as LDC expects to obtain recovery of these costs in the future. 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, 2010, operating expenses would have been $3,108,000 higher [2009 - $2,927,000 higher]. LDC is seeking recovery of the IFRS costs as part of its 2011 electricity distribution rate application.

d) 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 *Ontario Energy Board Act, 1998*, 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 is allowed to recover this balance. The recovery is expected to be achieved over a one-year period, which began on May 1, 2010.

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As at December 31, 2010, 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, 2010, would have been $6,123,000 higher and operating expenses would have been $9,698,000 higher.

e) Contact Voltage

The contact voltage balance relates to the expected recoverable amount incurred by LDC in connection with safety issues on the electricity distribution infrastructure which occurred in 2009. For the year ended December 31, 2010, a balance of $5,296,000 was transferred from the contact voltage account to the Regulatory Assets Recovery Account ["RARA"] following approval for recovery by the OEB *[note 2[b]]*. The remaining balance of $3,754,000 was not approved for recovery by the OEB and was therefore recorded to operating expenses.

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.

LDC accounts for the differences between its financial statement carrying value and tax basis of assets and liabilities following the liability method in accordance with CICA Handbook Section 3465 *[note 3[p]]*. As at December 31, 2010, LDC has recorded a future income tax asset of $254,817,000 [December 31, 2009 - $250,948,000], and a corresponding regulatory liability of $254,817,000 [December 31, 2009 - $250,948,000] with respect to its rate-regulated activities.

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.

In its decision regarding the electricity distribution rates of LDC issued on May 15, 2008, the OEB approved the disposition of net regulatory liabilities of $18,622,000, consisting of settlement variances of $14,590,000 and pre-market opening line loss variance of $4,032,000, over a one-year period commencing May 1, 2008 and ending April 30, 2009.

On April 16, 2009, the OEB approved 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 May 1, 2009 and ending 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 May 1, 2010 and ending April 30, 2012.

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

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h) PILs Variances

As at December 31, 2010, LDC has accumulated a PILs variance amount representing differences that have resulted from a legislative or regulatory change to the tax rates or rules assumed in the rate adjustment model totalling an over-recovery of $5,675,000 [December 31, 2009 - $15,197,000].

i) Settlement Variances

This account is comprised of the variances between amounts charged by LDC to customers, based on regulated rates, and the corresponding cost of non-competitive electricity service incurred by LDC after May 1, 2002. The settlement variances relate primarily to service charges, non-competitive electricity charges, imported power charges and the global adjustment. Accordingly, LDC has deferred 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, 2010, settlement variances of $20,016,000 were disposed through rate adjustments [2009 - $6,628,000].

9. CREDIT FACILITIES

On May 3, 2010, the Corporation renewed its revolving credit facility ["Revolving Credit Facility"], for a two-year term, expiring on May 3, 2012. 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 Revolving Credit Facility contains a negative pledge, customary covenants and events of default.

As at December 31, 2010, $nil [December 31, 2009 - $45,176,000] had been utilized under the Revolving Credit Facility. As at December 31, 2010, no amounts had been drawn for working capital purposes [December 31, 2009 - $nil].

Additionally, the Corporation negotiated 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, 2010, $46,077,000 had been drawn on the line of credit [December 31, 2009 - $nil].

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10. OTHER LIABILITIES

Other liabilities consist of the following:

	2010 $	2009 $
Customers' advance deposits	18,790	17,002
Other	1,577	2,472
	20,367	19,474

11. LONG-TERM DEBT

Long-term debt consists of the following:

	2010 $	2009 $
Senior unsecured debentures		
Series 1 – 6.11% due May 7, 2013	223,838	223,406
Series 2 – 5.15% due November 14, 2017	248,793	248,653
Series 3 – 4.49% due November 12, 2019	248,546	248,416
Series 4 – 6.11% due December 30, 2011	245,057	—
Series 5 – 6.11% due May 6, 2013	245,057	—
Series 6 – 5.54% due May 21, 2040	198,546	—
Promissory note payable to the City	—	490,115
	1,409,837	1,210,590
Less: Current portion of debentures	245,057	—
Long-term debt	1,164,780	1,210,590
Comprising:		
Debentures	1,164,780	720,475
Promissory note payable to the City	—	490,115

All long-term debt of the Corporation ranks equally.

a) Senior unsecured debentures

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

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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 mature on December 30, 2011. Accordingly, the principal amount of the Series 4 debentures is classified as a short-term liability as at December 31, 2010.

