

ANNUAL INFORMATION FORM
FOR THE YEAR ENDED DECEMBER 31, 2011



MARCH 23, 2012

HYDRO ONE INC.
ANNUAL INFORMATION FORM
FOR THE YEAR ENDED DECEMBER 31, 2011

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Except where otherwise indicated, all information presented herein is as at December 31, 2011.

DEFINITIONS

For convenience, in this Annual Information Form:

“**ADS**” means the Advanced Distribution System;

“**CDM**” means conservation and demand management;

“**CDM Code**” means the CDM Code for Electricity Distributors;

“**DS**” refers to a distribution station;

“**DSC**” means the Distribution System Code;

“**EA**” means the *Environmental Assessment Act* (Ontario);

“**Electricity Act**” means the *Electricity Act, 1998*, as amended;

“**FERC**” means the Federal Energy Regulatory Commission;

“**FIT**” means the feed-in-tariff program of the OPA;

“**GEA**” means the *Green Energy and Green Economy Act, 2009*;

“**GTA**” means the Greater Toronto Area;

“**Hydro One**”, “**our company**”, “**we**”, “**us**”, “**our**”, and “**the company**” refer to Hydro One Inc. and its subsidiaries and predecessors, except where the context requires otherwise;

“**IESO**” refers to the Independent Electricity System Operator, previously named the Independent Electricity Market Operator;

“**IASB**” refers to the International Accounting Standards Board;

“**IFRS**” means International Financial Reporting Standards;

“**IPSP**” means the Integrated Power System Plan developed by the OPA;

“**LDC**” means local distribution company;

“**LTEP**” means “Ontario’s Long Term Energy Plan, Building Our Clean Energy Future”, announced by the Province on November 23, 2010;

“**LRAM**” means Lost Revenue Adjustment Mechanism;

“Market Rules” means the rules made under Section 32 of the *Electricity Act* that are administered by the IESO;

“Micro FIT” means the micro feed-in-tariff program of the OPA;

“Ministry” or “Minister” shall mean the Ministry of Energy or the Ministry of Energy and Infrastructure and, as applicable, its respective Minister;

“NERC” means the North American Electric Reliability Corporation;

“NPCC” means the Northeast Power Coordinating Council Inc.

“OEB” refers to the Ontario Energy Board;

“OEB Act” means the *Ontario Energy Board Act* 1998, as amended;

“OEFC” means the Ontario Electricity Financial Corporation;

“OGCC” means Hydro One’s Ontario Grid Control Centre located north of Toronto, Ontario;

“OHSAS18001” means Occupational Health and Safety Assessment Series 18001 standard;

“Ontario” refers to the Province of Ontario as a geographical area;

“OM&A” means Operations, Maintenance and Administration;

“OPA” refers to the Ontario Power Authority;

“OPG” refers to Ontario Power Generation Inc.;

“Open Access” refers to the opening of Ontario’s wholesale and retail electricity markets to competition which officially occurred on May 1, 2002;

“OSC” means the Ontario Securities Commission;

“PCB” means polychlorinated biphenyls;

“Province” refers to the Government of the Province of Ontario;

“PWU” refers to the Power Workers’ Union;

“ROE” refers to return on equity;

“RPP” refers to the regulated price plan structure for the cost of electricity supplied to low volume and designated customers;

“Society” refers to the Society of Energy Professionals;

“SS” refers to a Switching Station;

“TOU” refers to “time-of-use” rates;

“TS” refers to a transformer station; and

“U.S. GAAP” means accounting principles generally accepted in the United States of America.

CORPORATE STRUCTURE

Hydro One Inc. was incorporated as Ontario Hydro Services Company Inc. by Articles of Incorporation dated December 1, 1998 under the *Business Corporations Act* (Ontario). On May 1, 2000, we changed our name to Hydro One Inc.

Our registered office and head office is located at 483 Bay Street, 15th Floor, North Tower, Toronto, Ontario, M5G 2P5.

The following are our principal subsidiaries, each of which is wholly-owned by us and is incorporated under the laws of Ontario:

- Hydro One Networks Inc. — carries on all business relating to our ownership, operation and management of electricity transmission and distribution systems and facilities;
- Hydro One Brampton Networks Inc. — carries on the business relating to our ownership, operation and management of electricity distribution systems and facilities in Brampton, Ontario;
- Hydro One Remote Communities Inc. — carries on all business relating to our ownership, operation, maintenance and construction of generation and distribution assets used in the supply of electricity to remote communities throughout Northern Ontario; and
- Hydro One Telecom Inc. — carries on all of our business relating to leasing dark fibre and providing lit telecommunications capacity to other telecommunication carriers, large corporations, government, healthcare, and education institutions.

FORWARD-LOOKING INFORMATION

This Annual Information Form contains, and Hydro One’s oral and written public communications often contain, forward-looking statements that are based on current expectations, estimates, forecasts and projections about the business of Hydro One and the industry in which Hydro One operates and includes beliefs and assumptions made by the management of our company. Such statements include, but are not limited to, statements about the general development of our business; statements related to the OEB’s RPP and TOU pricing; expectations regarding the exemption of TOU pricing for rural customers and the timeline for converting those customers to TOU pricing; statements related to the GEA and our Green Energy Plan, the Ontario Clean Energy Benefit Act, the IPSP and the Ministry’s LTEP and Supply Mix Directive including the additional investments arising therefrom, and our ability to recover the

costs of such investments; statements related to the FIT program; statements about smart meters including their capabilities, costs and cost recovery; statements related to the buildout of an advanced distribution solution for our distribution business, including future investments and the recoverability of those investments; expectations regarding the Cornerstone project; the expected impact of CDM programs and targets including funding expectations; statements related to U.S. GAAP and our adoption of U.S. GAAP including the effects it will have on our revenue requirement; expectations regarding connections of new generation to our transmission and distribution systems, including their cost and impact on our systems; expectations regarding future renewable energy generation, including the possibility of incurring capital expenditures related thereto; statements about our strategy, including our strategic objectives; statements regarding future capital expenditures and our capital and other investment plans; statements regarding the reliability of our distribution and transmission systems including equipment performance; statements about our transmission capacity; expectations regarding load growth and new generation; statements regarding our current and future capital projects including expected benefits, completion dates and our ability to recover the costs related to such projects and to obtain environmental and other regulatory approvals in connection therewith; statements about our ongoing initiatives including the expected results and their completion dates; expectations regarding NERC standards, the cost impact of their adoption, and possible recovery of these costs in rates; statements related to the attraction and retention of staff and the maintenance and development of the skills and competence of existing employees; statements about our outsourcing arrangement with Inergi LP; expectations regarding environmental expenditures and other environmental matters including the expected work and costs of compliance with PCB regulations, potential future costs related to asbestos and land assessment and remediation, our ability to recover such costs and the need for environmental approvals and assessments; expectations regarding the OEB's plan for a renewed regulatory framework for electricity; expectations regarding our operating agreement with the IESO; statements regarding our transmission and distribution rates and customer bills resulting from our rate applications; statements related to the East-West Tie Line project; statements related to our connection assets including recovery of costs related thereto; expectations regarding developments in the statutory and operating framework for electricity distribution and transmission in Ontario including changes to rates, rate orders, cost recovery, rates of return and rate structures in both our transmission and distribution businesses; expectations regarding the recoverability of our expenditures in future rates and the effects it may have; statements related to the filing and status of our applications to the OEB and the timing of decisions from the OEB; expectations regarding our strategy for rationalization of distribution assets; the possibility of the Province making declarations pursuant to our memorandum of agreement with them; expectations regarding workforce demographics; statements regarding our borrowing requirements; the estimated impact of changes in the forecast long-term Government of Canada bond yield (used in determining our regulated rate of return) on our net income; expectations regarding anticipated expenditures associated with transferring assets located on Indian lands; statements regarding provincial ownership of our transmission corridors; statements regarding future pension contributions and our pension plan; our expectation regarding our need for the OEFC indemnity associated with the original transfer orders; expectations regarding implementation of health and safety programs; statements regarding labour relations; and legal proceedings in which we are currently involved. Words such as "aim", "could", "would", "expect", "anticipate", "intend", "attempt", "may", "plan", "will", "believe", "seek", "estimate", and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve assumptions and risks and uncertainties

that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed, implied or forecasted in such forward-looking statements. Hydro One does not intend, and Hydro One disclaims any obligation to update any forward-looking statements, except as required by law.

These forward-looking statements are based on a variety of factors and assumptions including, but not limited to: no unforeseen changes in the legislative and operating framework for Ontario's electricity market; favourable decisions from the OEB and other regulatory bodies concerning outstanding rate and other applications; no delays in obtaining the required approvals; no unforeseen changes in rate orders or rate structures for our distribution and transmission businesses; no unfavourable changes in environmental regulation; satisfactory resolution of the issue of rate regulated accounting by adoption and application of U.S. GAAP; a stable regulatory environment; and no significant event occurring outside the ordinary course of business. These assumptions are based on information currently available to Hydro One including information obtained by Hydro One from third-party sources. Actual results may differ materially from those predicted by such forward-looking statements. While Hydro One does not know what impact any of these differences may have, its business, results of operations, financial condition and its credit stability may be materially adversely affected. Factors that could cause actual results or outcomes to differ materially from the results expressed or implied by forward-looking statements include, among other things:

- the risks associated with being controlled by the Province including the possibility that the Province may make declarations pursuant to our memorandum of agreement with it, as well as potential conflicts of interest that may arise between us, the Province and related parties;
- public opposition to and delays or denials of the requisite approvals and accommodations for projects necessary to increase transmission and distribution capacity;
- the risk that previously granted regulatory approvals may be subsequently challenged, appealed or overturned;
- the risk that unexpected capital expenditures may be needed to support renewable generation or resolve unforeseen technical issues;
- the risks related to our work force demographic and our potential inability to attract and retain qualified personnel;
- the risks associated with the execution of our capital and maintenance programs necessary to maintain the performance of our aging asset base;
- the risk that we will be unable to source the materials necessary to support our work programs;
- the risks associated with being subject to extensive regulation including risks associated with OEB action or inaction;
- the timing and results of regulatory decisions regarding our revenue requirements, cost recovery and rates;
- the risk that load or consumption could fall below projected levels;
- unanticipated changes in our costs;
- the risks of counter-party default on our outstanding derivative contracts;
- the risks associated with changes in interest rates or discount rates;
- the risks associated with changes in the forecast long-term Government of Canada bond yield;

- the risk that we are not able to arrange sufficient cost effective financing to repay maturing debt and to fund capital expenditures and other obligations;
- the potential impact of not being able to recover our pension costs;
- future interest rates, investment returns, changes in benefits and changes in actuarial assumptions;
- the risk to our facilities posed by severe weather conditions, natural disasters or catastrophic events and our limited insurance coverage for losses resulting from these events;
- the risk that we may incur significant costs associated with transferring assets located on Indian lands;
- the risks associated with information system security and with maintaining a complex information technology system infrastructure and transitioning most of our financial and business processes to an integrated business and financial reporting system;
- the potential for substantial and currently undetermined or underestimated environmental costs and liabilities;
- the risk that assumptions that form the basis of our recorded environmental liabilities and related regulatory assets may change;
- the risk that the presence or release of hazardous or harmful substances could lead to claims by third parties and/or governmental orders;
- the risk that future environmental expenditures is not recoverable in future electricity rates;
- the risk that it may be determined that exposure to electric and magnetic fields emanating from power lines and other electric sources may cause health problems;
- the potential that we may incur significant expenses to replace some or all of the functions currently outsourced if our agreement with Inergi LP is terminated;
- the impact of the ownership by the Province of lands underlying our transmission system;
- the impact of the GEA and the LTEP on our company and the costs and expenses arising therefrom; and
- the impact of increased competition on our transmission business.

Hydro One cautions you that the above list of factors is not exclusive. Some of these and other factors are discussed in more detail under “Risk Factors” in this Annual Information Form. You should review the section entitled “Risk Factors” in detail.

In addition, Hydro One cautions you that forward-looking information provided in this Annual Information Form concerning potential future expenditures is provided in order to provide context to the nature of some of our future plans and may not be appropriate for other purposes.

ABOUT HYDRO ONE

Hydro One is wholly owned by the Province and our transmission and distribution businesses are regulated by the OEB. Our industry, including our company, is governed within the broad legislative framework of the *Electricity Act* and the *OEB Act*.

Our Mission and Vision

Our mission and vision are driven by our core values: health and safety, excellence, stewardship and innovation. We live our values every day in everything we do and they represent what is most important to us.

As stewards of the Province's electricity grid, our core role is to provide safe, reliable and cost-effective electricity transmission and distribution and to connect clean and renewable sources of generation to the province's electricity grid.

Overview

We are the largest electricity transmission and distribution company in Ontario. We own and operate substantially all of Ontario's electricity transmission system, accounting for approximately 96.6% of Ontario's transmission capacity based on the revenue approved by the OEB. Based on assets, our transmission system is one of the largest in North America and our distribution system is the largest in Ontario. We have three reportable segments: (1) our transmission business; (2) our distribution business; and (3) our other business.

Our transmission business, which represented approximately \$10 billion of our total assets of \$18 billion as at December 31, 2011, transmits electricity through a high-voltage network from generators to our own distribution networks, to local distribution companies, and to transmission connected companies. We also own and operate facilities that interconnect our transmission system with systems in neighbouring provinces and states.

Our distribution business, which represented approximately \$7 billion of our total assets of \$18 billion as at December 31, 2011, distributes electricity through our low-voltage distribution system to municipalities and to rural areas. Customers of our distribution business include local distribution companies, customers with loads exceeding 5MW, and rural and urban customers. Hydro One Brampton Networks Inc. is our urban distribution company serving customers in the GTA. We also operate through our subsidiary, Hydro One Remote Communities Inc., small, regulated generation and distribution systems in remote communities across Northern Ontario that are not connected to Ontario's electricity grid.

Our other business segment is primarily represented by the operations of Hydro One Telecom Inc. This subsidiary markets dark and lit fibre-optic capacity to telecommunications carriers and commercial customers with broadband network requirements. The assets of this segment constituted approximately \$700 million of our total assets of \$18 billion as at December 31, 2011.

GENERAL DEVELOPMENT OF THE BUSINESS

The following is a description of our company's business and how it has developed, with a particular emphasis on the past three years. In this section, we will also describe the electricity sector landscape, recent legislative and political activity, our strategy, as well as an overview of our transmission and distribution businesses.

Electricity Sector Landscape

As a participant in the Ontario electricity sector, our company is affected by the following key parties in the electricity sector in Ontario.

OPA

The OPA was created in 2004 by virtue of an amendment to the *Electricity Act*, and its objects are defined in Part II.1 of the *Electricity Act*. It is a non-profit corporation without share capital, and it is licenced and regulated by the OEB. The OPA's mandate is to ensure the adequacy and efficiency of electricity supply in Ontario through planning of electricity supply and demand. The OPA's mission is to ensure that electricity needs are met for the benefit of Ontario now and in the future. The OPA plans and procures electricity supply from diverse resources and facilitates the measures needed to achieve conservation targets.

OEB

The OEB is the principal regulator of Ontario's electricity industry. It is an independent adjudicative tribunal that regulates Ontario's electricity sector in the public interest, and ensures an adequate level of consumer protection in the energy market. The OEB licenses all participants in the electricity sector, including the IESO, generators, transmitters, distributors, wholesalers and retailers. The OEB's mandate and authority come from the *OEB Act*, the *Electricity Act*, and a number of other provincial statutes.

IESO

The IESO is the system controller of Ontario's electricity system. The IESO manages the reliability of Ontario's power system, forecasts the demand and supply of electricity and co-ordinates emergency preparedness for Ontario's electricity system. The IESO also operates the wholesale electricity market, while ensuring fair competition through market surveillance.

Recent Legislative Activity

IPSP, Supply Mix Directive, and LTEP

The Province issued a directive to the OPA on September 17, 2008, requiring the OPA to revisit the IPSP, which was originally filed with the OEB in 2007, with a view to establishing new targets in a number of areas, including renewable energy sources and conservation. The directive also asked the OPA to undertake an enhanced process of consultation with First Nations and Métis communities in light of potential duty to consult obligations. As a result of the directive, the OEB adjourned its review of the IPSP on October 2, 2008.

On November 23, 2010, the Province released a draft Supply Mix Directive for consultation. The draft Supply Mix Directive was intended to outline the goals to be achieved by a new IPSP.

Also on November 23, 2010, the Province released the LTEP, which set out Ontario's expected electricity needs until 2030. The LTEP supports continued procurement of renewable energy generating capacity up to 10,700 MW. The LTEP addressed seven key areas: demand, supply, conservation, transmission, Aboriginal communities, capital investments and electricity prices. The LTEP stated that the Province intended to direct Hydro One to carry out three priority transmission projects to enable new generation, as follows:

1. Southwestern Ontario Series Compensation
2. Re-conductoring Sarnia to London Circuits
3. New Transmission Line west of London

On February 17, 2011, the Province issued a Supply Mix Directive to the OPA for the preparation of a new IPSP consistent with, and to meet the goals of, the LTEP. The Supply Mix Directive outlined the key matters outlined in the LTEP which the OPA is to address including, demand, conservation, nuclear, coal phase-out and potential conversion, renewables-hydroelectric resources, renewables other than hydroelectric, natural gas, transmission, smart grid, reliability and operability, impacts of the plan on electricity consumers, consultation with First Nations and regulatory observance. In a letter of even date to the OEB regarding this Supply Mix Directive, the Minister noted that he expected the new IPSP to be submitted to the OEB later in 2011 for its review and for stakeholder and public review, and directed the OEB to carry out its review not later than 12 months following the submission of the new IPSP.

On February 17, 2011, the Province sent a directive to the OEB requiring it to amend the transmission licence of Hydro One Networks Inc. to require Hydro One to proceed with three priority transmission projects in southwestern Ontario, identified in the LTEP, and to increase short circuit and/or transformer capacity at up to 15 of its transformer stations to enable the connection of small scale renewable energy generation facilities. On February 28, 2011, the OEB issued a Decision and Order to amend Hydro One Networks Inc.'s transmission licence in accordance with this directive.

Regulated Price Plan Structure

On April 1, 2005, the OEB implemented the RPP. The RPP regulates only the commodity price of electricity and does not affect the rates charged for transmission and distribution of electricity. The RPP also introduced seasonal consumption thresholds. For residential customers, the price threshold (the amount of electricity that is charged at the lower price) between the lower tier price and the upper tier price is 600 kWh per month in the summer and 1,000 kWh per month in the winter. For non-residential customers, the price threshold between the lower tier price and the upper tier price is 750 kWh per month in both the summer and the winter. A summary of some recent prices per kWh set for RPP customers follows:

RPP Pricing (per kWh)		
Winter (Nov. 1, 2010 – April 30, 2011)	Lower Tier Price	6.4 cents
	Upper Tier Price	7.4 cents
Summer (May 1, 2011 – Oct. 31, 2011)	Lower Tier Price	6.8 cents
	Upper Tier Price	7.9 cents
Winter (Nov. 1, 2011 – April 30, 2012)	Lower Tier Price	7.1 cents
	Upper Tier Price	8.3 cents

As stated above, RPP pricing came into effect on April 1, 2005. Eligible customers will continue to pay RPP electricity prices until such time as Hydro One installs a smart meter and the necessary systems are in place to start billing these customers for electricity on a TOU basis. Once customers are eligible to be billed on a TOU basis, regular RPP prices will no longer be available and instead they will be billed the RPP-TOU prices.

One of the OEB's goals through TOU pricing is to provide an incentive for consumers to shift some consumption away from periods of high total consumption (called "on-peak") to periods of low demand (called "off-peak"). All eligible Hydro One distribution customers have been migrated to TOU billing as of June 2011, except certain customers located in very rural and very sparsely populated areas, for whom an exemption has been obtained until December 31, 2012. Below is a chart outlining the three TOU periods and the price for each.

RPP Pricing (per kWh) –TOU Prices		
Winter (Nov. 1, 2010 – April 30, 2011)	Off-peak Price	5.1 cents
	7pm – 7am	
	Mid-peak Price	8.1 cents
	11am – 5pm	
Summer (May 1, 2011 – Oct. 31, 2011)	On-peak Price	9.9 cents
	7am – 11am, 5pm – 7pm	
	Off-peak Price	5.9 cents
	7 pm – 7 am	
Winter (Nov. 1, 2011 – April 30, 2012)	Mid-peak Price	8.9 cents
	7 am – 11 am, 5 pm – 7 pm	
	On-peak Price	10.7 cents
	11 am – 5 pm	
	Off-peak Price	6.2 cents
	7 pm – 7 am	
	Mid-peak Price	9.2 cents
	11 am – 5 pm	
	On-peak Price	10.8 cents
	7 am – 11 am, 5 pm – 7 pm	

New RPP prices are computed at six-month intervals and are the result of an integrated consideration of re-basing and true-ups. Price changes become effective at the beginning of a calendar month.

Ontario Clean Energy Benefit Act

As announced in its 2010 Ontario Economic Outlook and Fiscal Review, the Province introduced the *Ontario Clean Energy Benefit Act, 2010*, which is designed to assist Ontario electricity consumers through the transition to a cleaner electricity system. Under this Act, eligible residential, farm and small business consumers will receive financial assistance in the amount of a 10% credit, with respect to the total cost of electricity on their bills, including tax. This credit is applied to their electricity costs for each billing period, and is available with respect to electricity consumed on or after January 1, 2011 and before January 1, 2016.

Conservation and Demand Management

The Province has established specific provincial targets for CDM, and Hydro One's distribution businesses have built expenditures into their plans to help meet these targets. The OEB requires each distributor to file an annual report, including a cost-benefit analysis, by April 30 of each year in respect of the results of its respective CDM program.

The OPA annually files with the OEB proposed expenditure and revenue requirements and fees for review pursuant to subsection 25.21 of the *Electricity Act*. Included in these applications are the OPA's costs required to manage the CDM programs intended for implementation by local distribution companies such as Hydro One.