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.

The Corporation may redeem some or all of the debentures (other than the Series 4 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.

b) Promissory note payable to the City

On July 1, 1999, LDC issued a promissory note to the City ["Initial Note"] in the principal amount of $947,000,000 in partial consideration for the assets in respect of the electricity distribution system transferred by the Toronto Hydro-Electric Commission and the City to LDC effective July 1, 1999. The Initial Note was non-interest bearing until December 31, 1999 and interest bearing thereafter at the rate of 6% per annum. Pursuant to the terms of By-law No. 374-1999 of the City made under section 145 of the *Electricity Act, 1998*, the principal amount of the Initial Note was adjusted effective January 1, 2000 to $980,231,000 to reflect the deemed debt to equity structure of LDC permitted by the OEB. At the same time, the Initial Note was replaced by a promissory note ["Replacement Note"] issued by LDC, which was interest bearing at the rate of 6.8% per annum. At December 31, 2002, the Replacement Note was payable on the earlier of demand and December 31, 2003.

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

On September 5, 2006, the Corporation announced that it and the City had amended and restated the City Note effective May 1, 2006 by fixing the interest rate at 6.11% and establishing an agreed repayment schedule. The Corporation is required to pay the principal amount of the note as follows: $245,058,000 on the last business day before each of December 31, 2007, December 31, 2009, December 31, 2011 and on May 6, 2013. On December 31, 2007, the Corporation made the first scheduled payment of $245,058,000 to the City in accordance with the terms of

the City Note. On December 31, 2009, the Corporation made the second scheduled payment of $245,058,000 to the City in accordance with the terms of the City Note. Interest is calculated and payable quarterly in arrears on the last business day of March, June, September and December of each year.

During the first quarter of 2010, the City made the determination to monetize its interest in the City Note under which the Corporation had $490,115,000 of indebtedness outstanding to the City. Concurrent with the closing of the transaction on April 1, 2010, the City Note was converted, in accordance with its terms, into Series 4 and Series 5 debentures of the Corporation which were sold by a syndicate of underwriters as part of a secondary offering by the City and issued by the Corporation under the terms of an existing trust indenture as supplemented to effect the offering. The Corporation did not receive any proceeds from the transaction. Following the completion of the transaction, the Corporation has no further indebtedness outstanding to the City under the terms of the City Note and the City Note has been cancelled.

12. EMPLOYEE FUTURE BENEFITS

Pension

For the year ended December 31, 2010, the Corporation's OMERS current service pension costs were $12,024,000 [2009 - $11,348,000].

Employee future benefits other than pension

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

The Corporation measures its accrued benefits obligation for accounting purposes as at December 31 of each year. The latest actuarial valuation was performed as at January 1, 2010.

a) Accrued benefit obligation

	2010 $	2009 $
Balance, beginning of year	177,144	128,804
Experience loss at beginning of year	8,013	6,393
Current service cost	3,485	4,793
Interest cost	11,102	10,240
Benefits paid	(7,197)	(6,891)
Actuarial losses	7,480	33,805
Balance, end of year	**200,027**	177,144

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

	2010 $	2009 $
Accrued benefit obligation	200,027	177,144
Unamortized net actuarial losses	(27,952)	(12,654)
Unamortized past service costs	(2,178)	(3,142)
Post-employment benefits liability	169,897	161,348

c) Components for net periodic defined benefit costs

	2010 $	2009 $
Current service cost	3,485	4,793
Interest cost	11,102	10,240
Actuarial losses	15,493	33,805
Cost incurred in the year	30,080	48,838
Differences between costs incurred and costs recognized in the year in respect of:		
Actuarial gains	(15,298)	(34,334)
Past service costs	964	964
	(14,334)	(33,370)
Defined benefit costs recognized	15,746	15,468
Capitalized as part of property, plant and equipment	7,388	7,043
Charged to operations	8,358	8,425

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d) Significant assumptions

	2010 %	2009 %
Accrued benefit obligation as at December 31:		
Discount rate	5.8	6.0
Rate of compensation increase	4.0	4.0
Benefit costs for years ended December 31:		
Discount rate	6.0	7.5
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, 2010, medical costs are assumed to increase at 7.5% [2009 - 8.0%] graded down by 0.5% [2009 - 0.5%] annual decrements to 5.0% [2009 - 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 2010:

	Increase $	Decrease $
Total of current service and interest cost (at 6.0%)	2,568	(1,777)
Accrued benefit obligation as at December 31, 2010 (at 5.8%)	30,231	(23,262)

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 2010:

	Increase $	Decrease $
Accrued benefit obligation as at December 31, 2010	(27,096)	35,140
Estimated expense for fiscal 2011	(1,449)	3,197

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13. ASSET RETIREMENT OBLIGATIONS

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

	2010 $	2009 $
Balance, beginning of year	7,552	6,528
ARO liabilities settled in the year	(2,290)	(87)
Accretion expense	194	291
Revision in estimated cash flows	(451)	820
Balance, end of year	5,005	7,552

As at December 31, 2010, the Corporation estimates the undiscounted amount of cash flows required over the next one to fifty years to settle the ARO is $6,560,000 [December 31, 2009 - $9,274,000]. Discount rates ranging from 1.39% to 6.60% [December 31, 2009 - 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.

14. CAPITAL DISCLOSURES

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

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

As at December 31, 2010, the Corporation's definition of capital includes shareholder's equity and long-term debt which includes the current portion of long-term debt, and has remained unchanged from December 31, 2009. As at December 31, 2010, shareholder's equity amounted to $1,039,379,000 [December 31, 2009 - $998,254,000] and long-term debt, including the current portion of long-term debt, amounted to $1,409,837,000 [December 31, 2009 - $1,210,590,000]. The Corporation's capital structure as at December 31, 2010 is 58% debt and 42% equity [December 31, 2009 - 55% debt and 45% equity]. There were no changes in the Corporation's approach to capital management during the year.

As at December 31, 2010, 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, 2010, consolidated funded indebtedness to consolidated capitalization ratio was 57% [December 31, 2009 - 55%].

The Corporation's Revolving Credit Facility limits the debt to capitalization ratio to a maximum of 75%. As at December 31, 2010, the debt to capitalization ratio was 58% [December 31, 2009 - 56%].

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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, 2010 and as at December 31, 2009, the Corporation was in compliance with all covenants included in its long-term debt agreements and short-term Revolving Credit Facility.

15. FINANCIAL INSTRUMENTS

a) Recognition and measurement

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

	2010 $		2009 $	
	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	330,151	330,151	211,370	211,370
Accounts receivable, net of allowance for doubtful accounts	168,988	168,988	150,795	150,795
Unbilled revenue	287,893	287,893	295,647	295,647
Investments	—	—	47,930	47,930
Accounts payable and accrued liabilities	373,543	373,543	318,317	318,317
Customers' advance deposits	64,252	64,252	51,698	51,698
Senior unsecured debentures				
Series 1 – 6.11% due May 7, 2013	223,838	245,310	223,406	247,967
Series 2 – 5.15% due November 14, 2017	248,793	273,725	248,653	265,874
Series 3 – 4.49% due November 12, 2019	248,546	259,777	248,416	249,581
Series 4 – 6.11% due December 30, 2011	245,057	255,199	—	—
Series 5 – 6.11% due May 6, 2013	245,057	267,177	—	—
Series 6 – 5.54% due May 21, 2040	198,546	217,188	—	—
Promissory note payable to the City	—	—	490,115	529,886

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The following table reconciles the Corporation's Level 3 fair value measurements, which includes its investments from January 1, 2009 to December 31, 2010:

Fair value measurements using Level 3 inputs	2010 $	2009 $
Balance, beginning of year	47,930	52,908
Gain (loss) included in net income	2,420	(1,049)
Transfers out of Level 3[2]	(50,350)	—
Settlements[1]	—	(3,929)
Balance, end of year	—	47,930

(1) Settlements relate to share of accumulated cash received from the conduit trusts on the investments.
(2) The Corporation's investments were transferred to Level 2 as at September 30, 2010 due to change in valuation methodology to mark-to-market using quotes received from market participants. On October 8, 2010, the Corporation sold all of its investments for cash consideration of $50,350,000 *[note 7]*.