Section 27.2 of the *OEB Act* gives the Province the power to issue a directive to the OEB to take steps to establish CDM targets to be met by LDCs and other licencees. The directive may require the OEB to specify, as a condition of a licence, the conservation targets to be met by LDCs and other licencees. A directive to the OEB and a directive to the OPA were issued by the Province and made public on April 23, 2010. The OPA was directed to advance conservation, and this directive was categorized into three areas; (i) strategic co-ordination of OPA contracted province-wide programs; (ii) energy efficiency and demand response programs for First Nation and Métis communities; and (iii) support and funding of CDM research and innovation. The OEB issued its CDM Code on September 16, 2010. On November 11, 2010, the OEB issued final CDM targets. Hydro One Networks Inc. was assigned a peak demand reduction target of 214 MW and an energy reduction target of 1,130 GWh, and Hydro One Brampton Networks Inc. was assigned a peak demand reduction target of 46MW and an energy reduction target of 190 GWh, in each case for the period 2011-2014, which is equivalent to a 1% reduction in overall power usage.

The CDM Code required LDCs to submit to the OEB a CDM strategy by November 1, 2010. In our submission, we included a description of how we intended to achieve the CDM target over the period 2011-2014. It is estimated that 77% of Hydro One Networks Inc.'s target, and 83% of Hydro One Brampton Networks Inc.'s target, will be met through OPA-contracted Ontario-wide CDM programs. The remainder of the target was expected to be achieved through six additional programs for which we sought OEB approval for a total budget of approximately \$40 million, which would have been funded by all ratepayers through the Global Adjustment Mechanism. A hearing for the review and approval of Hydro One Networks Inc.'s and Hydro One Brampton Networks Inc.'s joint CDM application and funding for the six individual programs began on March 4, 2011. The OEB adjourned the hearing on March 7, 2011, and Hydro One Networks Inc. and Hydro One Brampton Networks Inc. subsequently sought, and obtained, OEB approval

to withdraw their respective applications. Our company will continue to focus on using OPA-contracted Programs to meet its mandated conservation targets.

On January 5, 2012, the OEB issued a set of draft CDM guidelines to all electricity distributors. These guidelines provide more specific guidance on certain provisions in the CDM Code and what evidence should be filed by distributors in support of an application for OEB-Approved CDM programs. Two key subjects were discussed in the guidelines:

1. TOU savings:
 - a. Savings associated with TOU pricing are eligible to be counted towards the CDM targets
 - b. The OEB recommended that evaluations of TOU savings should be conducted by the OPA for the entire province, and then allocated to distributors.
2. LRAM:
 - a. LRAM Variance Account (“LRAMVA”) to be introduced.
 - b. LRAMVA is defined as the difference between:
 - i. The level of CDM programs activities included in the distributors load forecast; and
 - ii. The results of actual, verified impacts of CDM activities undertaken by distributors between 2011 to 2014 for OPA-contracted CDM programs and OEB-Approved CDM programs.

Procurement of New Generation

Pursuant to a Provincial directive, the OPA set up the FIT program for renewable generation. The program is divided into large generation projects and small generation projects. The smaller generation projects (10 kW or under) are referred to as the Micro FIT program. Pursuant to these programs, the OPA has entered into contracts or conditional contracts with generators pursuant to which the OPA will pay these generators a fixed rate for power produced over a specified period of time. Hydro One continues to work towards connecting those projects for which there are firm contracts and in which technical and economic assessments permit.

The Province announced on October 31, 2011 that a review would be completed of the FIT program. Reviews were planned to occur every two years when the FIT program was originally announced. The public and stakeholders were invited to submit comments and suggestions up to December 14, 2011.

Developments at Hydro One

Advanced Distribution System

As part of its strategy to leverage the infrastructure from its smart meter investment, Hydro One launched its “ADS initiative”. The initial thrust of this initiative was to prepare for the wide adoption of distributed renewable generation. Funding envelopes of \$92 million in capital and \$20 million in OM&A were approved by the OEB as part of Hydro One Networks Inc.’s distribution rate case for the test years 2010 and 2011, to be recovered via a rate rider to be

reviewed only with respect to the actual level of spending. Significant additional investment is expected in future years, subject to business case and regulatory approvals.

In 2011 the ADS project completed the design phase of the initiative. During 2012, the project is expected to develop and install the field equipment and central software control system in a pilot zone within Ontario. The goal and objectives of the pilot will be to confirm the operational design decisions and provide real time experience with the components.

Smart Meters

The *Electricity Act* originally provided the framework for the installation of smart meters in all homes and small businesses in Ontario by December 31, 2010. Electricity distributors are accountable for the deployment of smart meter infrastructure and related technology for communications to meet minimum requirements as defined in the regulations. The Province has appointed the IESO to be the entity whose mandate includes the storage of all provincial hourly data. Distributors are also accountable for the implementation of TOU pricing.

Hydro One Networks Inc. and Hydro One Brampton Networks Inc. have installed approximately 1.3 million smart meters as of the end of 2011 and are in the process of completing development of systems and required integration to support TOU rates. These meters are capable of measuring and reporting usage over predetermined periods, being read remotely, and, when combined with the systems being provided by the IESO, of providing customers with access to information about their electricity consumption on a daily basis. Smart meters are regarded by the Province as an integral means of promoting a culture of conservation.

Smart meter activities continue to progress largely according to plan. Hydro One Networks Inc. has installed approximately 1.2 million smart meters as of the end of 2011 and has commissioned the new systems, made changes to legacy systems, and completed the required integration with the IESO's Meter Data Management Repository (MDM/R), to implement TOU pricing.

In this regard, Hydro One Networks Inc. achieved its OEB target of switching approximately 1.05 million customers to TOU pricing as of the end of June 2011. Furthermore, Hydro One Brampton Networks Inc. moved approximately 129,500 customers to TOU pricing as of the end of July 2011. These customers now consume power and receive bills based on RPP TOU prices and have access to their hourly usage information via the internet as soon as the day after it is consumed.

Total project costs continue to be significant with capital expenditures in 2011 amounting to approximately \$66.1 million for Hydro One Networks Inc. and \$4.5 million for Hydro One Brampton Networks Inc. and planned expenditures in 2012 expected to be approximately \$80.2 million for Hydro One Networks Inc. and a minimal amount for Hydro One Brampton Networks Inc.

In 2010, Hydro One Networks Inc. filed an application with the OEB under Section 74 of the *OEB Act* for an exemption from mandated TOU pricing impacting approximately 150,000 customers. These customers are located in very rural and sparsely populated portions of Hydro One's service territory where additional cellular communications equipment is required to support smart metering. Early in 2011, the OEB granted this exemption and Hydro One

Networks Inc. continues to investigate and assess alternative smart metering solutions that may provide a more economical means to serve these areas.

Cornerstone

Cornerstone is a project being undertaken by our company for the planned, phased replacement of key enterprise Information Technology (“IT”) systems in Hydro One that have reached “end-of-life”. As well, Cornerstone is designed to transform business processes supported by these new enterprise IT systems and continue to meet business requirements. Together, the new enterprise IT systems and transformed business processes (composed of four phases) are enabling Hydro One to deliver efficiency gains back into the business. Phase One implemented the enterprise systems and functions to support the supply chain, asset management and work management functions and was completed in 2008. Phase Two extended the IT system functionality to replace legacy systems supporting the finance, reporting, payroll and human resource functions and was completed in 2009. Phase Three is focused on further optimization between 2011 and 2014, during which time the new enterprise IT system will be expanded within business units to derive additional benefits surrounding business planning, asset analytics, supply chain optimization and field work management optimization. The last phase, Phase Four, is currently underway and will replace the legacy customer information and billing systems. It is being undertaken between 2011 and 2013.

Adoption of U.S. GAAP

We previously planned to adopt IFRS effective January 1, 2012 with comparative restatement of our 2011 results. In the absence of a definitive IASB plan to provide guidance on rate-regulated accounting, we began evaluating the option of adopting U.S. GAAP in lieu of IFRS in the first quarter of 2011. On July 7, 2011, we filed our application with the OSC for exemptive relief from the requirements of section 3.2 of National Instrument 52-107 *Acceptable Accounting Policies and Auditing Standards* that would otherwise require us to file our consolidated financial statements based on IFRS starting with reporting periods commencing after January 1, 2012. Our application requested approval to instead adopt U.S. GAAP, without becoming a Securities and Exchange Commission registrant, for our 2012, 2013 and 2014 fiscal years. This was approved by the OSC on July 21, 2011, and the requested exemptive relief was granted. Ontario Regulation 395/11 requires that Hydro One prepare its consolidated financial statements in accordance with U.S. GAAP for financial years on or after January 1, 2012.

Additionally, on November 23, 2011, the OEB issued its Decision with Reasons approving the necessary adjustments to Hydro One Networks Inc.’s 2012 transmission revenue requirement and variance accounts resulting from the use of U.S. GAAP. Our Board of Directors has approved a resolution authorizing us to report under U.S. GAAP.

Recent Developments

Debt issuance

On January 13, 2012, our company issued \$300,000,000 aggregate principal amount of 3.20% notes due 2022 pursuant to our medium term note program.

The Commission on the Reform of Ontario's Public Service (the "Drummond Report")

The Drummond Report, released on February 15, 2012, made several recommendations relating to our company and our industry. The recommendations relating to our company and industry included (but are not limited to) the following: eliminating the Ontario Clean Energy Benefit as quickly as possible, having a review performed on all other energy subsidy programs against measures of value for money and achievement of specific policy goals, having an IPSP produced built on the foundation of the LTEP, consolidating the Province's 80 LDCs along regional lines, reviewing the FIT program, reviewing the roles of various electricity sector agencies to identify areas for economies in administration, restructuring the wholesale electricity market, and seeking efficiencies within the operations of OPG and our company through means such as strategic partnerships.

FIT Program Review

On March 22, 2012, the Province released the results of the first review of the FIT, which was announced in October, 2011, and committed to continue the program. The Province accepted all of the recommendations resulting from the review, which include: to continue its commitment to clean energy, to streamline processes and create jobs, to encourage greater community and aboriginal participation, to improve municipal engagement, to reduce prices to reflect lower costs, and to expand Ontario's clean energy economy. See "Procurement of New Generation".

Our Strategy

Hydro One's corporate strategy is based on our mission and vision and our values. Our mission and vision is to be an innovative and trusted company delivering electricity safely, reliably and efficiently to create value for our customers. Our values represent our core beliefs:

- Health and Safety – nothing is more important than the health and safety of our employees and those who work on our property, as well as maintaining a safe environment for the public
- Excellence – We achieve excellence through continuous training, ensuring we are prepared and equipped to deliver high quality service
- Stewardship – We invest in our assets and people to build a safe, environmentally sustainable electricity network in a commercial manner
- Innovation – We innovate through new processes, people and technology to allow us to find better ways to meet the needs of our customers

We have eight strategic objectives that are inextricably linked with one another. They drive the fulfillment of our mission and vision.

- *Creating an injury-free workplace and maintaining public safety.* Health and safety must be integrated into all that we do. We must continue to create a passion for preventing injury. We will strengthen our already strong safety culture through our Journey to Zero initiative and achieve world-class results. We will continue to reinforce that nothing is more important than the health and safety of our employees.

- *Satisfying our customers.* We will meet our commitments, make customers our focus in our planning, communicate effectively, coordinate across lines of business, and maximize opportunities to improve our corporate image.
- *Continuous innovation.* Innovation is critical to achieving our mission and vision and represents one of our core values. Over the next two decades, Hydro One will install innovative solutions that improve the reliability and efficiency of the transmission and distribution systems and provide our customers with more capability to manage their power costs.
- *Building and maintaining reliable, cost-effective power delivery systems.* Our transmission strategy is to provide a robust and reliable provincial grid that accommodates Ontario's emerging generation profile, manages an aging asset base and meets demand requirements through prudent expansion and effective maintenance. Our distribution strategy is focused on incorporating ADS technology, providing reliable service over a diverse geography, supporting the connection of renewable generation, seeking efficiencies through productivity initiatives and remaining open to opportunities to rationalize the distribution sector.
- *Protecting and sustaining the environment.* Consistent with our value of stewardship, Hydro One plays a central role in reducing Ontario's carbon footprint, through the delivery of clean and renewable energy and through measures that allow our customers to manage and reduce their energy use.
- *Employee Engagement.* We believe our primary strength is the capability of our people. In order to sustain this advantage, we must address the issues of labour demographics, diversity, development of critical core competencies, and skill and knowledge retention. Our labour strategy will enable us to make significant gains in the areas of labour flexibility, productivity improvement and cost reduction.
- *Maintenance of a commercial culture that increases value for our shareholder.* We are committed to keeping rates as low as possible for our customers, and delivering income and dividends to our shareholder. This is possible through our focus on reducing costs, managing our assets effectively and increasing productivity.
- *Productivity improvement and cost-effectiveness.* To achieve our mission and vision, we must constantly strive for productivity through efficiency and effective management of costs. Productivity is key to meeting our other strategic objectives and, in particular, to achieving value for our customers and our shareholder.

Hydro One recognizes the pivotal role innovation will play in building a smart electricity grid that supports a clean environment for Ontario. We are committed to becoming the industry leader in putting innovative solutions to work for the well-being of the Ontario economy and its residents.

As an award winning company, in 2011, we were named one of the best 50 corporate citizens in Canada by Corporate Knights, the leading corporate ranking of Canadian corporate citizenship, which considers companies' relative carbon, water, waste, energy impacts as well as pension fund quality, board diversity, ratio of lowest paid worker to CEO-pay, and tax dollar generation.

Our Transmission Business

Overview

Our transmission system operates at 500 kV, 230 kV and 115 kV and transmits electricity to customers consisting of 48 local distribution companies, our own distribution businesses and 93 transmission connected companies. Electricity is also delivered to utilities in other jurisdictions through inter-ties. Electricity is supplied by generators, both within and outside Ontario, of which 99 in Ontario are connected directly to the transmission grid. Our transmission system serves over four million customers, directly or indirectly, and transported approximately 141.5 TWh of energy throughout Ontario in 2011. Revenues from our transmission business accounted for approximately 25% of our total revenues in 2011 and approximately 26% and 24% of our total revenues in 2010 and 2009, respectively.

Our transmission system forms an integrated transmission grid that can be divided into two components based on function. The integrated network, or bulk system, operates primarily at 500 kV or 230 kV over relatively long distances and links major sources of generation to transmission stations and larger area load centres. The area supply system operates at 230 kV or 115 kV and links the bulk system to local generators and loads, such as local distribution companies, industrial customers and our own retail distribution operations. Transformer stations located near load centres step down the high voltage to the level required for retail distribution systems or end-use customers connected directly to our transmission system.

Our transmission system is interconnected with the North American eastern system that is comprised of virtually all of the electric utilities east of the Continental Divide. Our transmission business owns and operates 26 inter-ties at 345 kV, 230 kV, 115 kV and 69 kV levels with New York (7), Québec (11), Michigan (4), Manitoba (3) and Minnesota (1).

Through these 26 interconnections, we can accommodate imports of about 4,600 MW and exports of approximately 6,000 MW of electricity. In operation, the actual import and export capabilities may be restricted significantly by limitations within our or another jurisdiction's transmission networks, unscheduled power flows between interconnected systems and local load and generation patterns.

Our transmission system is relatively free of restrictions in its ability to supply electricity to major load centres from generating sources located across Ontario, although there are certain short duration periods when the transmission constraints restrict economical utilization of generation. A 500 kV system serves as the transmission "backbone" around the GTA with 500 kV connections to Northern Ontario, Ottawa, London and the major generating facilities in Ontario. As new generation projects are assessed in Ontario, the impact on the transmission system is assessed and where required, transmission investment plans are initiated in a timely manner.

Transmission Planning

Hydro One develops transmission plans for new transmission facilities and for refurbishment and replacement of existing transmission facilities, as required. The plans for new facilities identify proposed equipment, configuration, routing and resulting capacities for network, local area and

connection/transformation investments. We also consult with customers to determine the need, timing and technical solutions for new connection/transformation facilities. We consult with affected communities, stakeholders and First Nations and Métis as part of the project development process for new or upgraded transmission lines.

The need for additional network and local area capabilities is determined in consultation with the OPA (which plans future generation and CDM programs), customers and in response to governmental policy and direction. The need for short-term and long-term solutions may also be highlighted in the reliability reports issued by the IESO. The IESO assesses the system impact of proposed facilities based on requests by Hydro One, as required by the Market Rules. Projects involving new transmission lines longer than 2 kilometres are subject to the OEB's leave-to-construct approval. A "transmission line" or "transmission station" as prescribed in Ontario Regulation 116/01 made under the EA is subject to the "Environmental Screening Process", as defined in such Regulation, and may be subject to a class environmental or full environmental assessment approval.

Hydro One's plans to maintain, refurbish or replace existing facilities are developed on the basis of maintenance standards, asset condition assessments and end-of-life criteria specific to each type of equipment. Priorities are assigned to each type of investment based on the risks that it mitigates. These investment plans are also included in our rate filings submitted to the OEB.

Transmission Capital Expenditure Plans

Transmission system capital expenditures are anticipated to be significant over the 2012 to 2013 period, amounting to about \$2.0 billion net overall. Our capital investment plan is designed to address Ontario's changing generation profile, accommodate load growth in areas throughout Ontario and support the expected increase in renewable energy generation in furtherance of the GEA as discussed below. Additionally, this plan seeks to sustain or improve our transmission reliability performance, which is in the top quartile ranking in Canada for transmission systems of 230kV and above. This plan also furthers our ongoing objective of sustaining the performance of aging assets through refurbishment programs and end-of-life asset replacements.

On December 22, 2010, Hydro One Networks Inc. received a letter from the Minister requesting it to immediately proceed with the planning and development work to advance the three projects referred to in the LTEP, namely, series compensation in southwest Ontario, reconductoring west of London, and a new line west of London, in an expedited timeframe.

The Minister, on February 17, 2011 issued a directive to the OEB, which in turn issued a Decision and Order on February 28, 2011, to amend the transmission licence of Hydro One Networks Inc. to develop and seek approval for the following projects the scope and timing of which shall be in accordance with the recommendations of the OPA:

1. upgrade one or more existing transmission lines west of London; and
2. build a new transmission line west of London.

Additionally, the licence amendment requires Hydro One Networks Inc. to develop and implement the following transmission projects, the scope and timing of which shall be in accordance with the recommendations of the OPA:

1. one or more devices to enhance transfer capability such as series or static var compensators or other similar devices in southwestern Ontario; and
2. increase short circuit and/or transfer capacity at up to fifteen of our transmission stations during a 48-month period starting March 1, 2011 to enable the connection of small scale renewable energy generation facilities.

In addition to the projects noted above, we are also pursuing a number of additional projects as part of our company's transmission investments. These projects, together with those noted above, will require various approvals, including, but not limited to, OEB approvals and EA approvals. Set out below are our current major transmission capital development projects for which we have obtained or are actively seeking the requisite approvals. The major transmission system capital development projects described below are at different stages of development and may not proceed to construction if requisite approvals are not obtained or if anticipated generation does not materialize.

Major Transmission Capital Development Projects

- New 500kV Bruce to Milton Double Circuit Transmission Line

The IESO's December 2007 Ontario Reliability Outlook indicated that existing transmission in southern Ontario cannot accommodate the generation expected to come into service in the Bruce area over the next few years. The Province supported this view, and the OPA determined that the preferred solution to increase the transfer capability of Hydro One Networks Inc.'s current 500kV system is to build a new 500kV double circuit transmission line between the Bruce Nuclear Station and the Milton SS to securely incorporate all eight units from the Bruce nuclear facilities and the committed and potential wind generation in the area.

The OEB approval for the 500kV line was obtained, with conditions, in September 2008 and in December 2009, conditional approval under the EA was received. In October 2009, Niagara Escarpment Commission ("NEC") approval was obtained but the approval was subsequently appealed. The appeal hearing commenced on January 26, 2010, and was completed on April 6, 2010. The hearing officer issued his report to the Minister of Natural Resources on October 28, 2010; and on May 10, 2011, the Minister directed the NEC to issue a Development Permit upon Hydro One Networks Inc.'s satisfying certain conditions. All conditions have been satisfied and the Development Permit was issued on September 14, 2011. Construction activities in this area are now underway.

Hydro One Networks Inc. informed the OEB that the costs for this project are expected to exceed original estimates. In addition, by letter dated January 7, 2011, Hydro One Networks Inc. informed the OEB that as a result of the change in costing methodology the total projected cost of \$695 million in our rate application would be revised to \$755 million. The new line is planned to be in service in 2012.

On February 26, 2010, an expropriation of land application was filed with the OEB under the *OEB Act*. An oral hearing concerning the expropriation commenced on November 11, 2010, where Hydro One Networks Inc. was seeking expropriation authority for 57 properties out of 355 properties affected by the project. Hydro One Networks Inc. had secured voluntary agreements for the required land rights on all other properties and for an additional 10 properties subsequent

to the commencement of the hearing, leaving a balance of 47 properties to be expropriated. Construction of the project commenced in the spring of 2010 on the properties where the necessary approvals and property rights have been acquired. On March 15, 2011, the OEB issued a Decision and Order authorizing Hydro One Networks Inc. to expropriate the interests in the remaining 47 properties. Acquisition of property rights for these remaining properties carried on (through either voluntary settlements or expropriation) and was completed in July 2011, allowing project construction to begin on these remaining properties at that time.

- Northeast Transmission Reinforcement: Install Four Shunt Capacitor Banks

In order to enable renewable generation in Northern Ontario as per the Province's direction and to mitigate congestion on the interface between Northern Ontario and Southern Ontario, the OPA has recommended near-term measures to reinforce the transmission system in Northeastern Ontario. These measures included the installation of series capacitors on the North-South 500 kV circuits at Nobel SS (in-service as of November 30, 2010), a Static Var Compensator ("SVC") and new shunt capacitor banks at Porcupine TS (in-service as of December 20, 2011), an SVC at Kirkland Lake TS (in-service as of March 2011), a new shunt capacitor bank at Essa TS (in-service as of November 24, 2011), a new shunt capacitor banks at Hanmer TS (in-service as of December 23, 2011) and a refurbished shunt capacitor bank at Hanmer TS.

These projects have been approved by the OEB as part of the 2011 - 2012 Transmission Rate Filing.

- Woodstock Area Transmission Reinforcement

Customer load supplied in the Woodstock area of Southern Ontario at 115kV has exceeded the reliable transmission capacity. This project is designed to increase transmission capacity through 11 km of new 230kV double-circuit line on the existing 115kV right-of-way between Ingersoll TS and a new station called Karn TS. The project also includes construction of the new Karn TS. These projects are expected to increase the transmission capacity in the Woodstock area to 290MW in preparation for future growth. All required approvals have been obtained, and the in-service date of this project is currently planned for April 2012.