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

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

The Corporation's credit risk associated with accounts receivable is primarily related to electricity bill payments from LDC customers. LDC has approximately 700,000 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, 2010, LDC held security deposits in the amount of $64,252,000 [December 31, 2009 - $51,698,000].

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

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Credit risk associated with accounts receivable is as follows:

	2010 $	2009 $
Total accounts receivable	180,900	163,375
Less: Allowance for doubtful accounts	(11,912)	(12,580)
Total accounts receivable, net	168,988	150,795
Of which:		
Outstanding for not more than 30 days	147,457	129,243
Outstanding for more than 30 days but not more than 120 days	21,635	20,796
Outstanding for more than 120 days	11,808	13,336
Less: Allowance for doubtful accounts	(11,912)	(12,580)
Total accounts receivable, net	168,988	150,795

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, 2010, total unbilled revenue was $287,893,000 [December 31, 2009 - $295,647,000]. Unbilled revenue outstanding is considered current.

As at December 31, 2010, 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 in holding certain financial instruments. The Corporation's objective is to minimize net interest expense. The Corporation attempts to minimize interest rate risk by issuing long-term fixed rate debt, and by extending or shortening the term of its short-term money market investments by assessing the monetary policy stance of the Bank of Canada, while ensuring that all payment obligations are met on an ongoing basis.

Under the Corporation's Revolving Credit Facility *[note 9]*, the Corporation may obtain short-term borrowings for working capital purposes. These borrowings may expose the Corporation to fluctuations in short-term interest rates (borrowings in the form of prime rate loans in Canadian dollars and BAs and letters of credit). The fee payable for BAs and letters of credit is based on a margin determined by reference to the Corporation's credit rating.

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

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Liquidity risk

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

December 31, 2010	Due within 1 year $	Due between 1 year and 5 years $	Due after 5 years $
Financial liabilities			
Accounts payable and accrued liabilities	373,543	—	—
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 4 – 6.11% due December 30, 2011	245,057	—	—
Series 5 – 6.11% due May 6, 2013	—	245,057	—
Series 6 – 5.54% due May 21, 2040	—	—	200,000
	618,600	470,057	700,000

Hedging and Derivative risk

As at December 31, 2010 and December 31, 2009, the Corporation had not entered into hedging and derivative financial instruments.

Foreign exchange risk

As at December 31, 2010, the Corporation has limited exposure to the changing values of foreign currencies. While the Corporation purchases goods and services which are payable in U.S. dollars, and purchases U.S. currency to meet the related payables commitments when required, the impact of these transactions is not material to the consolidated financial statements.

16. 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.

17. 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

	2010 $	2009 $
Rate reconciliation		
Income before PILs	91,705	61,875
Consolidated Statutory Canadian federal and provincial income tax rate	31.00%	33.00%
Expected provision for PILs	28,429	20,419
Temporary differences not benefited	(1,303)	(1,097)
Other	(1,546)	420
Provision for PILs	25,580	19,742
Effective tax rate	27.89%	31.91%
Components of provision for PILs		
Current tax provision	24,709	19,326
Future income tax provision related to the origination and reversal of temporary differences	871	416
Provision for PILs	25,580	19,742

Consolidated Balance sheets

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

	2010 $	2009 $
Property, plant and equipment and intangible assets	152,894	154,515
Regulatory adjustments	63,704	62,737
Post-employment benefits liability	42,474	40,337
Other taxable temporary differences	7,606	5,641
Capital loss carryforwards	4,840	4,387
Non-capital loss carryforwards	509	479
Valuation allowance	(15,880)	(14,947)
Future income tax assets	256,147	253,149

As at December 31, 2010, the Corporation has accumulated non-capital losses for PILs purposes of approximately $2,037,000 [December 31, 2009 - $1,916,000], which are available to reduce taxable income in future years. The Corporation has also accumulated taxable capital losses of $19,359,000 [December 31, 2009 - $17,546,000] which

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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 $1,537,000 of non-capital losses will expire in or after 2026.

18. SHARE CAPITAL

Share capital consists of the following:

	2010 $	2009 $
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 2010, the board of directors of the Corporation declared and paid dividends totalling $25,000,000 [2009 - $25,170,000] to the City.

19. RELATED PARTIES

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

For the year ended December 31, 2010, LDC provided electricity to the City in the amount of $122,483,000 [2009 - $112,579,000]. As at December 31, 2010, included in "unbilled revenue" is a balance amounting to $9,830,000

[December 31, 2009 - $9,679,000] receivable from the City related to the provision of electricity for the previous months.

For the year ended December 31, 2010, LDC provided relocation and other services related to the City in the amount of $1,466,000 [2009 - $886,000]. As at December 31, 2010, included in LDC's "Accounts receivable, net of allowance for doubtful accounts" is $3,377,000 [December 31, 2009 - $1,183,000] receivable from the City related to relocation services and other construction activities.

For the year ended December 31, 2010, LDC and TH Energy provided energy management services, street lighting services and consolidated billing services to the City amounting to $19,429,000 [2009 - $20,964,000]. As at December 31, 2010, included in LDC's and TH Energy's "Accounts receivable, net of allowance for doubtful accounts" is $2,968,000 [December 31, 2009 - $5,045,000] receivable from the City related to these services.

For the year ended December 31, 2010, LDC purchased road cut and other services of $7,909,000 [2009 - $6,873,000] from the City. As at December 31, 2010, included in "Accounts payable and accrued liabilities" is $11,606,000 [December 31, 2009 - $5,492,000] payable to the City related to services received from the City.

For the year ended December 31, 2010, LDC and TH Energy paid property tax expenses to the City of $6,159,000 [2009 - $6,279,000].

For the year ended December 31, 2010, LDC received funds in advance for future expansion projects from the City amounting to $13,264,000 [2009 - $14,162,000].

As at December 31, 2010, the outstanding principal with respect to the City Note was $nil [December 31, 2009 - $490,115,000] *[note 11]*. For the year ended December 31, 2010, interest of $7,487,000 [2009 - $44,919,000], on the City Note was paid to the City.

20. COMMITMENTS

Operating lease obligations and future commitments

As at December 31, 2010, the future minimum annual lease payments under property operating leases and future commitments with remaining terms from one to five years and thereafter are as follows:

	$
2011	9,047
2012	6,605
2013	4,841
2014	4,843
2015	4,341
Thereafter	6,814
Total	**36,491**

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

December 31, 2010

21. 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.

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*, R.S.C. 1985, c. I-15. A statement of defence has been filed. Prior to any certification of the action as a class proceeding, cross summary judgment motions are scheduled to be heard on June 16 and 17, 2011 to determine whether the *Interest Act* has been breached. If the court finds a breach of the *Interest Act*, subject to appeals, the proceeding will continue, and LDC will rely on other defences. While LDC believes it has a defence to this Claim, there is no guarantee that it will be successful in defending the action and therefore, the outcome of this proceeding could have a material impact on the Corporation consolidated financial statements and results of operations.

Late Payment Charges Class Action

By Order dated July 22, 2010, the Ontario Superior Court of Justice consolidated and approved the settlement of two class actions against LDC, one commenced in 1994 and the other, against all Ontario MEUs, in 1998. The actions sought $500,000,000 and $64,000,000, respectively, in restitution for late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the *Criminal Code*. The claims made against LDC and the definition of the plaintiff classes were identical in both actions such that any damages payable by LDC in the first action would reduce the damages payable by LDC in the second action, and vice versa.

The July 22, 2010 court order formalized a settlement pursuant to which the defendant MEUs will pay the amount of $17,000,000 plus costs and taxes in settlement of all claims. The amount allocated for payment by each MEU is its proportionate share of the settlement amount based on its percentage of distribution service revenue over the period for which it has exposure for repayment of late payment penalties exceeding the interest rate limit in the *Criminal Code*. LDC's share of the settlement amount was expected to be $7,750,000, payable on June 30, 2011. Under the settlement, all the MEUs involved in the settlement, including LDC, have requested an order from the OEB allowing for the future recovery from customers of all costs related to the settlement. LDC has accrued a liability and a corresponding regulatory asset in the amount of $7,750,000 *[note 24[d]]*.