- Toronto Midtown Transmission Reinforcement Project

Supply to the midtown Toronto area is currently provided by three 115 kV circuits between Leaside TS and Wiltshire TS. These circuits supply Bridgman TS and Dufferin TS from Leaside TS and also provide load transfer capability between the Leaside TS and Manby TS. This project will replace a section of aging cable and is expected to provide additional capacity by adding one 115kV circuit between Leaside TS and Bridgman TS. The current expected in-service date for the project is 2014. Hydro One Networks Inc. has obtained all the requisite approvals for this project and is currently proceeding to complete the acquisition of the required land rights.

- Rebuild Hearn SS

The existing 115 kV Hearn switching station was originally identified by our company as due for major refurbishment within the next five years. Hydro One Networks Inc. now plans to rebuild the Hearn TS and preliminary engineering and project development work is underway. The

project is classified as station work and does not require project-specific approval from the OEB. EA approvals will be obtained as part of the preliminary engineering work that is underway. The expected in-service date is currently planned for the end of 2013.

- Upgrade 115 kV Switch Yards at Manby TS, Leaside TS, Hawthorne TS & Allanburg TS

To allow the incorporation of new renewable generation in the Toronto, Ottawa and Niagara areas, the short circuit capability at each of Manby TS, Leaside TS, Hawthorne TS and Allanburg TS 115 KV yards will be increased from the existing 40 KA to 50 KA by replacing the 115 KV breakers. The expected in-service date for this work is late 2013.

- Niagara Reinforcement Project

This project comprises the construction of 76km of 230kV line from our Allanburg TS in the Niagara area to our Middleport TS in the Hamilton area. The Niagara Reinforcement Project is designed to relieve transmission bottlenecks that limit transfer of Niagara area generation and imports from New York State. The Niagara Reinforcement Project status is considered substantially on time with the exception that some project work has been delayed due to access issues created by a blockade related to aboriginal land claims on a section of the line. As a result, the OEB concluded that the project deserves special regulatory treatment and in its ruling of August 2007, the OEB determined that interest capitalized against this project could be expensed and recovered as a period cost from January 1, 2007. It is anticipated that the project can be completed approximately two months after the successful conclusion of the land claims matter between the Province and the Six Nations.

Transmission Projects at the Local Load Connection Level

At the local load connection level, Hydro One continues to address supply needs with our customers in order to meet their load growth. For projects required to provide reliable delivery of electricity to communities, the participation and support of the affected LDCs as partners in joint planning studies and throughout the consultation and approval processes continue to be essential. To address future needs of local load connections, we are in discussions with customers for major transmission expansions or new transformer stations and, where necessary, line connections in locations such as Mississauga, Oshawa, Woodstock, Essex County, Ancaster and Brampton. Targeted investments in customer delivery point performance, power quality, and our 115kV and 230kV systems are expected to lead to improved reliability.

Transmission Sustainment

In order to maintain our top quartile performance, our investment plan includes increased program expenditures for sustainment initiatives to manage the replacement and refurbishment of our aging transmission infrastructure. Increased investment is being focused on those transmission assets that most impact reliability. Targeted component replacement programs such as gas insulated switchgear, air blast circuit breakers, and transformers, as well as improved control initiatives to protect against animal contacts, have been adopted to remain in the top quartile in transmission reliability performance in North America. Also, we have continued to move to more station refurbishments than have been undertaken historically. Given the current

age of our assets and infrastructure, where these broader, integrated investments are possible, significant efficiencies can be gained.

Transmission Assets

Our transmission assets can be divided into four functional categories: transmission stations, transmission lines, network operations and telecommunication facilities.

Transmission Stations

Transmission station facilities are used for the delivery of power, voltage transformation and switching, and serve as connection points for both customers and generators.

Transmission stations can be broadly classified into two categories. The first category consists of terminal stations, including switchyards located at generating facilities, which are used mainly for switching and voltage transformation between the 500kV, 230kV, and 115kV systems. The second category consists of customer supply stations, which are transmission stations that deliver power from the transmission system to wholesale customers. Currently, most transmission stations used for customer supply consist of paired circuits and step-down transformers that are meant to ensure that the failure of any one element will not result in a permanent loss of supply. For smaller or remote loads, a simpler station design with a single transformer or a single circuit is used.

Our transmission system includes 286 transmission stations whose components may include high voltage power transformers, power circuit breakers, high voltage switches, capacitor and reactor banks, protection and control systems, metering and monitoring systems together with site infrastructures such as buildings and security systems.

Transmission Lines

Our transmission lines are classified into bulk power lines and area supply lines. Bulk power transmission lines are main lines delivering power from generating stations or interconnections to receiving terminal stations. Bulk power transmission lines are part of the integrated transmission network and generally operate at 500kV or 230kV, with a few at 115kV. Area supply lines take power from the transmission network at the receiving stations and transmit it to customer supply transformer stations at customer load centres. The usual voltage levels of area supply lines are 230kV or 115kV. All of these lines are overhead except for approximately 282 circuit kilometres of underground cables in urban areas.

The transmission system includes approximately 29,000 circuit kilometres of high voltage lines whose major components consist of cables, conductors, wood or steel support structures, foundations, insulators, connecting hardware and grounding systems

Network Operations

All of our transmission assets and many of our sub-transmission assets are managed from one location, the OGCC. As owners and operators of the largest portion of the Ontario transmission network, we have the responsibility under the *Electricity Act* to ensure that our assets are

operated in a safe and reliable manner which optimizes connection performance to our customers.

Accordingly, the OGCC is the controlling authority for our company's transmission network and for large portions of the sub-transmission network. The OGCC is an operating centre that monitors and controls our transmission and sub-transmission networks via the Network Management System. With this computer system, the OGCC remotely operates transmission equipment, responds to alarms and contingencies, and can restore and reroute interrupted power.

The OGCC reviews, approves, performs and/or authorizes all switching and control actions on our transmission system and sub-transmission system assets. The OGCC also provides the dispatch function across the entire company for transmission and distribution assets. The OGCC coordinates all planned transmission and sub-transmission equipment outages with stakeholders and customers. Additionally, the OGCC is responsible for notifying affected customers of any planned distribution outages. For forced distribution outages, the OGCC creates outage tickets which contain all the relevant information for the outage, dispatches field crews, communicates estimated time of repair and confirms outage restoration with the Hydro One distribution customer.

The OGCC is fully supported by onsite customer service, engineering, operations technology, training, process and business planning staff. There is a fully functional back-up facility which would be staffed in the event of an evacuation of the OGCC.

Telecommunications Facilities

Our telecommunications requirements include services necessary for protection and operation of the power system as well as voice and administrative data. Power system protection and control, and voice communications required for control and restoration of transmission and distribution assets have very stringent reliability and security requirements which must continue to be met during prolonged blackout conditions. These telecommunications requirements are vital to meeting our transmission reliability compliance obligations, ensuring the protection of our assets and ensuring efficient and rapid restoration following contingencies. These requirements are met through the use of our own facilities and services acquired from other telecommunications service providers. The reliability and availability of telecommunication services used in the protection and operation of our transmission system are vital to meeting our interconnection obligations, ensuring the protection of our assets and ensuring the reliability of our transmission system. Historically, if telecommunications service providers were not able or willing to provide the required services at an appropriate cost, we installed our own telecommunication facilities. These owned facilities include systems constructed using various communication technologies such as fibre optic and metallic cables, wireless transmission and power line carrier equipment.

In May 2011, Hydro One's Board of Directors authorized the Wide Area Network Initiative project with anticipated completion at the end of 2014. This project is being undertaken to meet growing telecom bandwidth requirements, which are expected to increase more than tenfold over 2009 levels by the end of 2012 in a cost-effective manner. The project is being executed in four stages.

Projects Relating to Interconnection

An interconnection (or intertie) is a transmission facility that physically connects adjacent transmission systems belonging in different jurisdictions (e.g. provinces or countries) for the purpose of electrical power transfers.

Michigan

Two of our interties with the State of Michigan have been upgraded with the installation of two, three phase shifting transformers and an autotransformer. The Phase Angle Regulators (“PAR”) were put into operation during emergency situations in 2005. This equipment will provide greater control of the Michigan interties to manage power flows across the Ontario-Michigan border and indirectly across the Ontario-New York border once placed in service with the International Transmission Company (“ITC”) PARs at its Bunce Creek facility. As a result, Ontario’s export capacity will be increased by 1,000MW and our import capacity by 500MW once they are fully operational.

In July 2010, installation of the final PAR in Michigan was completed. Hydro One and ITC have agreed to revised agreements concerning the interconnection. Placing the PARs in service is now contingent on ITC obtaining a Presidential Permit in the U.S. It is expected that this will be accomplished during 2012. During routine testing of our PARs in December 2011, it was determined that one of our PARs has suffered a fault. We are currently investigating whether that PAR is repairable or has to be replaced.

NERC (North American Electric Reliability Corporation)/NPCC (Northeast Power Coordinating Council Inc.)

In Ontario, the Market Rules mandate that we comply with the reliability standards established by NERC and NPCC, and our transmission licence mandates that we comply with the Market Rules. A Market Rule amendment effective July 8, 2011 caused those NERC and NPCC reliability standards that have not otherwise been stayed or revoked and referred back to the standards authority (NERC and NPCC) for further consideration by the OEB to be declared in force in Ontario: (a) when the reliability standards are declared in force in the United States or, for NPCC reliability criteria, when declared in force by NPCC; and (b) after the expiry of the period for initiating a review before the OEB and the conclusion of any such review.

On November 18, 2010, FERC, as the United States regulatory agency overseeing NERC, issued Order No. 743 directing NERC to revise the definition of “bulk electric system” to address FERC’s technical concerns, and ensure that the definition encompasses all facilities necessary for operating an interconnected electric transmission network. FERC believes that the best way to accomplish these goals is to (a) eliminate the regional discretion in the current definition; (b) maintain a bright-line threshold that includes all facilities operated at or above 100 kV except defined radial facilities, and (c) establish an exemption process and criteria for excluding facilities that are not necessary for operating the interconnected transmission network. According to the FERC Order, NERC was directed to file the revised definition together with an implementation plan and exemption process by January 25, 2012. The definition, implementation plan and exemption process were approved by the NERC Board of Trustees on January 18, 2012, and was filed with FERC on January 25, 2012.

FERC will now assess and potentially approve the filing or remand with further instructions. NERC has completed its work with the industry to meet this January 2012 filing date. The new proposed definition and exception process are pending NERC's Board of Trustees approval at a time prior to the filing deadline. The proposed definition, implementation plan and exemption process were filed with the OEB on March 1, 2012.

If the proposed definition is applied in Ontario, significantly more transmission facilities (being all facilities at or above 100 kV except defined radial facilities) will have to comply with NERC reliability standards with, in Hydro One's assessment, little, if any additional improved reliability of the interconnected bulk electric system. Adopting this new approach would result in significant additional costs to the transmission facility owners, including Hydro One. We anticipate these costs would be spread over a number of years, and expect that they would be recovered in rates. We are currently working with the IESO and OPA on a "made in Ontario" exemption process that will allow the application of the new definition in a cost effective manner where reliability gains can be obtained.

NERC Critical Infrastructure Protection Standards

NERC Critical Infrastructure Protection ("Cyber Security") standards came into effect in 2009. The standards are designed to ensure that utilities and other users, owners, and operators of the bulk power system in North America have appropriate procedures in place to protect critical infrastructure from cyber attack. As a result, Hydro One's physical, electronic and information security processes have been upgraded to meet more stringent security requirements in order to meet NERC's requirements.

The NERC Critical Infrastructure Protection standards are currently evolving in response to FERC Order No. 706 (May 16, 2008) directing NERC to develop modifications to Standard CIP-002-1 Cyber Security – Critical Cyber Asset Identification to address their concerns regarding the identification of critical assets to which the standards apply. NERC filed a new version of the standards with FERC and the Canadian governmental authorities in February 2011 and continued working on revised standards addressing matters in the FERC Order that were not addressed in the filed standards. As of March 23, 2012, FERC has not yet approved the filed standards. NERC expects to complete the revised version of the standards before the end of 2012. According to both the filed standards and the proposed revised standards, the list of Hydro One's owned and operated assets to which the standards apply will increase, resulting in additional work, effort and associated costs.

Our Distribution Business

Our distribution systems provide customers with electricity distribution services through a low voltage distribution network. During 2011, approximately 29.2 TWh of electricity were delivered through the distribution system to approximately 1.4 million customers located in rural and urban areas (including approximately 138,000 urban retail customers located in Brampton, Ontario). The distribution systems also serve 23 local distribution companies that are not connected directly to our transmission system, another 33 local distribution companies that are connected to our transmission system and 29 customers with loads exceeding 5MW. The distribution system comprises approximately 120,000 circuit kilometres of lines operating mainly at voltages of 50kV or less, and we own 1,008 distribution and regulating stations. Our

distribution systems distribute electricity from our transmission system and more than 7,800 small generators (240 generators >10kW and approximately 7,600 <10kW). Unlike the systems found in densely populated areas that are designed to include built-in redundancy, our distribution systems supply mainly rural areas with low population densities. To provide a cost-effective service to these areas, the distribution systems are configured as a largely radial system, meaning that they are configured in straight lines, rather than loops, so that an outage at any point along the line causes all customers further down the line to lose power. As a result, component failures require immediate repair or replacement in order to restore service. Revenues from our distribution business accounted for approximately 74% of our total revenues in 2011 and approximately 74% and 73% of our total revenues in both 2009 and 2010, respectively.

Distribution Capital Expenditure Plans

Capital expenditures for the distribution portion of our business for the period 2012 to 2014 are estimated to be approximately \$2 billion. Consistent with our approved distribution rate application, capital expenditures for our distribution business for 2012 are expected to focus on new load connections, trouble calls and storm damage, wood pole replacement, and system capability reinforcement. In response to the GEA and the resulting FIT program being administered by the OPA with respect to implementing renewable energy technologies, we are also undertaking increased generation connection activity and upgrades to the distribution system to accommodate this new generation. Across Ontario, we are continuing with the replacement of distribution assets that have reached their end-of-life, with installations that operate at higher voltage and conform to current standards. In addition, we expect to continue to construct new lines and stations in response to system growth forecasts or high load relief requirements and the connection of new generation, and expect to continue our efforts to make the distribution system more efficient. The budget also includes investments in the ADS.

In addition, we are continuing to implement initiatives to improve the reliability performance of our distribution system through improved maintenance and line clearing practices.

The actual timing and expenditures is uncertain as it is dependent upon various approvals, including OEB rate application approvals, as well as the extent to which the cost of distribution system investments made to enable the connection of renewable generation can be recovered.

Distribution Assets

The electricity distribution system is made up of three system components: (i) low voltage lines connecting our transmission stations to our distribution stations and to some industrial customers, local generators and local distribution companies; (ii) distribution and regulating stations; and (iii) our distribution lines connecting the low voltage side of the distribution stations to industrial, commercial, farm, local generation and residential customers as well as embedded local distribution companies. These system components include equipment such as poles, conductors, transformers, reclosers, protection devices and switches. Other assets include service centres and equipment, such as our transportation fleet, computing equipment and service and construction equipment.

Remote Communities

Through our subsidiary Hydro One Remote Communities Inc., we operate 19 regulated generation and distribution systems across Northern Ontario which serve 21 remote communities that are not connected to Ontario's electricity grid, the facilities of which are owned either by us or by OEFC, or in the case of Marten Falls, by the Marten Falls First Nation. These remote communities include a total of approximately 3,500 customers. Electricity used by these remote communities is produced by 57 installed diesel generators owned or operated by us, which are supplemented by small amounts of wind or hydroelectric generation. Pursuant to Section 48.1 of the *Electricity Act* and Ontario Regulation 199/02 thereunder, we are required, through one or more of our subsidiaries, to operate and maintain existing generation and distribution assets in, and supply electricity to, these remote communities.

Our Telecommunications Business

Our telecommunications business, which is carried on by our subsidiary, Hydro One Telecom Inc., markets dark and lit fibre optic capacity to telecommunications carriers and commercial customers with broadband network requirements. Hydro One Telecom Inc. leverages its affiliated company's telecommunications assets and delivers state-of-the-art, broadband telecommunications solutions to carriers, independent service providers, and large public and private sector customers.

Hydro One Telecom Inc. is a CRTC-registered, non-dominant, facilities-based carrier, providing broadband telecommunications services in Ontario with connections to Montreal and Buffalo, New York and Detroit, Michigan. Its fibre network spans over 5,000 kilometers. Hydro One Telecom Inc. provides telecommunication systems management and related functions which are required for our transmission and distribution business including corporate data and voice networks. It also provides support for our smart meter and ADS operations.

Employees

At the end of 2011, our Hydro One Networks Inc. subsidiary had 5,428 regular (i.e., permanent) employees comprised of 645 non-represented executive and managerial staff, 3,455 employees represented by the PWU and 1,328 employees represented by the Society. Hydro One Inc., Hydro One Remote Communities Inc. and Hydro One Telecom Inc. together have 146 employees in total. Hydro One Inc., Hydro One Networks Inc., Hydro One Remote Communities Inc. and Hydro One Telecom Inc. also had 1,817 non-regular (i.e., temporary) employees comprised of 24 executive and managerial staff, 754 employees represented by the PWU, 83 employees represented by the Society and 956 employees represented by a combination of the Canadian Union of Skilled Workers (an electrical trade union) and the 16 construction building trade unions that have collective agreements with the Electrical Power Sector Construction Association. In addition, our Hydro One Brampton Networks Inc. subsidiary had 51 non-represented regular staff, 112 active employees represented by the Canadian Auto Workers, 44 employees represented by the International Brotherhood of Electrical Workers and 7 contract staff.

On March 23, 2011, our company and the PWU reached a Memorandum of Agreement for a renewal collective agreement. The term of the collective agreement is from April 1, 2011 to

March 31, 2013. Also in 2011, we negotiated three-year agreements with the Canadian Auto Workers and the International Brotherhood of Electrical Workers in Brampton, both of which expire on March 31, 2014. Finally, we negotiated a three-year agreement with the Canadian Union of Skilled Workers which expires on April 30, 2014. Our agreement with the Society expires on March 31, 2013. See “Risk Factors – Labour Relations Risk.”

We expect to continue to focus initiatives on the attraction and retention of staff and the maintenance and development of the skills and competence of all our employees to foster a productive work environment and to manage the impacts of anticipated retirements. A key goal of ours is to manage the demographics of our workforce, an issue which we are monitoring, as the average age of our work force is over 44 years with approximately 15 years of service. In response to this issue, a comprehensive management development program, as well as a succession planning program, have been implemented. Pursuant to the succession planning program, active recruitment of new employees in key areas is underway. See “Risk Factors – Work Force Demographic Risk.”

Compensation

On May 18, 2010, the *Public Sector Compensation Restraint to Protect Public Services Act, 2010*, came into effect. This statute imposes a two-year freeze until March 31, 2012, on the compensation structures of non-bargaining political and Legislative Assembly staff as well as compensation plans of non-bargaining employees in the broader public sector. This legislation applies to the non-bargaining employees of Hydro One. The legislation provides for an exception regarding employees represented by collective bargaining organizations, which include trade unions certified or recognized under the *Labour Relations Act*.

Outsourcing Arrangement with Inergi LP

Through our subsidiary Hydro One Networks Inc., we entered into an outsourcing services agreement with Inergi LP (an affiliate of CapGemini Canada Inc.) as of December 28, 2001, for services commencing March 1, 2002. Effective May 1, 2010, we utilized an option in our agreement to allow for the extension of the existing term to February 28, 2015. Under the agreement, Inergi LP provides us with customer service operations and settlements, as well as supply management services, pay operations services, enterprise technology and finance and accounting services.

The agreement guarantees aggregate minimum revenue to Inergi LP of approximately \$400 million over the final five years of the agreement; and provided that we purchase a minimum volume of services from Inergi equivalent to the guaranteed revenue, we have the freedom to purchase additional volume of services elsewhere. Fees are subject to decreases based on optional external benchmarking analyses every three years. Cap Gemini Ernst & Young US LLC has provided a financial guarantee, as well as a performance guarantee, of the obligations of Inergi LP. The agreement provides for rights of termination for each of the parties, including, on the part of our company, rights of early termination for convenience and upon the occurrence of specified business events. In such cases, we are obliged under the agreement to pay specified termination fees, as well as to contribute to resulting severance and other costs. See “Risk Factors – Risk Associated with Outsourcing Arrangement.”

Financial

We aim to maximize the value of our company while maintaining an effective borrowing capability through stable credit quality and delivering stable financial returns to our shareholder. We remain committed to understanding and staying abreast of best utility practices in order to execute our business in the most cost effective manner possible.

We believe that cost reductions and productivity improvements can be achieved through the joint management of our transmission and distribution businesses, the Inergi LP outsourcing arrangement pursuant to which we outsourced non-core functions to Inergi LP and the consolidation of our system operations functions.

Annual savings have been achieved in recent years as a consequence of our focus on operational excellence, and these savings have largely been reinvested in our work programs or have offset additional cost pressures. Going forward, we are continuing to focus on capital efficiency and workplace productivity, but additional savings opportunities are fewer, more complex and difficult to achieve.

Our company previously anticipated it would apply IFRS to its consolidated financial statements for fiscal periods beginning on or after January 1, 2012, with comparative restatement of the amounts recorded on the opening IFRS balance sheet as at January 1, 2011. In the absence of a definitive plan for a new project to consider the issuance of a rate-regulated accounting standard by the IASB, Hydro One began evaluating the option of adopting U.S. GAAP in lieu of IFRS in the first quarter of 2011. On July 7, 2011, our company filed an application with the OSC for exemptive relief from the requirements of section 3.2 of National Instrument 52-107 *Acceptable Accounting Policies and Auditing Standards* that would otherwise require it to file consolidated financial statements based on IFRS starting with reporting periods commencing after January 1, 2012. The Company's application requested approval to instead adopt U.S. GAAP, without becoming a Securities and Exchange Commission registrant, for its 2012, 2013 and 2014 fiscal years. On July 21, 2011, the OSC approved the company's application and granted it the requested exemptive relief. Hydro One's Board of Directors has approved a resolution authorizing it to report under U.S. GAAP. As a result, the company's March 31, 2012 consolidated financial statements will be prepared based on U.S. GAAP with one year of comparative restatement. The company's opening U.S. GAAP consolidated balance sheet as at January 1, 2010 will be based on a retrospective application of U.S. GAAP. The Company anticipates that its current application of Canadian GAAP for rate-regulated activities will generally be consistent with U.S. GAAP. Any differences between Canadian and U.S. GAAP and their impact on the company's consolidated financial statements will be assessed as part of the company's U.S. GAAP conversion project.

Pension Plan

We established a defined benefit registered pension plan on December 31, 1999. Hydro One Inc. manages and invests the assets and liabilities of the pension fund as plan sponsor and administrator of the plan. As of December 31, 2011, there were 5,463 active members and 7,375 pensioners and disabled and deferred members. In accordance with the requirements of the *Pension Benefits Act* (Ontario), an actuarial valuation prepared as at December 31, 2009, was

filed with the Financial Services Commission of Ontario in September, 2010. See “Risk Factors – Pension Plan Risk.”

Effective December 31, 1999, we established the Hydro One Inc. Supplementary Pension Plan to provide supplementary pension benefits. On October 30, 2001, this plan was amended to require the establishment of a trust for the purpose of creating security for payment of the supplementary pension benefits provided for therein. This trust was constituted as a Retirement Compensation Arrangement under the provisions of the *Income Tax Act* (Canada), and security was issued in the form of a letter of credit.

Insurance

We maintain insurance coverage, including liability, all risk property and boiler and machinery insurance. We also maintain other insurance coverage that is required by provincial statute, which covers automobile liability, pesticide liability and aircraft liability. We do not have insurance for damage to our transmission and distribution wires, poles and towers located outside our transmission and distribution stations including damage caused by severe weather, other natural disasters or catastrophic events or for environmental remediation costs. See “Risk Factors – Risk of Natural and Other Unexpected Occurrences.”

Environmental

Although primarily regulated at the provincial level, jurisdiction over the environment is shared by Canadian federal, provincial and local governments. As a result, we are subject to extensive federal, provincial and local regulation relating to the protection of the environment that governs, among other things, environmental assessments, discharges to water and land and the generation, storage, transportation, disposal and release of various hazardous substances. See “Risk Factors – Environmental Risk.” Estimated environmental liabilities are reviewed annually or more frequently if significant changes in regulation or other relevant factors occur. Estimated changes are accounted for prospectively.

Health, Safety and Environmental Management System

Hydro One has an environmental policy that in part states: We will identify, assess and manage significant environmental risks and integrate environmental considerations into our decisions. As part of our Health, Safety and Environmental management system, Hydro One has an environmental management system designed to realize our environmental policy by identifying and assessing the environmental effects of our operations and facilities and to aid in the continual improvement of our environmental performance. The management system includes an annual risk assessment of significant environmental aspects such as PCBs and our land remediation program. This environment management system has identified and assessed hazards and risks, and controls have been implemented to mitigate significant risks. We continually update our environmental management system to reflect organizational changes and progress in achieving our environmental goals.

Permits and Approvals

We are required to obtain and maintain specified permits and approvals from federal, provincial and local authorities relating to the design, construction and operation of new and upgraded transmission and distribution facilities. Examples include EA approvals, permits for facilities to be located in parks or other regulated areas, water crossing permits, and approvals to discharge to air and water. Although the majority of the permits and approvals are under Provincial legislation, some projects may require environmental approvals from the federal government. Examples include *Fisheries Act* authorizations, *Navigable Waters Protection Act* authorizations and *Canadian Environmental Assessment Act* approvals. *Canadian Environmental Assessment Act* approvals may apply to projects located on federally-regulated lands, including First Nation reserve lands and federal parks. Interconnection facilities with neighbouring utilities in other provinces and states also require federal approval and will be subject to federal regulatory review.

The development of new transmission facilities and major expansions require approvals under the EA. Generally, larger projects are subject to the individual environmental assessment process. The majority of approvals fall under a class environmental assessment process which provides for more streamlined approvals. The scope, timing and cost of environmental assessments are dependent on the scale and type of project, the location (urban versus rural), the environmental sensitivity of affected lands and the significance of potential environmental effects.

Regulation of Releases

Federal, provincial and municipal environmental legislation regulates the release of specific substances into the environment through the prohibition of discharges that will or may have an adverse effect on the environment. Spills and leaks of substances occur in the course of our normal operations. Accordingly, we have spill, leak prevention and leak mitigation programs involving the testing, replacement, repair and installation of containment systems including re-gasketing of transformers and sulphur-hexafluoride filled equipment. In addition, we have an emergency response capability which we believe is sufficient to minimize the environmental impact of spills and to comply with our legal obligations.

Hazardous Substances

We manage a number of hazardous substances, such as polychlorinated biphenyls, herbicides and wood preservatives. In addition, some facilities have substances present which are designated for special treatment under occupational health and safety legislation such as asbestos, lead and mercury. We have environmental management programs in place to deal with PCBs and herbicides.

PCB

Under Environment Canada regulations introduced in 2008, all equipment and materials with PCBs in concentrations of 500 parts per million (ppm) or more, except pole-top transformers and their pole-top auxiliary electrical equipment and light ballasts, were to be disposed of by the end of 2009. Hydro One has applied for and received a permit from Environment Canada to allow

Hydro One to extend the time within which to dispose of specific equipment known or potentially contaminated with PCBs in concentrations of 500 ppm or more (the latest date being December 31, 2014). PCBs in concentrations of 50 ppm or more in pole-top transformers, pole-top auxiliary electrical equipment, light ballasts and other electrical equipment are required to be disposed of by the end of 2025. In addition, liquids with concentrations of 2 ppm or more that have been removed from equipment cannot be reused.

To date, approximately 97.7% of Hydro One's PCBs has been safely destroyed. PCB contaminated waste material is transported to a provincially-approved destruction facility where the PCB waste is either incinerated or chemically destroyed. The remaining 2.3% is found in extremely low concentrations (typically less than 500 ppm) in small volume electrical equipment that is geographically dispersed across Ontario. Hydro One estimates that approximately 262,000 pieces of equipment will require inspection, testing, retrofilling, replacement and/or disposal in order to comply with these regulations.

Our best consolidated estimate of Hydro One's estimated non-capital future expenditures to comply with the final PCB regulations introduced in 2008 is about \$242 million. After consideration of our 2011 spending of \$9 million, this represents reduction of about \$57 million in our estimated future expenditures to meet federal regulatory requirements with respect to PCBs. Our PCB testing expenditures for pole top distribution transformers are expected to be incurred in a relatively even pattern over the period from 2015 to 2023. Our expenditures to inspect and test equipment in our distribution and transmission stations are expected to be incurred prior to the end of 2014. Our non-capital future expenditures incurred to remediate equipment found to have PCB contamination in excess of acceptable regulatory thresholds are expected to be incurred in a relatively even pattern over the period from 2019 to 2025. As a result of this updated estimate of the future non-capital expenditures to comply with existing PCB regulations, we decreased our December 31, 2011, environmental liability by approximately \$55 million compared to the balance as at September 30, 2011. This liability represents the present value of our estimated future non-capital expenditures. As we anticipate that these future expenditures will continue to be recoverable in future electricity rates, an equivalent reduction of about \$55 million has also been recorded to the offsetting regulatory asset, reflecting the continued probability of future recovery of these PCB expenditures from customers.

Asbestos

As a result of regulatory changes, we expect to incur future expenditures to identify, remove and dispose of asbestos-containing materials installed in some of our facilities. In 2010, the Company completed a study with the aid of an external expert consultant to estimate the future expenditures required to remove asbestos prior to facility demolition. Based on this study, the Company has recorded a \$7 million liability in respect of this obligation as at December 31, 2011, based on the net present value of the Company's best estimate of the total future expenditures of \$18 million to complete its asbestos removal activities. We anticipate that such future expenditures will be recoverable in future electricity rates.

Herbicides

We use herbicides for the control of incompatible vegetation on transmission and distribution rights-of-way and for total vegetation control on station sites. We currently use an integrated vegetation management approach toward vegetation management using manual and mechanical cutting, together with the use of herbicides. The *Pesticides Act* (Ontario) and associated Regulation 63/09 include a public works exception under which herbicide application is allowed for utility programs. We are working with both government and external agencies to ensure we are in compliance. As indicated below, the historical use of herbicides has contaminated some of our properties and some nearby properties

On March 11, 2011, the Ministry of Natural Resources created an independent fact-finding panel to review the past use of 2,4,5-T herbicide in Ontario. The panel will investigate the use of 2,4,5-T by the Province's ministries and agencies and examine whether exposure to 2,4,5-T herbicide may have potential health impacts. The findings of the panel will be made available to the public. Predecessors to Hydro One have in the past used 2,4,5-T for vegetation control. It is too early to identify what impact, if any, the findings of the panel will have on Hydro One.

Wood Preservatives

Wood preservatives are used in wood poles to protect the wood against fungi and insects and thereby extend their service lives. In the past, we have used poles which were impregnated with pentachlorophenol. We respond to contamination problems related to pentachlorophenol migration as they arise.

Land Assessment and Remediation

Hydro One Networks Inc. has a voluntary land assessment and remediation program in place to identify and, where necessary, remediate contamination related to our transmission and distribution stations and service centres. Our Hydro One Remotes Communities Inc. subsidiary also has a program in place for generating stations it owns or operates. These programs involve the systematic identification of any contamination at or from these facilities and, where necessary, the development of remediation plans for our properties and adjacent private properties. Potential contaminants include insulating oils, substances previously used for vegetation control such as arsenic trioxide, and other substances such as fuel oil, gasoline, PCBs and wood preservatives such as pentachlorophenol. Phase I assessments have been completed for most of the transmission stations, service centres and remote generating stations. Limited Phase I assessments were undertaken at distribution stations given their large number and similar operating history. Site screening involving on-site soil sampling at the areas of greatest potential for contamination has been undertaken at the majority of these sites.

Hydro One Networks Inc. owns 2,212 sites. The number of sites where at least one soil or groundwater sample on site was found to be above the Ontario Ministry of the Environment standards (of at least one substance of concern) is approximately 880. We have completed the clean-up of 181 sites, which include sites where underground fuel dispensing/storage tanks were removed. We have developed a risk-based property ranking system to assist in establishing priorities for Phase II sampling. This system is supplemented with visual inspections of the sites and nearby receptors. Remediation and/or risk management is occurring based on Phase II

results and discussions with affected property owners and regulatory authorities. The Ontario Ministry of the Environment (at the local and head office level) and local health departments/medical officers of health are actively involved in the program. Further work may be required in the event we sell or decommission any of these sites.

Future consolidated expenditures related to Hydro One Networks Inc.'s land assessment and remediation program are currently estimated at approximately \$46 million. These expenditures are expected to be spent over the period ending 2020 with most of the expenditures occurring prior to 2017. The estimated consolidated expenditure for 2012 is approximately \$5 million.

Electric and Magnetic Fields

Electric and magnetic fields exist wherever electricity is used or transmitted, including electric power facilities such as transmission and distribution lines and substations, and within every building in Ontario that has electrical service. National and international health agencies, including the World Health Organization, have reported that the evidence is insufficient to conclude that the low levels of these fields in our communities have adverse effects on peoples' health.¹ Health Canada "does not consider guidelines necessary because the scientific evidence is not strong enough to conclude that typical exposures cause health problems."² We sponsor research and monitor national and international developments with respect to electric and magnetic fields. Public exposures to electric and magnetic fields are not currently regulated by either the federal or provincial governments and we are not aware of any current plans to regulate public exposures to electric and magnetic fields by these levels of government.

Health and Safety

Hydro One considers health and safety to be of paramount importance in the operation of its business and continues to maintain top quartile performance in key areas as well as to develop, implement and maintain progressive programs and initiatives. We are committed to creating and maintaining an injury-free workplace and maintaining public safety, with concentrated focus on the elimination of serious injuries or "near-misses" which have the potential to cause serious injuries. We have developed and are continuing to develop a number of programs and initiatives for accident prevention and to minimize the risk of injury to the public associated with our facilities and operations. Policies are in place for both employee health and safety and public safety.

Measures are in place to monitor lost time injuries and medical attention injuries as a result of a workplace injury. These indicators are monitored by management and by the Health, Safety and Environment Committee of the Board of Directors. Management compensation is tied, in part, to success in achieving annual health and safety performance targets. An effective early and safe

¹ E.g., World Health Organization (WHO). Electromagnetic Fields and Public Health. Fact sheet N°322 June 2007; Extremely Low Frequency Fields. Environmental Health Criteria, Vol. 238, Geneva, WHO, June 2007.

² Health Canada. It's Your Health: Electric and Magnetic Fields at Extremely Low Frequencies. http://www.hc-sc.gc.ca/iyh-vsv/enviro/magnet_e.html

return to work program has allowed us to ensure that, when injuries occur, employees recover and return to the workplace as soon as possible.

In 2011, we continued with the Journey to Zero safety initiative that was started in 2009. This initiative compares our approach to health and safety management with world class companies to see where gaps might exist. Opportunities for improvement have been prioritized and implementation continued during 2011. It is expected to continue in future years.

During 2011, there was a focus on the following areas: Journey to Zero initiatives, planning for OHSAS18001 registration, skills and safety training, field coaching/mentoring, young and new worker safety and a number of employee wellness initiatives. As in previous years, we continue to focus on specific areas of risk: electrical contacts, over-exertions and slips and trips. Through a review of incidents, we hope to understand contributing factors and prevention.

Hydro One has integrated the management of health and safety into a single health, safety and environment management system. Effective risk assessment and management are key elements to the successful minimization of risk and safety performance improvement. Within the organization, hazards and risks have been identified and assessed and controls have been implemented to mitigate significant risks.

Legal Proceedings and Regulatory Actions

In connection with the reorganization of Ontario Hydro, we succeeded Ontario Hydro as a party to various pending legal proceedings relating to the businesses, assets, real estate and employees transferred to us. We also assumed responsibility for future claims relating to the businesses, assets, real estate and employees acquired by us and arising out of events occurring prior to, as well as after, April 1, 1999. In addition to claims assumed by us, we are, from time to time, named as a defendant in legal actions arising in the normal course of business. There are currently no actions that are outstanding which are expected to have a material adverse effect on our company.

Electricity Transfer Tax Exemption

In 2009, the Province made permanent the transfer tax exemption applicable when publicly-owned utilities sell electricity distribution assets to other publicly-owned utilities in Ontario. The Province has indicated in the past that the transfer tax exemption is designed to encourage efficiencies and promote consolidation among Ontario's publicly-owned electricity utilities. Hydro One remains open to strategic opportunities to rationalize the distribution sector, on a voluntary and commercial basis, where they are consistent with both our mission and vision and direction from our shareholder. Our investment plan currently does not include any funding for LDC rationalization.

REGULATION

The Statutory and Operating Framework

General

The *Electricity Act*, and the *OEB Act*, primarily establish the broad legislative framework for Ontario's electricity market. The *Electricity Act* sets out the fundamental principles of Ontario's electricity industry, enabling open and non-discriminatory access to transmission and distribution systems. The *OEB Act* provides the OEB with the jurisdiction and mandate to regulate Ontario's electricity market.

The OEB provides a framework for the review of electric utilities' distribution and transmission revenue requirements so that rates may be established based on historical average or forecasted needs. See "Regulation – Rate Orders and Related Issues for Hydro One's Businesses – Distribution – Current Rate Orders and Distribution Rate Structure" and "Regulation – Rate Orders and Related Issues for Hydro One's Businesses – Distribution – Rate Orders for Hydro One Remote Communities Inc." Cost allocation issues are addressed on an ongoing basis by a working group established by the OEB.

On October 27, 2010, the OEB announced its plan to develop a renewed regulatory framework for electricity given the significant role network investment will have in the electricity sector in the future. This effort is intended to help ensure the reliable and cost-effective delivery of electricity to Ontario consumers. On November 8, 2011, the OEB released five OEB staff discussion papers and supporting consulting reports that are intended to initiate dialogue with stakeholders. These papers and reports looked at many issues, including: distribution network investment planning, regional planning, ADS, rate mitigation/smoothing and performance measurement. The anticipated outcome of this initiative is a regulatory framework with several potential areas of change including rate design, system codes, cost allocation, cost responsibility, reporting requirements, and performance measurement matrix.

Contractual Arrangements, Codes and Licences

Operating Agreement with the IESO

Under the *Electricity Act*, the IESO is required to enter into agreements with transmitters giving it the authority to direct the operations of the transmitters' systems. On June 8, 2001, we signed a 10-year operating agreement with the IESO, which became effective May 1, 2002, which sets out the specific responsibilities of both parties relating to the provision of transmission service. It is expected that the agreement between our company and the IESO will be renewed.

By contrast, the distribution portion of Ontario's network is not directed by the IESO and remains subject to the operational control of local distribution companies in accordance with the regulatory framework.

Hydro One's Relationships with Other Market Participants

Generators, local distribution companies and customers directly connected to our transmission system must enter into agreements with us to ensure reliable connection service in conformity with the Transmission System Code established by the OEB.

Some market participants, such as generators and large load customers embedded within distribution systems, are supplied from the wholesale market through lines and facilities that are defined or deemed by the OEB as “distribution” and owned by LDCs. At a minimum, under the *Electricity Act*, LDCs must provide non-discriminatory access for eligible generators and customers to the wholesale markets administered by the IESO. The LDCs must advise the IESO of any conditions in their distribution system that may affect the ability of embedded generators and loads to participate in the broader IESO administered markets.

Electricity Industry Codes

The OEB has issued and in some cases amended several codes that govern the operation of OEB-licenced entities in Ontario. These codes include the Affiliate Relationships Code for Electricity Distributors and Transmitters, the Standard Supply Service Code, the Transmission System Code, the Distribution System Code, the Retail Settlement Code, the Electricity Retailer Code of Conduct, the Smart Sub-Metering Code and the CDM Code. These codes and requirements prescribe minimum standards of conduct and standards of service for transmitters, distributors, smart sub-metering providers and/or retailers in the electricity market. These codes are available on the OEB website at www.ontarioenergyboard.ca.

Electricity Industry Licences

Hydro One Networks Inc.'s transmission and distribution licences were issued in 2003 and 2004, respectively. The licences for all of our regulated businesses have a 20-year term and incorporate reporting and record-keeping requirements in accordance with the OEB's Electricity Reporting and Record Keeping Requirements. The GEA amended our licences to accommodate the connection of renewable energy generation facilities and implementation of the ADS. See “Regulation – Contractual Arrangements, Codes and Licences – Transmission Licence” and “Regulation – Contractual Arrangements, Codes and Licences – Distribution Licence.”

Transmission Licence

The following are the key conditions of our transmission licence:

- ***Obligation to Enter into Agreement with the IESO*** – We are required to enter into the operating agreement with the IESO, providing for the IESO's direction of the operation of our transmission system. On June 8, 2001, we signed an operating agreement with the IESO. See “Regulation – Contractual Arrangements, Codes and Licences – Operating Agreement with the IESO.”

- ***Non-discriminatory Access*** – If a generator, distributor, retailer, wholesaler or customer requests that we convey electricity using our transmission system, subject to capacity constraints, we must make an offer to convey electricity on behalf of the applicant consistent with the applicable Market Rules and the Transmission System Code.
- ***Obligation to Connect and Priority Connection Access*** – We will not refuse to make an offer to connect to our transmission system which has been made in accordance with the terms of our transmission rate order, the Market Rules and the Transmission System Code unless we are permitted to do so by the OEB, the legislation or any codes, standards or rules with which we are obligated to comply as a condition of our licence. The connection procedures of our licence outline the respective responsibilities of Hydro One and of the connecting customer. We are required to provide priority connection access to the transmission system for qualified renewable energy generation facilities, i.e. those facilities that meet the requirements prescribed by Provincial regulations.
- ***Obligation to Maintain System Integrity*** – We must maintain our transmission system to the standards established in our agreement with the IESO, the Market Rules and any other recognized industry operating or planning standard which has been specified by the OEB.
- ***Transmission Rates*** – We may not impose charges for the transmission of electricity or connection to our transmission system except in accordance with our transmission rate order.
- ***Preparation of Plans*** – We are required to prepare plans for approval by the OEB in the manner and at the times mandated by the OEB or as prescribed by regulation, that identify expansion or reinforcement of the transmission system required to accommodate the connection of renewable energy generation facilities and to prepare plans for the development and implementation of the ADS in relation to the transmission system.
- ***Separation of Business Activity*** – Our transmission business must separate its financial records from those of any other business of Hydro One.
- ***Expansion of the Transmission System*** – Construction, expansion or reinforcement of our transmission system is subject to legislation, regulatory approvals, licences, codes and the Market Rules. Either the IESO or the OEB may require us to expand or reinforce our transmission system if it determines that doing so is necessary for the maintenance of security, reliability or integrity of the system. See “Description of the Business – Our Transmission Business – Projects Relating to Interconnection Capacity.”
- ***Information Disclosure*** – We are required to maintain records, provide the OEB with information it may require from time to time and inform the OEB of any material change in circumstances no more than 20 days after the date of occurrence.
- ***Restrictions on Provision of Information*** – We are restricted in our use and disclosure of information pertaining to consumers, retailers, wholesalers and generators. We must obtain consent for disclosure of such information, except in certain specified situations and inform such parties of the conditions under which their information may be disclosed without their consent.

Distribution Licences

The terms and conditions of our three distribution licences (Hydro One Networks Inc., Hydro One Brampton Networks Inc. and Hydro One Remote Communities Inc.) are similar to the terms and conditions of our transmission licence described above. In addition, these licences:

- ***Separation of Business Activity*** – require the distribution business to keep its financial records separate from those of the transmission business.
- ***Distribution Rates*** – create an obligation to charge rates in accordance with an order of the OEB and in accordance with the methods or techniques set out in the Electricity Distribution Rate Handbook, the Distribution System Code, the Standard Supply Service Code and the Retail Settlement Code.
- ***Code Compliance*** – require compliance with the Retail Settlement Code and the Affiliate Relationships Code for Electricity Distributors and Transmitters.
- ***Commodity Rebates*** – prescribe the manner by which we must pass through any rebates from OPG to customers.
- ***Obligation to Connect and Serve and Priority Connection Access*** – impose the obligation on our distribution business to connect a building to our distribution system under prescribed circumstances, and to sell electricity or ensure electricity is supplied to every person connected to our distribution system, in accordance with our distribution rate orders and the Standard Supply Service Code, and to sell electricity to consumers consistent with the terms and conditions of these instruments. We are also required to provide priority connection access to the distribution system for qualified renewable energy generation facilities, i.e. those facilities that meet the requirements prescribed by Provincial regulations.
- ***Preparation of Plans*** – We are required to prepare plans for approval by the OEB, in the manner and at the times mandated by the OEB or as prescribed by regulation, that identify expansion or reinforcement of the distribution system required to accommodate the connection of renewable energy generation facilities and to prepare plans for the development and implementation of the ADS in relation to the distribution system.