2 Secord Avenue

An action was commenced against LDC in September 2008 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of $30,000,000 as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[all tabular amounts in thousands of dollars]

December 31, 2010

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

Another action was commenced against LDC in February 2009 in the Ontario Superior Court of Justice seeking damages in the amount of $20,000,000 as compensation for damages allegedly suffered as a result of a fire and explosion in an underground vault at 2 Secord Avenue on July 20, 2008. This action is at a preliminary stage. The statement of claim has been served on LDC, a statement of defence has been filed, and a certification order issued. Affidavits of Documents have been produced by LDC to the other parties and examinations for discovery have commenced and are continuing. Given the preliminary status of this action, it is not possible to reasonably quantify the effect, if any, of this action on the financial performance of the Corporation. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

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

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. 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.

2369 Lakeshore Boulevard West

A third party action was commenced against LDC in October 2009 in the Ontario Superior Court of Justice under the *Class Proceedings Act, 1992* (Ontario) seeking damages in the amount of $30,000,000 as compensation for damages allegedly suffered as a result of a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. Subsequently, in March 2010, the plaintiff in the main action also added LDC as a defendant. The main action seeks damages in the amount of $10,000,000 from LDC. Both actions are at a preliminary stage. A third party claim and now the Statement of Claim in the main action have been served on LDC and statements of defence to the main action and the third party claim have not been filed. Accordingly, given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of 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 a fire in the electrical room at 2369 Lakeshore Boulevard West on March 19, 2009. Subsequently, in March 2010, the plaintiff in the main action also added LDC as a defendant. The main action seeks damages in the amount of $400,000 from LDC. Both actions are at a preliminary stage. Although a third party claim and the Statement of Claim in the main action have been served on LDC, statements of defence to the main action and the third party

claim have not been filed. Accordingly, given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of these actions on the financial performance of 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.

Adamopoulos v. LDC

An action was commenced against LDC in November 2004 in the Ontario Superior Court of Justice seeking damages in the amount of $7,750,000 as compensation for damages allegedly suffered as a result of a motor vehicle accident involving an LDC vehicle on January 9, 2001. This action is at an intermediate stage. The plaintiff's motion increasing its claim for damages to $23,790,000 was granted on July 7, 2010. The trial in this action is scheduled for May 2011. If damages were awarded, LDC would make a claim under its liability insurance which the Corporation believes would cover any damages which may become payable by LDC in connection with the action.

b) OEB PILs Proceeding

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

c) Payments in Lieu of Additional Municipal and School Taxes

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

The balance assessed by the Ministry of Revenue above the balance accrued by the Corporation amounts to $9,393,000 as at December 31, 2010. The Corporation has been working with the Ministry of Revenue and the Ministry of Finance to resolve this issue. However, there can be no assurance that the Corporation will not have to pay the full assessed balance in the future.

22. NET INCOME PER SHARE

The weighted daily average number of shares outstanding as at December 31, 2010 was 1,000 [December 31, 2009 - 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.

23. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2010 consolidated financial statements.

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

December 31, 2010

24. SUBSEQUENT EVENTS

a) Street Lighting Activities

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. Based on this updated asset valuation and the OEB's decision issued on February 11, 2010, LDC is seeking the OEB's approval to transfer $29,418,000 of street lighting assets from TH Energy to LDC. A final decision from the OEB in regard to such transfer is expected before the end of 2011.

b) 2011 Electricity Distribution Rates

On February 9, 2011, LDC filed with the OEB an amendment to its rate application filed on August 23, 2010 to reflect expected changes in accounting estimates used to derive electricity distribution rates. The amended distribution revenue requirement and rate base for the 2011 rate year commencing on May 1, 2011 and ending on April 30, 2012 are $555,400,000 and $2,360,500,000, respectively.

c) CDM Agreements with the Ontario Power Authority

On February 2, 2011, LDC entered into an agreement with the Ontario Power Authority ["OPA"] to deliver OPA-funded CDM programs in the amount of approximately $50,000,000 from January 1, 2011 to December 31, 2014. All programs to be delivered under this OPA agreement are expected to be fully funded and paid in advance by the OPA.

d) Late Payment Charges Class Action

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

e) Dividends

On March 11, 2011, the board of directors of the Corporation declared dividends in the amount of $14,063,000. The dividends are comprised of $8,063,000 with respect to net income for the year ended December 31, 2010, payable to the City on March 18, 2011 and $6,000,000 with respect to the first quarter of 2011, payable to the City on March 31, 2011.