Hydro One Networks Inc. holds an interim distribution licence to serve the community of Cat Lake in Northwestern Ontario. The interim licence was first issued in July 2006 and has been renewed regularly for sequential terms of three months each.

Rate Orders and Related Issues for Hydro One's Businesses

The OEB approves both the revenue requirements of and the rates charged by our regulated businesses. The rates are designed to permit our businesses to recover the allowed costs and to earn a formula-based annual rate of return on our common equity by applying a specified equity risk premium to forecast interest rates on long-term bonds.

The term “utility rate base” refers to the investment in regulated operations (consisting of gross plant in service, less accumulated depreciation, plus necessary working capital and in general excluding construction work in progress). Utility rate base is used to determine the capital structure for our regulated businesses, enabling a determination of approved financing charges and return on common equity for them.

Transmission

Current Rate Orders and Review of the Existing Transmission Rate Structure

Hydro One's transmission rates are determined through Uniform Transmission Rates, which are based on the fully allocated cost associated with providing each of the following three transmission service elements:

- **Network services** — the transmission network is the integrated part of our high voltage transmission system that is shared by all users and includes all 500 kV facilities, and the 230 kV and the 115 kV facilities that can be classified as commonly used;
- **Line connection services** — connection facilities are the radial parts of our high voltage transmission system, which are dedicated to serving a single customer or generator or a group of customers or generators. Transmission line connection facilities are the radial high voltage transmission lines connecting the transformer to the network; and
- **Transformation connection services** — the transformation connection assets consist of the high voltage transformation facilities that step down voltages from transmission levels to distribution levels to supply customers.

In addition, electricity exports from Ontario are levied an export charge for transmission of two dollars per MWh.

On May 19, 2010, Hydro One Networks Inc. filed its Transmission Revenue Requirement and Rate Application for 2011 and 2012 rates. The application included a request to approve Hydro One Networks Inc.'s Green Energy Plan for the transmission business. The oral hearing commenced on September 20, 2010, and concluded on October 7, 2010.

The OEB issued its Decision on the application on December 23, 2010. In the Decision, the 2011 revenue requirement was lowered from the initial request of \$1,446 million to approximately \$1,350 million and was raised from \$1,547 million to about \$1,660 million for 2012. These changes result in transmission rates increasing by approximately 7% in 2011 and 26% (11% excluding IFRS) in 2012 as compared with the 15.7% and 9.8% originally requested. The primary sources of the changes include a lower ROE of 9.66% in 2011 and 10.09% in 2012; denial of our construction work in progress in rate base request for Bruce to Milton and 3% and 4% blanket OM&A reductions in 2011 and 2012 respectively. The OEB ordered Hydro One to adopt IFRS in 2012 and reflect the \$200 million increase in 2012 revenue requirement. Hydro One Networks Inc.'s Green Energy Plan was not approved. The OEB approved the 2011 Uniform Transmission Rates on January 17, 2011. Rates were in effect for January 2011.

On January 17, 2011, the PWU submitted an appeal of the OEB decision on Hydro One's Transmission Revenue Requirement and Rate Application for 2011 and 2012 rates to the Superior Court of Justice (Divisional Court) citing that the OEB failed to permit Hydro One Networks Inc. to recover proposed prudently incurred OM&A costs (\$13 million in 2011 and \$18 million in 2012) and thereby making a legal error. The appeal does not affect the collection of the 2011 transmission rates during the appeal proceeding. In October 2011, the appeal in this matter was heard by the Court. In February 2012 the appeal was dismissed.

On July 15, 2011, Hydro One Networks Inc. filed its Motion to Vary the OEB's decision on its previous transmission rates application to determine its 2012 revenue requirement and electricity transmission rates as well as approval of the utilization of U.S. GAAP for regulatory accounting and reporting purposes as of January 1, 2012. In response, the OEB on its own motion held a written proceeding to consider adjustments to Hydro One Networks Inc.'s 2012 transmission revenue requirement and other adjustments and variance accounts that may be necessary should Hydro One Networks Inc. receive approval to use U.S. GAAP for regulatory purposes. The adoption of U.S. GAAP in lieu of modified IFRS will decrease the revenue requirement in 2012 by about \$200 million which in turn will decrease the rate increase by approximately 15%. OSC approval to adopt U.S. GAAP was received on July 21, 2011. The OEB issued its Decision with Reasons on November 23, 2011, approving all the resulting adjustments to the 2012 transmission base revenue requirement, capital expenditures and rate base as identified by Hydro One Networks Inc. in its evidence. The OEB also approved creation of variance accounts to track costs associated with the transition to U.S. GAAP and to record the 2012 impact of differences between Canadian GAAP and U.S. GAAP. The OEB also directed Hydro One Networks Inc. to conduct a review of its current and proposed capitalization practices. Given the unique circumstances of Hydro One Networks Inc.'s transmission and distribution operations, the OEB stated that Hydro One Networks Inc. should not be precluded from applying to extend the use of the U.S. GAAP accounting standard to its distribution business on appropriate terms and conditions, as a stand-alone application.

On December 1, 2011, Hydro One Networks Inc. submitted to the OEB its draft 2012 transmission revenue requirement that reflects the approved adoption of U.S. GAAP for rate setting purposes as well as the OEB directed update to 2012 cost of capital parameters. The proposed \$1,418 million 2012 revenue requirement was subsequently approved by the OEB, along with new 2012 uniform transmission rates effective January 1, 2012 reflecting an approximate 8% transmission rate increase.

Competition

Under the *OEB Act*, any licenced competitor can apply to the OEB for approval to build transmission network facilities in Ontario. The OEB's adoption of the Uniform Transmission Rate reduces the financial incentive for customers to seek alternative transmission.

Customers historically had the option to build and own their own transmission connection facilities and thereby avoid paying our connection charge. Only a few large industrial customers and local distribution companies chose to do so, likely because of the significant costs of construction. Under the new regulatory framework, in addition to avoiding our connection charge, local distribution companies that own their transmission connection facilities can include these assets in their rate base and earn a regulated return. Customers will generally, however, continue to have the option to have their new connection facilities incorporated within our existing transmission transformation and line pools or to build and own their new connection facility. We expect to continue to maintain and restore our existing connection assets, as well as bid on the construction and ownership of new facilities.

Bypass

Bypass occurs when we have invested in the provision of transmission facilities to a customer which then obtains all or part of its transmission services in another manner or takes action to avoid its use of our transmission services before the rates collected have paid for the investment. Recovery of the remaining costs for the stranded facilities then necessitates higher transmission rates from the remaining customers.

In its January 2001 decision respecting transmission rate design and cost allocation, the OEB addressed the issue of by-pass where a load customer installs a generator to serve all or part of its load. The OEB decided that customers would be assessed line and transformation connection charges based on their total demand for electricity, or gross load. However, given the desire to encourage new generation and the growth anticipated in the usage of the network (which would hold us harmless from the effects of stranding), customers would be assessed network charges based on their net load. In effect, customers who generate electricity on-site can save the network charges otherwise applicable to their purchase of electricity generated by third parties. The decision to assess line and transformation connection charges based on gross loads means that on-site generators bear a portion of the costs associated with Ontario's transmission infrastructure, thereby mitigating the potentially negative effect of on-site generation on our transmission business.

In August 2005, following an extensive consultation process, the OEB issued a revised Transmission System Code, which implements principles relating to transmission bypass, among other things.

Facilities Applications

Transmission line expansions greater than 2 kilometres in length require prior OEB approval under section 92 of the *OEB Act*, as well as environmental assessment and other approvals. OEB filing requirements for transmission applications which include filing requirements for leave to construct electricity transmission projects under section 92 of the *OEB Act* ensure a complete review of proposed transmission projects. Regardless of whether OEB leave to construct is received, cost recovery of approved facilities still needs a final approval from the OEB as part of a transmission rate application.

On August 29, 2007, the OPA filed its first IPSP with the OEB for approval. On September 17, 2008, the Minister issued a supplemental directive directing the OPA to revisit the current IPSP in order to accelerate conservation targets and increase the amount of renewable energy sources in the supply mix. Additionally, the Minister asked the OPA to undertake an enhanced process of consultation with First Nations and Métis communities in light of potential duty to consult obligations.

On September 21, 2009, the Province announced it had asked Hydro One to proceed and seek approvals for 20 transmission projects to support the GEA to help bring renewable energy to the grid. In early May, 2010, the OPA received a request from the Minister to identify the critical transmission projects that must proceed as quickly as possible in support of the FIT initiative and in support of solar/wind manufacturing and development initiative announced by the Province in January 2010. Work on the 20 transmission projects was suspended until the OPA completed an

updated transmission plan. On November 23, 2010, the Ministry posted the LTEP, which identified three priority transmission projects that the Province wished Hydro One to carry out. As previously noted, in a letter dated December 22, 2010, the Minister requested Hydro One to proceed with the planning and development work for the three priority projects. Subsequently, by a directive to the OEB dated February 17, 2011 and by a Decision and Order of the OEB dated February 28, 2011, Hydro One's transmission licence was amended to proceed with those three projects as well as develop and seek approvals for upgrades at up to 15 transmission stations.

On August 26, 2010, the OEB released its new policy entitled "Framework for Transmission Project Development Plans". This policy sets out a framework for new transmission investment in Ontario by introducing competition for transmission development through an open process.

On March 29, 2011, the Minister expressed the Province's interest in the OEB commencing a designation process for the East-West Tie Line. The East-West Tie project is the first network line expansion covered under the new approach. The OPA's proposed route is a 400 km, 230 kV double-circuit line to run beside an existing Hydro One Networks Inc. transmission corridor along the north shore of Lake Superior between Hydro One Networks Inc.'s transformer stations at Wawa in the east and Lakehead in the west. The target in-service date, set by the OPA in its report issued June 30, 2011, is 2017.

Hydro One, at whose facilities the new line will terminate, is also involved in the designation process as bidder through its one-third interest in the East-West Tie partnership (East-West Tie partnership is an equally-shared limited partnership of Great Lakes Transmission, Bamkushwada LP (a number of First Nations in the area of the East-West Tie), and Hydro One). The partnership filed an application with the Ontario Energy Board dated September 20, 2011 for an electricity transmission licence. Six other parties have also registered their intent to participate in the East-West Tie bid process. The OEB convened a meeting on January 10, 2012, to discuss the filing of plans and the process for the evaluation of plans.

Connection Cost Responsibility and Enabler Lines

In January 2008, the OEB initiated a consultation process to examine the issue of cost responsibility associated with the connection of generation and load facilities to electricity transmission systems.

On October 29, 2008, the OEB issued its proposal to amend the Transmission System Code, adopting a "hybrid" option for cost responsibility for enabler lines required by an approved IPSP or driven by a Minister's directive. The hybrid option would see initial pooling of the costs of enabler lines by the transmitter, with generators paying their pro-rata share when ready to connect.

On October 20, 2009, the OEB adopted final amendments to the Transmission System Code, making only minor changes to the previous proposed amendments. In its notice, the OEB recognized that certain generators may prefer to connect at the distribution level rather than the transmission level to minimize their connection costs, but proposes no off-setting changes to the proposed cost responsibility rules, stating that it expects transmitters to "plan accordingly". The new requirements became effective immediately.

Regulation Changes for the Allocation of the Global Adjustment

In October, 2010, the Province announced a change to the Global Adjustment allocation methodology. Under this new methodology, consumers with an average monthly peak demand in excess of 5 MW would be allocated Global Adjustment costs based on the “High Five” methodology. The “High Five” methodology allocates charges based on a customer’s demand during the highest five system peaks in the previous year instead of on a flat rate of \$7.0 per MWh of energy consumption. Customers with an average monthly peak demand of less than 5 MW will be charged for the Global Adjustment based on their energy consumption in the billing period, as per the current methodology. This new methodology may enable large industrial customers to lower their electricity costs and payment into the Global Adjustment thereby necessitating an increase to an average residential customer’s contribution, which will be reflected in the RPP rates set by the OEB every 6 months. Hydro One implemented this change on January 1, 2011, as directed by the new regulations.

Distribution

Current Rate Orders and Distribution Rate Structure

Hydro One Brampton Networks Inc.

On November 6, 2009, Hydro One Brampton Networks Inc. applied for an adjustment to its distribution rates in accordance with the OEB’s 2nd Generation Incentive Regulatory Mechanism. The request was for a reduction of 1.8% to its 2009 approved basic rates, the disposition of Group 1 Regulatory Assets totalling approximately \$8.8 million over two years, and no change to the smart meter funding adder of \$1.00 and the smart meter disposition rate rider of \$0.12 per metered customer per month. The net adjustment reflects the application of a price escalation factor less productivity, a reduction in corporate income tax rates, and a reduction to the Ontario Capital Tax rate. On April 13, 2010, the OEB approved the requested rate adjustments for establishing 2010 distribution rates.

On June 30, 2010, Hydro One Brampton Networks Inc. submitted a 2011 cost-of-service rate application, which was subsequently adjusted on September 2, 2010 to reflect the Canadian Accounting Standards Board’s decision to allow the deferral of the adoption of IFRS implementation for rate-regulated entities to January 1, 2012. The OEB rendered its decision on April 4, 2011 approving a revenue requirement of approximately \$59.5 million, the recovery of LRAM of approximately \$2.4 million over 20 months and the disposal of Group Two Regulatory Assets of approximately \$960 thousand over eight months. The decision had an implementation date of May 1, 2011 and an effective date of January 1, 2011. The distribution component of the bill for a customer using an average of 800 kWh/month increased by 2.8% and the total bill increase was approximately 0.5% in 2011.

On September 15, 2011, Hydro One Brampton Networks Inc. applied for an adjustment to its distribution rates in accordance with the OEB’s Third Generation Incentive Regulatory Mechanism. The requested adjustment to distribution rates reflects the application of a price escalation factor less productivity. On December 22, 2011 the OEB approved an increase of 0.78% to its 2011 approved basic rates, the disposition of regulatory Liability Accounts of approximately \$3.8 million over one year, and the recovery of approximately \$430 thousand for

LRAM over one year. On January 5, 2012, the OEB issued the final rate order. A typical residential customer (800kWh per month) will see a \$3.03 (13.21%) reduction in the distribution portion of their bill and a \$1.82 (1.74%) reduction on their total bill.

Hydro One Networks Inc.

On July 13, 2009, Hydro One Networks Inc. filed its distribution rate application for 2010 and 2011 requesting a revenue requirement of \$1,181 million for 2010 and \$1,294 million for 2011. In response to the GEA, our filing included Hydro One Networks Inc.'s Green Energy Plan, which identified the expansion or reinforcement of the distribution system required to accommodate the connection of renewable energy generation facilities and plans for the development and implementation of the ADS in relation to our distribution system. Hydro One Networks Inc. filed an update to the pre-filed evidence on September 25, 2009, to reflect new information on the recovery mechanisms and amounts to be borne by Hydro One Networks Inc.'s distribution customers for the Green Energy Plan investments. The updated application sought OEB approval of revenue requirements of approximately \$1,150 million and \$1,264 million based on a ROE of 8.11% and 9.09% for 2010 and 2011, respectively. In the course of the 2010-2011 distribution rates proceeding, the OEB panel indicated that the use of the OEB's revised ROE of 9.75 % in 2010 was appropriate. On February 18, 2010, the OEB rendered an interim decision approving, on a provisional basis, Hydro One Networks Inc.'s methodology for allocation of the Green Energy Plan costs between Hydro One Networks Inc. and all provincial customers. On February 24, 2010, the OEB advised utilities that it had revised the values for the ROE from 9.75 % to 9.85% for 2010. The OEB rendered its decision on April 9, 2010, approving a revenue requirement of \$1,146 million for 2010.

The 2010 revenue requirement was adjusted to reflect the OEB's decision to apply the higher ROE of 9.85% for 2010 and decreasing OM&A expenditures by \$40 million. The approved 2010 revenue requirement resulted in an average distribution rate increase of approximately 9.3% for 2010. The total bill increase due to delivery charges for an average residential customer consuming 1,000 KWh per month is approximately 3.3% or \$4.74 per month. The total bill increase due to delivery charges for an average residential customer consuming 800 kWh per month is approximately 3.2% or \$3.77 per month.

The 2011 revenue requirement was adjusted to reflect the OEB's decision to decrease OM&A expenditures by \$40 million and adjusted to reflect a \$44 million capital program reduction. On November 15, 2010, the OEB issued the cost of capital parameter updates for rates effective January 1, 2011. The new ROE value for 2011 is 9.66%. Applying the lower ROE produces a revised revenue requirement of \$1,218 million. The approved 2011 revenue requirement results in an average distribution rate increase of approximately 8.7% for 2011. The total bill increase for an average residential customer consuming 1,000 KWh per month is approximately 3.0% or \$5.03 per month. The total bill increase for an average residential customer consuming 800 kWh per month is approximately 3.5% or \$4.83 per month.

On December 1, 2011 Hydro One Networks Inc. submitted an application for approval to adopt U.S. GAAP for rate setting, regulatory accounting and regulatory reporting purposes for its distribution business as of January 1, 2012. It was estimated that the 2012 notional Hydro One distribution revenue requirement would be \$166 million higher if IFRS were utilized rather than

U.S. GAAP. A decision is expected in the first quarter of 2012. Hydro One has indicated to the OEB that it is not requesting any change to its approved distribution rates at this time.

On July 22, 2010, the OEB issued a letter in relation to low-income energy customers informing stakeholders about the initiatives that the OEB will undertake in the areas of: (1) emergency financial assistance; (2) targeted conservation and demand side management programs; and (3) more flexible customer service rules. On October 20, 2010, the OEB issued a letter to all distributors directing them to implement an emergency financial assistance program targeted for a January 2011 implementation. The OEB directed each distributor to establish an emergency financial assistance fund equal to 0.12% of total distribution revenue. Hydro One Networks Inc.'s fund is approximately \$1.5 million for 2011 and 2012. This cannot be funded through distribution rates or a variance account.

On August 4, 2010, the OEB issued a final direction on TOU pricing and mandated that all eligible Hydro One Networks Inc. consumers be transitioned to TOU pricing by June of 2011. Effective May 1, 2010, Hydro One Networks Inc. started migrating customers to TOU rates and as of June 30, 2011, Hydro One Networks Inc. successfully moved 1.05 million RPP customers to TOU billing, thereby meeting the target. On August 13, 2010, the OEB also issued new reporting requirements in relation to the implementation of smart meters and TOU pricing. Hydro One Networks Inc. filed its first report under the new requirement on September 10, 2010.

Hydro One Networks Inc. also filed an exemption with the OEB for approximately 150,000 customers that cannot be reached due to technology limitations. The OEB has granted Hydro One Networks Inc. the requested exemption from the requirement to apply TOU pricing by June 2011 to the 150,000 customers stated in the application. The exemption applies until December 31, 2012. The OEB has directed Hydro One Networks Inc. to file a quarterly report describing its progress toward implementing TOU pricing for the exempted customers. Hydro One Networks Inc. submitted its second report on January 31, 2012, indicating over 6,000 exempted customers had been successfully migrated to TOU billing.

Hydro One Remote Communities Inc.

Hydro One Remote Communities Inc.'s business is exempt from a number of sections of the *Electricity Act* which relate to the competitive market. For example, Hydro One Remote Communities Inc. continues to apply bundled rates to customers in remote communities. Hydro One Remote Communities Inc.'s business is run on a break even basis. As a result, any net income or loss in the year is recorded in a regulatory variance account for inclusion in the calculation of future customer rates.

Hydro One Remote Communities Inc. filed its application for 2011 rates under the OEB's 3rd Generation Incentive Regulation Mechanism (IRM) on October 15, 2010. The OEB's decision of March 28, 2011 approved an increase in basic rates for the distribution and generation of electricity of 0.38% effective May 1, 2011.

On November 25, 2011, an application for 2012 distribution rates was filed under the OEB's 3rd Generation IRM seeking approval for an increase to basic rates for the distribution and generation of electricity of approximately 0.4% effective May 1, 2012. Consistent with the OEB's Decision on Hydro One Networks Inc. transmission, an application to move to US GAAP was filed on December, 16, 2011.

On December 8, 2011, the OEB issued a letter indicating that the issue of U.S. GAAP could not be determined through an IRM application and invited a separate application to consider this issue. A separate application to consider this issue was filed on December 16, 2011 requesting the use of U.S. GAAP.

Rural and Remote Rate Protection

In approving electricity rates for a distributor which delivers electricity to rural or remote consumers, the OEB is required to provide rate protection for prescribed classes of consumers, including those who received rural rate assistance prior to April 1, 1999, by reducing the rates that would otherwise apply.

Since January 1, 2003, the amount of rate reduction for our rural consumers who occupy rural residential premises is \$127 million per year less the specific amounts established for distributors in three former remote communities.

In 2009, the OEB approved an annual amount of rate protection of \$27.5 million for our remote customers.

Rate Protection and Determination of Direct Benefits to Accommodate Renewable Energy Generation Facilities

On December 21, 2011, the OEB has issued a decision and order setting the Charge for Rural or Remote Electricity Rate Protection (“RRRP”) for 2012. The OEB noted that any over or under recovery of the total RRRP amount in 2012 will be tracked in a variance account held by Hydro One Networks Inc. The OEB has determined that effective January 1, 2012, the RRRP charge to be collected by the IESO shall remain at the current level of 0.13 cents per kilowatt-hour. The OEB has further determined that effective May 1, 2012, the RRRP charge to be collected by the IESO shall be reduced to 0.11 cents per kilowatt-hour.

The *OEB Act* as amended by the GEA now includes a new mechanism for rate protection whereby some or all of the OEB-approved costs incurred by a distributor to make an eligible investment for the purpose of connecting or enabling the connection of renewable energy generation to its distribution system may be recovered from all provincial ratepayers rather than solely from ratepayers of the distributor making the investment. Accordingly, on September 25, 2009, the OEB advised all LDCs and other interested parties of its intent to initiate a consultation process to address how the OEB should determine what constitutes direct benefits that accrue to the consumers of a distributor which has incurred costs to make an eligible investment in its distribution system to accommodate a renewable energy generation facility. The OEB issued a staff discussion paper on December 14, 2009 seeking input from distributors and other stakeholders on the proposed mechanism for allocating costs. The OEB’s policy is largely consistent with the approach that Hydro One Network Inc. took in the allocation of direct benefits and as such Hydro One has not re-submitted its allocation of direct benefits at this time. In June 2010, the OEB issued a report, which recognises the need for a framework that takes into account the significant diversity of distributors in relation to the amount of renewable energy generation to be connected and the magnitude of the associated eligible investment.

Connection Cost Responsibility

In response to the passage of the GEA the OEB issued on June 5, 2009 a Notice of Proposed Amendments to the DSC. The proposed amendments were intended to revise the OEB's current approach to assigning cost responsibility between a distributor and a generator for connection of renewable energy generation facilities. The amendments, which were finalized by the OEB on October 21, 2009, define three types of distribution assets associated with the connection of renewable energy generation – connection assets, expansion assets, and renewable enabling improvements. Connection asset costs will be borne by generators. Distributors are required to fund the following:

- all expansion costs identified in a plan,
- other generator-requested expansion costs up to a cap of \$90,000/MW per project (the generator paying the rest), and
- all renewable enabling improvements.

As noted above, Hydro One Networks Inc. filed with its 2010-2011 distribution rate application a Green Energy Plan which reflects the above categories of investments. On March 10, 2010, the OEB proposed further changes to the DSC that extend the rebate mechanism to include FIT generation customers. These latest amendments are consistent with the OEB's continued task of properly assigning costs between a distributor and a generator for the connection of a renewable energy generation facility to a distribution system.

On July 15, 2010, the OEB issued amendments to the DSC addressing the cost responsibility rules for connection of renewable generation. Prior to these amendments, there was an inherent incentive to delaying connection in the hope that another generator would connect first, and by doing so, have to absorb the cost of connection. The amendments are designed to eliminate incentives to delay connections in order to avoid contributing to expansion costs.

We have made commitments to connect a number of generators under the terms of various agreements executed prior to discovering certain technical problems with these connections, which we could not reasonably have foreseen at the time we entered into those agreements. The problems have caused or will cause power quality issues for our customers. Under the DSC, the generation proponents would normally bear the costs of resolving the connection issues; however the costs are significant and also were not foreseen by the generators. Thus, the issue for our company is cost recovery of incremental costs associated with connecting these generators. We applied to the OEB for an exemption to allow the costs to be incurred and recovered through the rate pool. In December 2010, the OEB decided that we should incur the costs, record them in deferral accounts, and apply for recovery in future rate applications, subject to the provision of evidence of the reasonableness of the costs incurred.

Distribution System Code Exemption

On April 19, 2011, we submitted an application to the OEB for six-month exemptions from certain sections of the DSC pertaining to timelines for processing applications for, and for connecting, micro-embedded generators. Our justification for the exemptions was based on the fact that the volume of micro-embedded connection requests far exceeded our expectations and that requests are anticipated to continue to increase. Also, we were seeking to align generation

connection timelines with those for load connections. Since the inception of the Micro FIT program, our company alone has issued over 10,000 Offers to Connect, of which over 7,600 projects have been connected. An exemption for six months was requested to deal with the anticipated high volume of micro-embedded generator applications, manage summer construction, new connects and high load periods, and make necessary revisions to business processes. The OEB released its Decision and Order on October 11, 2011, providing six-month exemptions for processing applications for indirect connections that require a site assessment, and new generation connection timelines (in line with those for load connections).

On December 14, 2011, the OEB issued its Final Order, directing Hydro One Networks Inc. to file its first compliance report on a monthly basis, until Hydro One Networks Inc. has met the DSC requirements for three successive months.

RISK FACTORS

Ownership by the Province

The Province owns all of our outstanding shares. Accordingly, the Province has the power to determine the composition of our Board of Directors and appoint the Chair, and influence our major business and corporate decisions. We and the Province have entered into a memorandum of agreement relating to certain aspects of the governance of our company. Pursuant to such agreement, in September 2008 the Province made a declaration removing certain powers from our company's directors pertaining to the off-shoring of jobs under the outsourcing arrangement with Inergi LP. See "Interest of Management and Others in Material Transactions – Relationships with the Province and Other Parties – Memorandum of Agreement". In 2009, the Province required Hydro One, among other entities, to adhere to certain accountability measures regarding consulting contracts and employee travel, meal and hospitality expenses. The Province may require us to adhere to further accountability measures or may make similar declarations in the future, some of which may have a material adverse effect on our business. Hydro One's credit ratings may change with the credit ratings of the Province, to the extent the credit rating agencies link the two ratings by virtue of Hydro One's ownership by the Province.

Conflicts of interest may arise between us and the Province as a result of the obligation of the Province to act in the best interests of the residents of Ontario in a broad range of matters, including the regulation of Ontario's electricity industry and environmental matters, any future sale or other transaction by the Province with respect to its ownership interest in our company, the Province's ownership of OPG, and the determination of the amount of dividend or proxy tax payments. We may not be able to resolve any potential conflict with the Province on terms satisfactory to us which could have a material adverse effect on our business.

Regulatory Risk

We are subject to regulatory risks, including the approval by the OEB of rates for our transmission and distribution businesses that permit a reasonable opportunity to recover the estimated costs of providing safe and reliable service on a timely basis and earn the approved rates of return.

The OEB approves our transmission and distribution rates based on projected electricity load and consumption levels. If actual load or consumption falls below projected levels, our rate of return for either, or both, of these businesses could be materially adversely affected. Also, our current revenue requirements for these businesses are based on cost assumptions that may not materialize. There is no assurance that the OEB would allow rate increases sufficient to offset unfavourable financial impacts from unanticipated changes in electricity demand or in our costs. Our load could also be negatively affected by successful CDM programs. The LTEP directs the OPA to achieve interim CDM targets of 4,550 MW of provincial summer peak demand and 13 TWh of cumulative energy savings by the end of 2015. The Minister's March 31, 2010 directive set a province-wide LDC CDM target of 1,330 MW and 6,000 GWh for the period 2011-2014. Hydro One Networks Inc. targets have been set at 214 MW and 1,130 GWh, and the targets for Hydro One Brampton Networks Inc.'s are set at 46 MW and 190 GWh, for the period 2011-2014. These expectations are factored into our revenue requirements for OEB approval, to ensure that the targeted CDM accomplishments do not result in deteriorated revenues. There is a risk that our revenues would be reduced if these targets are exceeded. In September 2010, the CDM Code for Electricity Distributors was established and sets out the obligations and requirements that licenced distributors must comply with in relation to the CDM targets set out in their licences. This code also sets out the conditions and rules that licenced distributors are required to follow if they choose to use OEB-approved CDM programs to meet their CDM targets. The implementation of this code could further deteriorate revenues without appropriate compensation. The OEB has recognized the need to compensate utilities for such lost revenue, but the approach, level and timing of any such compensation mechanism is yet to be determined. We are also subject to risk of revenue loss from other factors, such as economic trends and weather.

In response to the LTEP, we expect to make investments in the coming years to connect new renewable generating stations. There is the possibility that we could incur unexpected capital expenditures to maintain or improve our assets particularly given that new technology is required to support renewable generation and unforeseen technical issues may be identified through implementation of projects. The risk exists that the OEB may not allow full recovery of such investments in the future. To the extent possible, we aim to mitigate this risk by ensuring prudent expenditures, seeking from the regulator clear policy direction on cost responsibility, and pre-approval of the need for capital expenditures.

While we expect all of our expenditures to be fully recoverable after OEB review, any future regulatory decision to disallow or limit the recovery of such costs would lead to potential asset impairment and charges to our results of operations, which could have a material adverse effect on our company.

Risk Associated with Arranging Debt Financing

We expect to borrow to repay our existing indebtedness and fund a portion of capital expenditures. We have substantial amounts of existing debt, which mature between 2012 and 2015, including \$600 million maturing in 2012 and \$600 million maturing in 2013. We plan to incur capital expenditures of approximately \$1.8 billion in each of 2012 and 2013. Cash generated from operations, after the payment of expected dividends, will not be sufficient to fund the repayment of our existing indebtedness and capital expenditures. Our ability to arrange sufficient and cost-effective debt financing could be materially adversely affected by numerous

factors, including the regulatory environment in Ontario, our results of operations and financial position, market conditions, the ratings assigned to our debt securities by credit rating agencies and general economic conditions. Any failure or inability on our part to borrow substantial amounts of debt on satisfactory terms could impair our ability to repay maturing debt, fund capital expenditures and meet other obligations and requirements and, as a result, could have a material adverse effect on our company.

Risk Associated with Transmission Projects

The amount of power that can flow through transmission networks is constrained due to the physical characteristics of transmission lines and operating limitations. Within Ontario, new and expected generation facility connections, including those renewable energy generation facilities connecting as a result of the FIT program stemming from the GEA, and load growth have increased such that parts of our transmission and distribution systems are operating at or near capacity. These constraints or bottlenecks limit the ability of our network to reliably transmit power from new and existing generation sources (including expanded interconnections with neighbouring utilities) to load centres or meet customers' increasing loads. As a result, investments have been initiated to increase transmission capacity and enable the reliable delivery of power from existing and future generation sources to Ontario consumers.

In many cases, these investments are contingent upon one or more of the following approvals and/or processes: environmental approval(s); receipt of OEB approvals which can include expropriation; and appropriate consultation processes with First Nations and Métis. Obtaining OEB and/or EA approvals and carrying out these processes may also be impacted by opposition to the proposed site of transmission investments which could adversely affect transmission reliability and/or our service quality, both of which could have a material adverse effect on our company.

With the introduction on August 26, 2010, of the OEB's competitive transmission project development planning process, all interested transmitters will be required to submit a bid to the OEB for identified enabler facilities and network enhancement projects. Historically, we would have been awarded such projects through our rates and Section 92, Leave to Construct, applications. The facilitation of competitive transmission could impact our future work program and our ability to expand our current transmission footprint. In addition, bid costs are only recoverable by the successful proponent. This could have a material adverse effect on our company.

Asset Condition

We continually monitor the condition of our assets and maintain, refurbish or replace them to maintain equipment performance and provide reliable service quality. Our capital and maintenance programs have been increasing to maintain the performance of our aging asset base. Execution of these plans is partially dependent on external factors, such as outage planning with the IESO and transmission-connected customers, funding approval by the OEB, and supply chain availability for equipment suppliers and consulting services. In addition, opportunities to remove equipment from service to accommodate construction and maintenance are becoming increasingly limited due to customer and generator priorities.

Adjustments to accommodate these external dependencies have been made in our planning process, and we are focused on overcoming these challenges to execute our work programs. However, if we are unable to carry out these plans in a timely and optimal manner, equipment performance will degrade which may compromise the reliability of the provincial grid, our ability to deliver sufficient electricity and/or customer supply security and increase the costs of operating and maintaining these assets. This could have a material adverse effect on our company.

Work Force Demographic Risk

By the end of 2011, approximately 18% of our employees were eligible for retirement and by 2013 there could be up to 21% eligible to retire. Accordingly, our success will be tied to our ability to attract and retain sufficient qualified staff to replace those retiring. This will be challenging as we expect the skilled labour market for our industry to be highly competitive in the future. In addition, many of our employees possess experience and skills that will also be highly sought after by other organizations both inside and outside the electricity sector. We have already lost a considerable number of management staff, both those in executive positions and those who are logical successors for executive positions. We are therefore focused on earlier identification and more rapid development of staff who demonstrate management potential. Moreover, we must also continue to advance our technical training and apprenticeship programs and succession plans to ensure that our future operational staffing needs will be met. If we are unable to attract and retain qualified personnel, it could have a material adverse effect on our business.

Environmental Risk

Our health, safety and environmental management system is designed to ensure hazards and risks are identified and assessed, and controls are implemented to mitigate significant risks. This system includes a standing committee of our board of directors that has governance over environmental matters (see “Committees of the Board of Directors – Health, Safety and Environment Committee”). Given the territory that our system encompasses and the amount of equipment that we own, we cannot guarantee, however, that all such risks will be identified and mitigated without significant cost and expense to our company. The following are some of the areas that may have a significant impact on our operations.

We are subject to extensive Canadian federal, provincial and municipal environmental regulation. Failure to comply could subject us to fines and other penalties. In addition, the presence or release of hazardous or other harmful substances could lead to claims by third parties and/or governmental orders requiring us to take specific actions such as investigating, controlling and remediating the effects of these substances. We are currently undertaking a voluntary land assessment and remediation (LAR) program covering most of our stations and service centres. This program involves the systematic identification of any contamination at or from these facilities, and, where necessary, the development of remediation plans for our company and adjacent private properties. Any contamination of our properties could limit our ability to sell these assets in the future.

We record a liability for our best estimate of the present value of the future expenditures required to comply with Environment Canada’s PCB regulations and for the present value of the future

expenditures to complete our LAR program. The future expenditures required to discharge our PCB obligation are expected to be incurred over the period ending 2025 while our LAR expenditures are expected to be incurred over the period ending 2020. Actual future environmental expenditures may vary materially from the estimates used in the calculation of the environmental liabilities on our balance sheet. We do not have insurance coverage for these environmental expenditures.

Under applicable regulations, we expect to incur future expenditures to identify, remove and dispose of asbestos-containing materials installed in some of our facilities. We record an asset retirement obligation for the present value of the estimated future expenditures. The estimates are based on an external, expert study of the current expenditures associated with removing such materials from our facilities.

There is also risk associated with obtaining governmental approvals, permits, or renewals of existing approvals and permits related to constructing or operating facilities. This may require environmental assessment or result in the imposition of conditions, or both, which could result in delays and cost increases.

We anticipate that all of our future environmental expenditures will continue to be recoverable in future electricity rates. However, any future regulatory decision to disallow or limit the recovery of such costs could have a material adverse effect on our company.

Scientists and public health experts have been studying the possibility that exposure to electric and magnetic fields emanating from power lines and other electric sources may cause health problems. If it were to be concluded that electric and magnetic fields present a health risk, or governments decide to implement exposure limits, we could face litigation, be required to take costly mitigation measures such as relocating some of our facilities or experience difficulties in locating and building new facilities. Any of these could have a material adverse effect on our company.

Risk of Natural and Other Unexpected Occurrences

Our facilities are exposed to the effects of severe weather conditions, natural disasters, man-made events including cyber and physical terrorist type attacks and, potentially, catastrophic events, such as a major accident or incident at a facility of a third party (such as a generating plant) to which our transmission or distribution assets are connected. Although constructed, operated and maintained to industry standards, our facilities may not withstand occurrences of this type in all circumstances. We do not have insurance for damage to our transmission and distribution wires, poles and towers located outside our transmission and distribution stations resulting from these events. Losses from lost revenues and repair costs could be substantial, especially for many of our facilities that are located in remote areas. We could also be subject to claims for damages caused by our failure to transmit or distribute electricity. Our risk is partly mitigated because our transmission system is designed and operated to withstand the loss of any major element and possesses inherent redundancy that provides alternate means to deliver large amounts of power. In the event of a large uninsured loss we would apply to the OEB for recovery of such loss; however, there can be no assurance that the OEB would approve any such applications, in whole or in part, which could have a material adverse effect on our net income.

Risk Associated with Information Technology Infrastructure

Our ability to operate effectively in the Ontario electricity market is in part dependent upon us developing, maintaining and managing complex information technology systems which are employed to operate our transmission and distribution facilities, financial and billing systems, and business systems. Our increasing reliance on information systems and expanding data networks increases our exposure to information security threats. We mitigate this risk through various methods including the use of security event management tools on our power and business systems, by separating our power system network from our business system network, by performing scans of our systems for known cyber threats and by providing company-wide awareness training to our personnel. We also engaged the services of external experts to evaluate the security and privacy protection aspects of our smart meter program related to customer data. We perform vulnerability assessments on our critical cyber assets and we ensure security and privacy controls are incorporated into new IT capabilities. Although these security and system disaster recovery controls are in place, there can be no guarantee that there will not be system failures or security breaches. Any such system failures or security breaches could have a material adverse effect on our company.

Pension Plan Risk

We have a defined benefit registered pension plan for the majority of our employees. Contributions to the pension plan are established by actuarial valuations which are filed with the Financial Services Commission of Ontario on a triennial basis. The most recently filed valuation was prepared as at December 31, 2009 and was filed in September, 2010. Our company contributed \$145 million in respect of 2010 and \$148 million in respect of 2011 to its pension plan to satisfy minimum funding requirements. A one time additional payment of \$48 million was made in December 2010 and an additional contribution of \$3.8 million was also made in 2011 to complete the funding associated with the partial plan wind-up. Contributions beyond 2011 will depend on investment returns, changes in benefits and actuarial assumptions and may include additional voluntary contributions from time to time. Nevertheless, future contributions are expected to be significant. A determination by the OEB that some of our pension expenditures are not recoverable from customers could have a material adverse effect on our company, and this risk may be exacerbated as the quantum of required pension contributions increase.

Market and Credit Risk

Market risk refers primarily to the risk of loss that results from changes in commodity prices, foreign exchange rates and interest rates. We do not have commodity risk. We do have foreign exchange risk as we enter into agreements to purchase materials and equipment associated with our capital programs and projects that are settled in foreign currencies. This foreign exchange risk is not material. We could in the future decide to issue foreign currency denominated debt which we would anticipate hedging back to Canadian dollars, consistent with our company's risk management policy. We are exposed to fluctuations in interest rates as our regulated rate of return is derived using a formulaic approach, which is in part based on the forecast for long-term Government of Canada bond yields. We estimate that a 1% decrease in the forecast long-term Government of Canada bond yield used in determining our rate of return would reduce our transmission businesses' net income by approximately \$18 million and our distribution

businesses' net income by approximately \$10 million. Our net income is adversely impacted by rising interest rates as our maturing long-term debt is refinanced at market rates. We periodically utilize interest rate swap agreements to mitigate elements of interest rate risk.

Financial assets create a risk that a counter-party will fail to discharge an obligation, causing a financial loss. Derivative financial instruments result in exposure to credit risk, since there is a risk of counter-party default. We monitor and minimize credit risk through various techniques, including dealing with highly-rated counter-parties, limiting total exposure levels with individual counter-parties, and by entering into master agreements which enable net settlement and by monitoring the financial condition of counter-parties. We do not trade in any energy derivatives. We do, however, have interest rate swap contracts outstanding from time to time. Currently, there are no significant concentrations of credit risk with respect to any class of financial assets. We are required to procure electricity on behalf of competitive retailers and embedded LDCs for resale to their customers. The resulting concentrations of credit risk are mitigated through the use of various security arrangements, including letters of credit, which are incorporated into our service agreements with these retailers in accordance with the OEB's Retail Settlements Code. The failure to properly manage these risks could have a material adverse effect on our company.

Labour Relations Risk

The substantial majority of our employees are represented by either the PWU or the Society. Over the past several years, significant effort has been expended to increase our flexibility to conduct operations in a more cost efficient manner. Although we have achieved improved flexibility in our collective agreements, including a reduction in pension benefits for Society staff hired after November 2005 similar to a previous reduction affecting management staff, we may not be able to achieve further improvement. The existing collective agreement with the PWU will expire on March 31, 2013 and the existing Society collective agreement will expire on March 31, 2013. We face financial risks related to our ability to negotiate collective agreements consistent with our rate orders. In addition, in the event of a labour dispute, we could face operational risk related to continued compliance with our licence requirements of providing service to customers. Any of these could have a material adverse effect on our company.

Risk from Transfer of Assets Located on Indian Lands

The transfer orders by which we acquired certain of Ontario Hydro's businesses as of April 1, 1999 did not transfer title to some assets located on lands held for bands of Indians under the *Indian Act* (Canada). See "Interest of Management and Others in Material Transactions – Relationships with the Province and Other Parties – Transfer Orders." Currently, OEFC holds legal title to these assets and we manage them until we have obtained necessary authorizations to complete the title transfer. To occupy reserve land, Hydro One must have valid permits issued by Her Majesty the Queen in the Right of Canada. For each permit, we must negotiate an agreement (in the form of a Memorandum of Understanding) with the band, OEFC and any First Nation individuals who have occupancy rights. The agreement includes provisions whereby the First Nation consents to the federal Department of Aboriginal Affairs and Northern Development issuing a permit. It is difficult to predict the aggregate amount that we may have to pay, either on an annual or one-time basis, to obtain the required agreements from the Indian bands. However, we anticipate that the amount will exceed the approximately \$1.1 million that we paid in 2011. OEFC will continue to hold these assets until we are able to negotiate agreements with the Indian

bands and occupants. If we cannot reach satisfactory agreements and obtain federal permits, we may have to relocate these assets from the Indian reserve lands to other locations at a cost that could be substantial. In a limited number of cases, it may be necessary to abandon a line and replace it with diesel generation facilities. The costs relating to these assets could have a material adverse effect on our net income if we are not able to recover them in future rate orders.

Risk Associated with Outsourcing Arrangement

Consistent with our strategy of reducing operating costs, we amended and extended our outsourcing services agreement with Inergi LP, effectively renewing the arrangement until February 28, 2015. See “Description of the Business – Outsourcing Arrangement with Inergi LP.” If the agreement with Inergi LP is terminated for any reason, we could be required to incur significant expenses to transfer to another service provider, which could have a material adverse effect on our business, operating results, financial condition or prospects.

Risk from Provincial Ownership of Transmission Corridors

Pursuant to the *Reliable Energy and Consumer Protection Act, 2002*, the Province acquired ownership of our transmission corridor lands underlying our transmission system. Although we have the statutory right to use the transmission corridors, we may be limited in our ability to expand our systems. Also, other uses of the transmission corridors by third parties in conjunction with the operation of our systems may increase safety or environmental risks, which could have an adverse effect on our company.

DIVIDENDS

Dividends on our common shares and Series A preferred shares are declared at the discretion of our Board of Directors, and are recommended by our management based on our results of operations, maintenance of the deemed regulatory capital structure, financial condition, cash requirements and other relevant factors, such as industry practice and shareholder expectations.

Our company’s policy is to declare and pay cash dividends on our common shares on the basis of a calculation involving our regulated net income net of preferred dividends and non-regulated net income. Any factor that adversely affects our company’s net income would likely be reflected in our dividend payments.

We declared and paid to the Province annual dividends on our outstanding 100,000 common shares totalling \$150 million in 2011 as compared with \$10 million in 2010 and \$170 million in 2009. We declared and paid to the Province a total annual cumulative dividend on our outstanding 12,920,000 series A preferred shares of approximately \$18 million in each of 2011, 2010, and 2009, which was calculated at a rate of \$1.375 per annum per share, as stipulated in our company’s Articles of Incorporation. In addition, we made payments in lieu of taxes to the OEFC in 2011 in the amount of approximately \$80 million, as compared to \$48 million in 2010.

DESCRIPTION OF CAPITAL STRUCTURE

General Description of Capital Structure

The authorized share capital of our company consists of an unlimited number of common shares (the voting shares of our company) and an unlimited number of preferred shares. As at December 31, 2011, 100,000 common shares and 12,920,000 series A preferred shares were issued and outstanding, all of which are owned directly by the Province.

All of our company's voting securities are held by the Province. Accordingly, our company is controlled by the Province.

The common shares are not redeemable or retractable. Holders of our common shares are entitled to one vote per share at meetings of the shareholders of the common shares and to receive dividends if, as, and when declared by the Board of Directors of our company. Holders of common shares are also entitled to participate, pro rata to their holding of common shares, in any distribution of the assets of our company upon its liquidation, dissolution or winding-up. The series A preferred shares, as set forth in our Articles of Incorporation, entitle our company to redeem all or any part of these shares subject to certain terms and conditions as set forth therein. These series A preferred shares are entitled to a dividend at a rate of \$1.375 per annum per share. Our company has not issued any restricted securities.

CREDIT RATINGS

Our company's corporate credit ratings from approved rating organizations are as follows:

Rating Agency	Short-term Debt	Long-term Debt
Standard & Poor's Rating Services Inc. ("S&P")	A-1	A+
DBRS Limited ("DBRS")	R-1 (middle)	A (high)
Moody's Investors Services Inc. ("Moody's")	Prime-1	Aa3

The following information relating to credit ratings is based on information made available to the public by the rating agencies.

Credit ratings are intended to provide investors with an independent measure of the credit quality of an issue of securities. The rating agencies rate long-term debt instruments by rating categories ranging from a high of "AAA" to a low of "D" ("C" in the case of Moody's). Long-term debt instruments which are rated in the A category by S&P mean the obligor has a strong capacity to meet its financial commitments but are considered somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. However, the obligor's capacity to meet its financial commitments and obligations is still strong. S&P utilizes a "+" or a "-" modifier to indicate the relative standing within the rating category. Long-term debt instruments which are rated in the A category by DBRS are considered to be of a satisfactory credit quality, with substantial protection of interest and principal. Entities in the "A" category, however, are considered to be more susceptible to adverse economic conditions and have greater cyclical tendencies than higher-rated securities. The

“high” modifier indicates relative standing within this rating category by DBRS. Long-term debt instruments which are rated in the Aa category by Moody’s are judged to be of high quality and are subject to very low credit risk. Moody’s applies numerical modifiers to each generic rating classification from Aa to Caa. The modifier 3 indicates a ranking in the lower end of that generic rating category.

The ratings mentioned above are not a recommendation to purchase, sell or hold our company’s debt securities and do not comment as to market price or suitability for a particular investor. There can be no assurance that the ratings will remain in effect for any given period of time or that the ratings will not be revised or withdrawn entirely by any or all of S&P, DBRS and Moody’s at any time in the future if in their judgment circumstances so warrant.

MARKET FOR SECURITIES

Our Debentures (7.35%) due 2030, Series 2 Notes (6.93%) due 2032, Series 3 Notes (5.77%) due 2012, Series 4 Notes (6.35%) due 2034, Series 5 Notes (6.59%) due 2043, Series 9 Notes (5.36%) due 2036, Series 10 Notes (4.640%) due 2016, Series 11 Notes (5.000%) due 2046, Series 12 Notes (4.89%) due 2037, Series 13 Notes (5.18%) due 2017, Series 15 Notes (5.00%) due 2013, Series 17 Notes (6.03%) due 2039, Series 18 Notes (5.49%) due 2040, Series 19 Notes (3.13%) due 2014, Series 20 Notes (4.4%) due 2020, Series 21 Notes (2.95%) due 2015, Series 22 Notes (Floating Rate 3-month BA + 0.40%) due 2015, Series 23 Notes (4.39%) due 2041, Series 24 Notes (4.00%) due 2051, and Series 25 Notes (3.20%) due 2022 are currently outstanding and are not listed on any exchange or similar market for securities.

Trading Price and Volume

The debt securities issued by our company are not listed on a recognized exchange or quoted on a recognized quotation and trade reporting system.

Prior Sales

Our company issued the following tranches of medium term notes in 2011:

Note	Principal Amount (million) (\$)	Sale Price (\$) / \$100 principal amount	Gross Proceeds (\$)
Series 21 (2.95%) due 2015	250	99.581	\$248,952,500
Series 22 (Floating Rate 3-month BA + 0.40%) due 2015	50	100.00	\$50,000,000
Series 23 (4.39%) due 2041	300	99.901	\$299,703,000
Series 24 (4.00%) due 2051	100	99.980	\$99,980,000

On January 13, 2012, we issued an additional \$300 million aggregate principal amount of Series 25 Notes (3.20%) due 2022 for gross proceeds of \$299,772,000.

DIRECTORS AND OFFICERS

Directors

The following table sets forth the name, municipality of residence and principal occupation of each of our directors, as of December 31, 2011.

<u>Name and Municipality of Residence</u>	<u>Principal Occupation</u>
James Arnett ⁽²⁾ Toronto, Ontario Canada (Director and Chair from March 31, 2008 to December 8, 2008, and Director and Chair from February 17, 2009 to present)	Chair of the Board of Directors of Hydro One Inc.
Sami Bébawi ⁽⁶⁾ Montreal, Québec Canada (Director since October 8, 2004)	President, Geracon Inc.
Kathryn A. Bouey ^{(1) (5) (6)} Toronto, Ontario Canada (Director since March 30, 2007)	President, TBG Strategic Services Inc. Corporate Director
George Cooke ⁽¹⁾⁽⁴⁾⁽⁷⁾ Toronto, Ontario Canada (Director since January 25, 2010)	President and CEO, The Dominion of Canada General Insurance Company
Laura Formusa Toronto, Ontario Canada (Director since March 30, 2007)	President and Chief Executive Officer, Hydro One Inc.
Janet Holder ⁽⁴⁾⁽⁵⁾⁽⁷⁾ Prince George, British Columbia Canada (Director since July 1, 2010)	Executive Vice President, Western Access, Enbridge Inc.
Don MacKinnon ^{(4) (5)} Chatsworth, Ontario Canada (Director since June 11, 2002)	President, Power Workers' Union

Name and Municipality of Residence**Principal Occupation**

Michael J. Mueller ⁽¹⁾⁽²⁾⁽⁶⁾
 Tecumseh, Ontario
 Canada
 (Director since March 30, 2007)

Corporate Director

Walter Murray ⁽¹⁾⁽³⁾⁽⁷⁾
 Bracebridge, Ontario
 Canada
 (Director since November 10, 2005)

Corporate Director

Robert L. Pace ⁽²⁾⁽³⁾⁽⁷⁾
 Glen Margaret, Nova Scotia
 Canada
 (Director since March 30, 2007)

President and Chief
 Executive Officer,
 The Pace Group Ltd.

Gale Rubenstein ⁽²⁾⁽³⁾⁽⁴⁾
 Toronto, Ontario
 Canada
 (Director since March 30, 2007)

Partner, Goodmans LLP

Douglas E. Speers ⁽³⁾⁽⁵⁾⁽⁶⁾
 Coldwater, Ontario
 Canada
 (Director since November 10, 2005, Chair from December 8,
 2008 to February 17, 2009)

Corporate Director

- (1) Member of the Audit and Finance Committee
- (2) Member of the Corporate Governance Committee
- (3) Member of the Human Resources Committee
- (4) Member of the Regulatory and Public Policy Committee
- (5) Member of the Health, Safety and Environment Committee
- (6) Member of the Business Transformation Committee
- (7) Member of the Investment – Pension Committee

James Arnett was appointed Chair of Hydro One Inc. on March 31, 2008. Mr. Arnett has had a distinguished career as a senior executive, corporate director and lawyer. Prior to his appointment as Chair of Hydro One Inc., during 2007 Mr. Arnett's principal occupation was Counsel to Fraser Milner Casgrain LLP from which he retired on January 31, 2010. Mr. Arnett chaired the Province of Ontario's 2007 Agency Review Panel that reviewed the way compensation is set for senior executives in Ontario's electricity sector agencies, and how those agencies can work together more efficiently. He was special advisor to the Premier of Ontario on the steel industry from 2004-2006 and on the automobile industry from 2008-2009. Mr. Arnett is a former president and CEO of Molson Inc. and between 1997 and 2000, he led Molson's transformation from a diversified holding company to a focused brewing company. Prior to that, he was a senior partner in a major Canadian law firm as the Toronto Corporate/Commercial Head and as resident partner in the firm's Washington, D.C. office. He is a Past Chair of the

Toronto East General Hospital. Mr. Arnett holds a Bachelor of Arts degree and an LL.B from the University of Manitoba and an LL.M from the Harvard Law School.

Sami Bébawi is the president of his own construction project management company, Geracon Inc. From 1999 until December 31, 2006 he was an Executive Vice President of SNC-Lavalin Group Inc. and member of the Office of the President and President of the heavy construction company Socodex Inc. Mr. Bébawi also had the corporate responsibility in project management policy at SNC-Lavalin Group Inc. He is an engineering graduate with a Masters Degree and has several years of experience in designing and building thermal, hydro and nuclear power plants. Mr. Bébawi is a Member of the Ordre des ingénieurs du Québec and is a conjunct professor at Concordia University, Montréal. Mr. Bébawi has been a Director of our company since October 8, 2004.

Kathryn A. Bouey is President of TBG Strategic Services Inc., a management consulting firm. From 2001 to 2005, Ms. Bouey was the Deputy Minister of the Management Board Secretariat, Province of Ontario and previously held other senior management positions with the Province, including: Deputy Minister of Intergovernmental Affairs (1999-2001); and Assistant Deputy Minister, Corporate Services Group, Ministry of Health and Long-Term Care (1997-1999). She is currently a Director of St. Joseph's Health Centre. Previously, she held the position of Chair of the Ontario Civil Service Commission and has served on the boards of the Canadian Comprehensive Auditing Foundation, OPG, the Ontario Financing Authority, the Ontario Pension Board, and Sheridan College Institute of Technology and Applied Learning. Ms. Bouey obtained a Master of Arts (Economics) from Carleton University in 1981 and was certified by the Institute of Corporate Directors in 2006. She has been a Director of our company since March 30, 2007.

George L. Cooke was appointed the President and CEO, The Dominion of Canada General Insurance Company ("The Dominion") in 1992. Prior to his appointment with The Dominion, Mr. Cooke was Vice President (Ontario Division), S.A. Murray Consulting Inc. (a government relations consulting firm) between 1990 and 1992. His previous experience also includes Special Advisor, Policy to the Ontario Deputy Premier and Treasurer (1989-1990), General Manager, Ontario Automobile Insurance Board (1988-1989), and positions with the OEB (1980-1988). Mr. Cooke obtained a Bachelor of Arts degree (Hons.) in Political Studies (1975) and a Masters of Business Administration degree (1977) from Queen's University, Kingston, Ontario. He also holds an Honorary Doctor of Laws degree (1999) from Assumption University in Windsor. He is currently a member of the board of directors of: The Dominion of Canada General Insurance Company, E-L Financial Corporation Limited, Insurance Bureau of Canada, and the Property & Casualty Insurance Compensation Corporation. Mr. Cooke has been a Director of our company since January 26, 2010.

Laura Formusa was appointed President and Chief Executive Officer, Hydro One Inc., on November 23, 2007, having served as the company's acting President and Chief Executive Officer since December 8, 2006. Ms. Formusa's career spans more than 30 years at Ontario Hydro and Hydro One Inc. She practised law in the areas of corporate/commercial, regulatory and environment and held various senior positions within the company until being appointed Hydro One's General Counsel in 2003. Ms. Formusa earned her Bachelor of Laws degree at Osgoode Hall Law School and was admitted to the Law Society of Upper Canada in 1980, following her call to the Bar of Ontario. Ms. Formusa is currently serving a second term as

Trustee to the Banting Research Foundation and is a member of the Board of Directors of DHX Media Ltd. Ms. Formusa was also certified by the Institute of Corporate Directors in 2010 and has been a Director of our company since March 30, 2007.

Janet Holder was appointed Executive Vice President, Western Access, Enbridge Inc. on September 1, 2011 and is responsible for the overall leadership of the Corporation's Northern Gateway Pipelines Project. Previously, Ms. Holder was President, Gas Distribution of Enbridge Inc., a role she held since January 2008. She has spent much of her career in Gas Distribution and also held senior roles with Enbridge in Corporate and Liquids Pipelines. She has held a number of executive positions with Enbridge's various businesses since 1992 including: Vice President, Support Services, Enbridge Pipelines Inc. (2006-2008); and Vice President, Market Services, Enbridge Inc. (2004-2006). Ms. Holder obtained a Bachelor of Science degree (Chemical Engineering) from the University of New Brunswick (1979) and a Master of Business Administration degree (1982) from McMaster University, Hamilton, Ontario. She is currently a member of the board of directors of several organizations including: the Canadian Gas Association (First Vice Chair), the Ontario Energy Association, Saint Elizabeth Health Care Foundation (Chair and Director), Saint Elizabeth Health Care Governance Board, West Park Healthcare Centre Foundation (Vice Chair), and the University of New Brunswick Board of Governors. Ms. Holder is a former member of the Board of Enbridge Gas Distribution Inc. She is also the 2011 United Way Toronto Campaign Chair. Ms. Holder also holds a Chartered Director's designation (McMaster University) and has been a Director of our company since July 1, 2010.

Don MacKinnon has been President of the PWU, an electricity industry workers union, since May 2000 and a lineman by trade since 1971. He was Vice-President of the Union for 11 years prior to being elected President. In 2000, Mr. MacKinnon was appointed by the Minister of Energy, Science and Technology to the Electricity Transition Committee. He was a member of the Board of Directors of the Electrical and Utilities Safety Association and the Retail Management Board of Ontario Hydro. In 2003, Mr. MacKinnon was appointed by the Minister of Energy to the government's Electricity Conservation and Supply Task Force. In 2005, Mr. MacKinnon became a member of the Canadian Nuclear Association's Board of Directors. He is also a member of the National Round Table on the Environment and the Economy, and in October 2011 became a member of the Advisory Committee of the Centre for Labour Management Relations at Ryerson University. Most recently, Mr. MacKinnon joined the Board of Plug'nDrive Ontario and became a member of the Board Advisory Council of the Waterloo Institute for Sustainable Energy (WISE), University of Waterloo. Mr. MacKinnon has been a Director of our company since June 11, 2002.

Michael J. Mueller is a former Global leader of PricewaterhouseCoopers' (PwC) Private Company Services/Middle Market Practice and a former member of PwC's Global Audit Leadership Team, Global Advisory Leadership Team and the Global Markets Council. Prior to his retirement from PwC in July 2007, his previous positions with the firm also included National Managing Partner for Canada and Senior Relationship Partner for a number of the firm's most significant clients. He is also a Chartered Accountant, and a Chartered Business Valuator. Until 2009, he was a Certified Insolvency Practitioner. In December 2008, Mr. Mueller was appointed to the Ontario Economic Advisory Panel by the Minister of Finance of Ontario and in July 2010 was appointed as a member of the Board of Directors of SMART Technologies Inc. Mr. Mueller's past community involvement includes: member of the Board of

Governors of the Stratford Shakespearean Festival of Canada; President of the Windsor Symphony Society; President, Better Business Bureau of Windsor and Essex Counties; and is a current Director of the Windsor-Essex Economic Development Commission, Chair of the Odette School of Business, University of Windsor and a member of Caesars Windsor, Compliance Committee. He has been a Director of our company since March 30, 2007.

Walter Murray is a former Vice-Chairman and member of the Executive Committee of RBC Capital Markets, an international corporate and investment bank. Prior to his retirement from the RBC Royal Bank in April 2005, his 38-year career included Senior Executive Investment Banking responsibility for overseeing and directing all financial and advisory activity with a portfolio of major Canadian and International accounts; Executive head of Corporate Banking activities across Canada, and several other Executive postings, including serving as Regional Executive for RBC's Midwestern USA Corporate Banking operations. Mr. Murray has been a Director of our company since November 10, 2005.

Robert L. Pace is the President and Chief Executive Officer of The Pace Group Ltd. The Pace Group owns and operates a number of companies across Atlantic Canada, including: Maritime Broadcasting System Ltd., a 24 radio station group; MBS Realty Ltd.; and Shredder's. He began his professional career with the Halifax law firm Chandler Moore, where he practiced family and commercial law. Between 1981 and 1984, Mr. Pace served as Atlantic Advisor to the Prime Minister of Canada. Mr. Pace is currently a member of the Board of Directors of Canadian National Railway Company; Canadian Health Care Consulting Services Ltd.; High Liner Foods Incorporated; the Atlantic Salmon Federation; the Public Gardens Restoration Committee (Halifax); and the Walter and Duncan Gordon Foundation. Mr. Pace was called to the Nova Scotia Bar in 1981 following the completion of his Bachelor of Laws degree at Dalhousie University, where he also completed an MBA in 1977. He has been a Director of our company since March 30, 2007.

Gale Rubenstein is a partner of the law firm Goodmans LLP and a member of the firm's Executive Committee. She practices law primarily in the areas of commercial insolvency and restructuring with emphasis on financial institutions, both domestic and international, and on pension restructurings. Ms. Rubenstein was senior counsel to the liquidators of numerous financial institutions and has been counsel to the Superintendent of Financial Institutions (Canada) and the Superintendent of Financial Services (Ontario). She has authored numerous papers on the insolvency of insurance companies and banks, and is update author of LexisNexis Canada's Insurance Companies Act: Legislation and Commentary. She obtained her Bachelor of Law degree from Osgoode Hall Law School and is a current Director of the Insolvency Institute of Canada; a member of Insol International; a Director of the Canadian Lawyer Liability Assurance Society; and a Director of Osgoode Hall Alumni Association. She has been a Director of our company since March 30, 2007.

Douglas E. Speers is the former Chairman and Director of Emco Corporation, a leading Canadian distributor of building materials for the residential, commercial and industrial construction markets. Prior to his appointment as Chairman of Emco Corporation, Mr. Speers was Emco's President and CEO from 1997 - 2004. Between 1971 and 1988, he held several senior positions with Imperial Oil Ltd. in Canada and Exxon International in New York City. Mr. Speers is a Professional Engineer - Province of Ontario, a member of the Advisory Board of the Richard Ivey School of Business, and past Chair and Director of the Ivey Management

Services Company. He is a member of the boards of a number of privately-held companies and has been a Director of our company since November 10, 2005.

Each director is elected annually to serve for one year or until his or her successor is elected or appointed.

Information Regarding Certain Directors

Walter Murray was a director of Ivernia Inc. (“Ivernia”) when it was the subject of a temporary “management and insider cease trade order” issued by the Ontario Securities Commission on May 22, 2003 as a result of a delay in filing audited annual consolidated financial statements for the 2002 financial year and certain other disclosure documents within the periods required by Canadian securities laws. The required filings were delayed as a result of continuing negotiations regarding a joint venture and the obtaining of financing for Ivernia, the outcome of which would impact the presentation of Ivernia’s financial statements. All outstanding disclosure filings were completed and the cease trade order expired on July 23, 2003.

Executive Officers

The following table sets forth the name, municipality of residence and position of each of our executive officers as of December 31, 2011.

<u>Name and Municipality of Residence</u>	<u>Position With Our Company</u>
James Arnett Toronto, Ontario Canada	Chair of the Board of Directors of Hydro One Inc.
Laura Formusa Toronto, Ontario Canada	President and Chief Executive Officer
Sandy Struthers Toronto, Ontario Canada	Executive Vice-President and Chief Financial Officer
Joseph Agostino Toronto, Ontario Canada	General Counsel
Myles D’Arcey Toronto, Ontario Canada	Senior Vice-President, Customer Operations
Nairn McQueen Dundas, Ontario Canada	Senior Vice-President, Engineering & Construction Services

<u>Name and Municipality of Residence</u>	<u>Position With Our Company</u>
Carmine Marcello Thornhill, Ontario Canada	Executive Vice-President, Strategy
Wayne Smith Toronto, Ontario Canada	Senior Vice-President, Grid Operations
Peter Gregg Oakville, Ontario Canada	Executive Vice-President, Operations
John Fraser Mississauga, Ontario Canada	Senior Vice-President, Internal Audit & Chief Risk Officer
John Macnamara Waterdown, Ontario Canada	Vice President, Health, Safety & Environment
Robert Cultraro Pickering, Ontario Canada	Senior Vice-President, Chief Investment & Pension Officer

James Arnett's biographical information is presented above under "Directors".

Laura Formusa's biographical information is presented above under "Directors".

Sandy Struthers was appointed as Executive Vice-President and Chief Financial Officer effective November 1, 2010. Prior to this, Mr. Struthers was Senior Vice President and Chief Financial Officer. Mr. Struthers joined Hydro One in 2000 as a Director in the Finance area and has held a number of senior positions in Finance, including Director, Financial Strategy and Director, Merger & Acquisitions Finance. In 2005, he was appointed to the position of Chief Information Officer where he implemented a number of significant advancements in our company's IT infrastructure. Prior to joining Hydro One, Mr. Struthers was a partner in a national accounting firm.

Joseph Agostino was appointed as General Counsel on December 13, 2007, after having served as Acting General Counsel since December 8, 2006. On November 24, 2011, Mr. Agostino was appointed as the Chief Compliance Officer for Hydro One and its subsidiaries. He joined Ontario Hydro in 1995 and has previously held the position of Assistant General Counsel of Hydro One Networks Inc.

Myles D'Arcey was appointed as Senior Vice-President, Customer Operations of Hydro One Networks Inc. on May 1, 2005. Mr. D'Arcey is also President and Chief Executive Officer of

Hydro One Remote Communities Inc. He joined Ontario Hydro in 1978 and has held the position of Vice President, Station Services of Hydro One Networks Inc.

Nairn McQueen was appointed as Senior Vice-President, Engineering & Construction Services effective April 15, 2009 after serving as Vice President, Engineering & Construction Services of Hydro One Networks Inc. from August 28, 2002. Prior to joining Hydro One Network Services Inc. in 2000 as Director of Engineering, Mr. McQueen was V.P., Engineering and Project Management Services for Agra Monenco.

Carmine Marcello was appointed as Executive Vice-President, Strategy, effective November 1, 2010. Prior to this, Mr. Marcello was Senior Vice-President, Asset Management and Corporate Projects of Hydro One Networks Inc. effective April 15, 2009 after serving as Vice President, Asset Management from March 6, 2009 and Vice-President, Corporate Projects of Hydro One Networks Inc. from March 21, 2007. Carmine joined Ontario Hydro in 1987 and has held a number of senior positions including Director, System Investment and Director, Ontario Grid Control Centre Transformation.

Wayne Smith was appointed Senior Vice-President, Grid Operations of Hydro One Networks Inc. effective April 15, 2009 after serving as Vice-President, Grid Operations of Hydro One Networks Inc. from January 1, 2005. He joined Ontario Hydro in 1980 and has held the position of Director of Investment Planning in Asset Management of Hydro One Networks Inc.

Peter Gregg was appointed Executive Vice-President, Operations, effective November 1, 2010. Prior to this, he was Senior Vice-President, Corporate & Regulatory Affairs of Hydro One Networks Inc. on April 1, 2009. Mr. Gregg joined Hydro One Networks Inc. in 2004 as Vice-President, Corporate Affairs and was appointed as Vice President, Executive Office in 2005 and then Vice-President, Corporate and Regulatory Affairs in early 2007. Prior to joining Hydro One Networks, Mr. Gregg was responsible for Corporate Affairs and Communications at the Greater Toronto Airport Authority.

John Fraser was appointed Vice-President, Internal Audit & Chief Risk Officer on May 1, 2003. Prior to joining Hydro One Networks Inc. on May 12, 1999, he was Senior Vice-President, Quality Assurance, Newcourt Credit Group Inc. He has previously held the positions of General Auditor of Ontario Hydro Services Company Limited, General Auditor and Chief Risk Officer of Ontario Hydro Services Company Limited, and General Auditor and Chief Risk Officer of Hydro One Networks Inc.

John Macnamara was appointed Vice-President, Health, Safety & Environment on May 4, 2009. Prior to joining Hydro One Networks in 2009 as Vice President, Health, Safety & Environment, Mr. Macnamara was Global Vice-President, Health and Safety and Co-chair of Global Joint Health and Safety Committee at Arcelor Mittal.

Robert Cultraro was appointed Senior Vice-President and Chief Investment & Pension Officer effective June 1, 2011. Prior to this, Mr. Cultraro was Hydro One's acting Vice-President, Pension Fund. Mr. Cultraro joined Hydro One on January 2, 2006 as Director, Pension Fund.

There is no family relationship between any director or executive officer and any other director or executive officer.

Indebtedness of Directors and Executive Officers

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

INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

Relationships with the Province and Other Parties

Overview

The Province of Ontario owns all of our outstanding shares. As a result, the Province has the power to control all governance decisions affecting us, including the composition of our Board of Directors. Accordingly, the Province exercises control over our policies, the acquisition or disposition of assets, the incurrence of further debt and the payment of dividends to holders of our common and preferred shares.

The OEB is the principal regulator of Ontario's electricity industry. The Province appoints the board members of the OEB and fills any vacancies on the OEB. The OEB is obligated to implement approved directives of the Province concerning general policy and objectives to be pursued by the OEB and other directives aimed at addressing existing or potential abuses of market power by industry participants. The IESO directs the operation of our transmission system. The Board of Directors of the IESO, other than its Chief Executive Officer, is appointed by the Province in accordance with the regulations in effect from time to time under the *Electricity Act*.

The OPA is mandated to forecast supply and demand of electricity over the medium and long term and to conduct planning and implement measures to meet the supply and demand needs. Its Board of Directors is appointed by the Province.

Transfer Orders

The transfer orders pursuant to which we acquired Ontario Hydro's electricity transmission, distribution and energy services businesses as of April 1, 1999 did not transfer any asset, right, liability or obligation where the transfer would constitute a breach of the terms of any such asset, right, liability or obligation or a breach of any law or order. The transfer orders also did not transfer title to some assets located on lands held for bands or bodies of Indians under the *Indian Act* (Canada). The transfer of title to these assets did not occur because authorizations originally granted by the Canadian Minister of Indian and Northern Affairs for the construction and operation of these assets could not be transferred without the consent of such Minister and the relevant Indian bands or bodies or, in several cases, because the authorizations had either expired or had never been properly issued. These assets consist primarily of approximately 70 km of

transmission lines and distribution lines used to deliver electricity on reserves (of which 14 km of lines are used solely for serving customers off the reserves). OEFC holds these assets.

We are obligated under the transfer orders to manage both the assets held in trust until we have obtained all consents necessary to complete the transfer of title to these assets to us and the assets otherwise retained by OEFC that relate to our businesses. We have entered into an agreement with OEFC under which we are obligated, in managing the assets, to take instructions from OEFC if our actions could have a material adverse effect on it. OEFC has retained the right to take control of and manage the assets, although it must notify and consult with us before doing so and must exercise its powers relating to the assets in a manner that will facilitate the operation of our businesses. The consent of OEFC is also required prior to any disposition of these assets.

The Province also transferred officers, employees, assets, liabilities, rights and obligations of Ontario Hydro in a similar manner to its other successor corporations. These transfer orders include a dispute resolution mechanism to resolve any disagreement among the various transferees with respect to the transfer of specific assets, liabilities, rights or obligations.

The transfer orders do not contain any representations or warranties from the Province or OEFC with respect to the transferred officers, employees, assets, liabilities, rights and obligations. Furthermore, under the *Electricity Act*, OEFC was released from liability in respect of all assets and liabilities transferred by the transfer orders, except for liability under our indemnity from OEFC as discussed below. By the terms of the transfer orders, each transferee indemnifies OEFC with respect to any assets and liabilities not effectively transferred, and is obligated to take all reasonable measures to complete the transfers where the transfers were not effective.

Indemnities

OEFC indemnified us with respect to the failure of the transfer orders to transfer any asset, right or thing or any interest therein related to our business to us and some of our subsidiaries, some adverse claims or interests of third parties or based on title deficiencies arising from the transfer orders, except for some claims and rights of the Crown, and claims related to any equity account previously referred to in the financial statements of Ontario Hydro including amounts relating to any judgment, settlement or payment in connection with litigation initiated by some utilities commissions. The Province has unconditionally and irrevocably guaranteed to us and our subsidiaries the payment of all amounts owing by OEFC under its indemnity.

The indemnity specifically excludes any matter for which we have agreed or are required to indemnify OEFC pursuant to or in connection with any transfer order. It also excludes any claim related to any aboriginal title or rights or the absence of a permit, right-of-way, easement or similar right in respect of lands held for Indian bands under the *Indian Act* (Canada). It also excludes any payment made, or loss, expense or liability incurred by us as a result of the failure of a transfer order to transfer any asset of Ontario Hydro described in the provisions of the transfer order relating to ineffective transfers.

The indemnity does not cover the first \$10,000 in value of each claim and only applies to the amount by which the total of all claims exceeds \$10 million. We are obliged to pay OEFC a fee for the indemnity of \$5 million per year until such time as the parties agree that the indemnity should be terminated. We anticipate that we will require the indemnity until all indemnifiable

claims have been identified and finally determined by a non-appealable court order. The indemnity ceases to be available to any of our subsidiary corporations if we cease to control them unless the cessation of ownership results from the sale of the shares of a subsidiary in connection with the enforcement of security on such shares by an arm's-length creditor of Hydro One. The indemnity can be assigned under some conditions with the consent of the Minister of Finance.

The Province has also agreed to indemnify the directors of Hydro One for any liabilities reasonably incurred by them in respect of any civil, criminal or administrative action or proceeding to which they are made a party to the extent that these liabilities result from a claim or determination that their approval of the indemnity by OEFC constituted a breach of their duty to exercise the care, diligence or skill that a reasonably prudent person would exercise in comparable circumstances.

We have indemnified OEFC in respect of the damages, losses, obligations, liabilities, claims, encumbrances, penalties, interest, deficiencies, costs and expenses arising from matters relating to our business and any failure by us to comply with our obligations to OEFC under agreements dated as of April 1, 1999. These obligations include obligations to employ the employees transferred to us under the transfer orders, make and remit employee source deductions, i.e., tax withholding amounts, and employer contributions, manage the real and personal properties which OEFC continues to hold in trust or otherwise and take any necessary action to transfer all of these properties to us, to pay realty taxes and other costs, provide access to books and records and to assume other responsibilities in respect of the assets held by OEFC in trust for us.

Operational Matters

Hydro One receives its revenues, which are in part collected by the IESO from customers, in accordance with the rules established under the *Electricity Act* and the *OEB Act* from time to time.

Hydro One and the IESO have entered into an operating agreement, which took effect in May 2002, setting out the specific responsibilities of both parties relating to the provision of transmission service. Hydro One also purchases power from the IESO administered spot market.

Hydro One has several service agreements with the other successor corporations to Ontario Hydro, primarily OPG. These services include field and engineering, logistics, corporate and telecommunications.

Payments in Lieu of Corporate Taxes

We and our subsidiaries are exempt from taxes under the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario) and the *Taxation Act, 2007* (Ontario) because we are wholly owned by the Province, and each of our subsidiaries is, in turn, wholly owned (directly or indirectly) by us. However, pursuant to the *Electricity Act*, we and each of our subsidiaries are required to pay amounts to OEFC, which are referred to as payments in lieu of corporate taxes or proxy taxes, in respect of each taxation year, generally equal to the amount of tax that we would be liable to pay under the *Income Tax Act* (Canada) and for the taxation years ending prior to January 1, 2009, the *Corporations Tax Act* (Ontario) and the *Taxation Act, 2007* (Ontario) thereafter if we were not exempt from taxes thereunder.

Memorandum of Agreement

We entered into a memorandum of agreement with the Province in March 2008 relating to our mandate, responsibilities, performance expectations and executive compensation. Under this agreement, we must prepare investment plans for new transmission and distribution projects and prioritize investments in transmission and distribution capacity to support projects necessary to maintain ongoing grid security and reliability. This agreement also requires that we undertake special initiatives communicated from time to time by the Province by way of unanimous shareholder agreement or declaration in accordance with the provisions of the *Business Corporations Act* (Ontario). Additionally, this agreement requires that we obtain approval from the Province in advance of any proposal to issue or transfer shares in Hydro One or its subsidiaries, any major transaction, including the sale of assets, which would potentially have a material effect on the financial interest of the Province or our ability to make payments to OEFC or payments in lieu of corporate taxes (proxy taxes) under the *Electricity Act*.

Effective September 24, 2008, the Province made a declaration pursuant to the memorandum of agreement and Section 108 of the *Business Corporations Act* (Ontario) (the “Shareholder Directive”) pertaining to off-shoring of jobs under the outsourcing arrangement with Inergi LP (the “Inergi Agreement”). The declaration allows the Province to assume all decision-making power in respect of the off-shoring of jobs under the Inergi Agreement and removes these powers from the Board of Directors of Hydro One. The directors and officers of Hydro One are charged with performing that which is necessary to carry out the intention of the Shareholder Directive.

Effective April 19, 2011, the Province made a declaration preventing our company from seeking cost recovery through the regulatory process for the upgrades from either Micro FIT or small-scale FIT generators, whether directly or indirectly, for costs related to investment and expenditures made, or required to be made in order to appropriately fund the upgrades at up to fifteen (15) transmission stations pursuant to the February 28, 2011 licence condition amendments made to Hydro One Networks Inc.’s transmission licence.

Copies of the memorandum of agreement and the Shareholder Directives have been filed with the securities regulatory authorities in each province of Canada and are available at www.sedar.com.

TRUSTEES AND REGISTRARS

The trustee and registrar for our company’s debt securities is Computershare Trust Company of Canada, located in Toronto, Ontario.

The U.S. trustee and registrar for certain of our company’s debt securities is Bank of Nova Scotia Trust Company of New York located in New York, New York.

MATERIAL CONTRACTS

Except for the following, since January 1, 2002, our company did not enter into any material contracts, other than contracts in the ordinary course of business:

- (a) (i) a third supplemental trust indenture dated as of January 31, 2003 relating to the issuance of Series 4 Notes in the aggregate principal amount of \$1,000,000,000, of which \$200,000,000 was drawn down on January 31, 2003, \$120,000,000 was drawn down on June 25, 2004 and \$65,000,000 was drawn down on August 24, 2004, pursuant to the Trust Indenture dated as of June 4, 2001 between Hydro One and Computershare Trust Company of Canada (the “Trust Indenture”);
- (ii) a fourth supplemental trust indenture dated as of April 22, 2003 relating to the issuance of Series 5 Notes in the aggregate principal amount of \$1,000,000,000, of which \$250,000,000 was drawn down on April 22, 2003 and \$65,000,000 was drawn down on August 20, 2004, pursuant to the Trust Indenture;
- (iii) a fifth supplemental trust indenture dated as of June 23, 2003 relating to the issuance of Series 6 Notes in the aggregate principal amount of \$1,000,000,000, of which \$500,000,000 was drawn down on June 23, 2003, pursuant to the Trust Indenture;
- (iv) a sixth supplemental trust indenture dated as of February 24, 2004 relating to the issuance of Series 7 Notes in the aggregate principal amount of \$1,000,000,000, of which \$250,000,000 was drawn down on February 24, 2004, and \$150,000,000 was drawn down on May 19, 2005, pursuant to the Trust Indenture;
- (v) a seventh supplemental indenture dated as of November 15, 2004 relating to the issuance of Series 8 Notes in the aggregate principal amount of \$1,000,000,000, of which \$400,000,000 was drawn down on November 15, 2004, pursuant to the Trust Indenture;
- (vi) an eighth supplemental indenture dated as of May 19, 2005 relating to the issuance of Series 9 Notes in the aggregate principal amount of \$1,000,000,000, of which \$350,000,000 was drawn down on May 19, 2005 and \$250,000,000 was drawn down on April 24, 2006, pursuant to the Trust Indenture;
- (vii) a ninth supplemental trust indenture dated as of March 3, 2006 relating to the issuance of Series 10 Notes in the aggregate principal amount of \$1,000,000,000, of which \$300,000,000 was drawn down on March 3, 2006 and \$150,000,000 was drawn down on August 22, 2006, pursuant to the Trust Indenture;
- (viii) a tenth supplemental trust indenture dated as of October 19, 2006 relating to the issuance of Series 11 Notes in the aggregate principal amount of \$1,000,000,000, of which \$75,000,000 was drawn down on October 19, 2006, and \$250,000,000 was drawn down on September 13, 2010, pursuant to the Trust Indenture;
- (ix) an eleventh supplemental trust indenture dated as of March 13, 2007 relating to the issuance of Series 12 Notes in the aggregate principal

amount of \$1,000,000,000, of which \$400,000,000 was drawn on March 13, 2007, pursuant to the Trust Indenture;

- (x) a twelfth supplemental trust indenture dated as of October 18, 2007 relating to the issuance of Series 13 Notes in the aggregate principal amount of \$1,000,000,000, of which \$300,000,000 was drawn down on October 18, 2007 and \$300,000,000 was drawn down on March 3, 2008, pursuant to the Trust Indenture;
- (xi) a thirteenth supplemental trust indenture dated as of March 3, 2008 relating to the issuance of Series 14 Notes in the aggregate principal amount of \$1,000,000,000, of which \$250,000,000 was drawn down on March 3, 2008, pursuant to the Trust Indenture;
- (xii) a fourteenth supplemental trust indenture dated as of November 10, 2008 relating to the issuance of Series 15 Notes in the aggregate principal amount of \$1,000,000,000, of which \$400,000,000 was drawn down on November 10, 2008 and \$200,000,000 was drawn down on January 14, 2009, pursuant to the Trust Indenture;
- (xiii) a fifteenth supplemental trust indenture dated as of November 19, 2008 relating to the issuance of Series 16 Notes in the aggregate principal amount of \$1,000,000,000, of which \$100,000,000 was drawn down on November 19, 2008 and \$100,000,000 was drawn down on January 13, 2009, pursuant to the Trust Indenture;
- (xiv) a sixteenth supplemental trust indenture dated as of March 3, 2009 relating to the issuance of Series 17 Notes in the aggregate principal amount of \$1,000,000,000, of which \$300,000,000 was drawn down on March 3, 2009, pursuant to the Trust Indenture;
- (xv) a seventeenth supplemental trust indenture dated as of July 16, 2009 relating to the issuance of Series 18 Notes in the aggregate principal amount of 1,000,000,000, of which \$300,000,000 was drawn down on July 16, 2009 and \$200,000,000 was drawn on March 15, 2010, pursuant to the Trust Indenture;
- (xvi) an eighteenth supplemental trust indenture dated as of November 19, 2009 relating to the issuance of Series 19 Notes in the aggregate principal amount of \$1,000,000,000, of which \$250,000,000 was drawn down on November 19, 2009, and \$500,000,000 was drawn down on January 22, 2010 pursuant to the Trust Indenture;
- (xvii) a nineteenth supplemental trust indenture dated as of March 15, 2010 relating to the issuance of Series 20 Notes in the aggregate principal amount of \$1,000,000,000, of which \$300,000,000 was drawn down on March 15, 2010, pursuant to the Trust Indenture;
- (xviii) a twentieth supplemental trust indenture dated as of September 13, 2010 relating to the issuance of Series 21 Notes in the aggregate principal amount of \$1,000,000,000, of which \$250,000,000 was drawn down on September 13, 2010, and \$250,000,000 was drawn down on January 19, 2011, pursuant to the Trust Indenture;
- (xix) a twenty-first supplemental trust indenture dated as of January 24, 2011 relating to the issuance of Series 22 Notes in the aggregate principal amount of \$1,000,000,000, of which \$50,000,000 was drawn down on January 24, 2011, pursuant to the Trust Indenture;

- (xx) a twenty-second supplemental trust indenture dated as of July 29, 2011 amending the definition of “Canadian GAAP” in the Trust Indenture;
- (xxi) a twenty-third supplemental trust indenture dated as of September 26, 2011 relating to the issuance of Series 23 Notes in the aggregate principal amount of \$1,000,000,000, of which \$300,000,000 was drawn down on September 26, 2011, pursuant to the Trust Indenture;
- (xxii) a twenty-fourth supplemental trust indenture dated as of December 22, 2011 relating to the issuance of Series 24 Notes in the aggregate principal amount of \$1,000,000,000, of which \$100,000,000 was drawn down on December 22, 2011, pursuant to the Trust Indenture; and
- (xxiii) a twenty-fifth supplemental trust indenture dated as of January 13, 2012 relating to the issuance of Series 25 Notes in the aggregate principal amount of \$1,000,000,000, of which \$300,000,000 was drawn down on January 13, 2012, pursuant to the Trust Indenture.

Each of these supplemental trust indentures supplement the terms of the Trust Indenture, which contains customary covenants and representations by our company for the public issuance of debt securities in the Canadian market.

- (b) a Dealer Agreement dated August 23, 2011 between our company and BMO Nesbitt Burns Inc., Casgrain & Company Limited, CIBC World Markets Inc., Desjardins Securities Inc., HSBC Securities (Canada) Inc., Laurentian Bank Securities Inc., Merrill Lynch Canada Inc., National Bank Financial Inc., RBC Dominion Securities Inc., Scotia Capital Inc. and TD Securities Inc. (collectively, the “Dealers”), relating to the public offering of unsecured medium term notes of Hydro One in a maximum aggregate principal amount of up to \$3,000,000,000. The Dealer Agreement, as amended, provides for the appointment of the Dealers as non-exclusive agents of Hydro One to solicit, from time to time, offers to purchase its medium term notes in Canada and, in certain circumstances, the United States.

Copies of these documents are available on www.sedar.com.

INTERESTS OF EXPERTS

For the year ended December 31, 2011, KPMG LLP provided the following services to our company:

- (a) quarterly review of our company’s consolidated financial statements;
- (b) annual audit of our company’s consolidated financial statements;
- (c) annual audit of Hydro One Networks Inc.’s transmission and distribution businesses, Hydro One Remote Communities Inc.’s and Hydro One Brampton Networks Inc.’s financial statements; and
- (d) annual audit of our company’s pension fund and the following companies which hold our alternative asset investments: HOPF-HFG Investments Ltd., HOPF-HFM Investments Ltd., HOPF-PEJ Investments Ltd. and HOPF-PEP Investments Ltd.

KPMG LLP is independent in Canada in accordance with its rules of professional conduct.

For the year ended December 31, 2011, Deloitte & Touche LLP provided an annual valuation of our company's goodwill balance.

Mercer Human Resource Consulting LLC provides the following services to our company:

- (a) annual accounting actuarial valuation (valuation report prepared) for registered and unregistered pension and other post-employment and post retirement plans;
- (b) tri-annual funding actuarial valuation (last valuation completed as of December 31, 2009, next valuation scheduled for 2012); and
- (c) annual accounting actuarial valuation for supplementary pension plan for purposes of letters of credit (valuation report prepared).

ADDITIONAL INFORMATION

Additional Information about Hydro One is available on SEDAR (System for Electronic Document Analysis and Retrieval) at www.sedar.com.

As our sole shareholder is the Province, we are not required to prepare an information circular. Additional financial information is contained in our audited comparative consolidated financial statements, together with the auditors' report thereon, and our Management's Discussion and Analysis for our most recently completed fiscal year, each of which may be found on SEDAR at www.sedar.com.

STATEMENT OF EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

Overview

This discussion and analysis outlines Hydro One's disciplined approach to executive compensation, the elements of management compensation and the compensation paid to its Named Executive Officers ("NEOs").

Hydro One's executive compensation program is designed:

- to attract, motivate and retain executives with the skills necessary to sustain and develop a safe, reliable and efficient electricity delivery system, and
- to establish pay levels, based on performance, which are competitive with Canadian utility and energy companies and other comparable companies, both publicly and privately owned.

Given the competitiveness of the market for skilled employees in the electricity sector and the challenges confronting Hydro One and others in the electricity sector with respect to employee demographics, Hydro One seeks to attract, retain and compensate sufficient qualified staff to

replace those retiring as well as to position the company for its future work and infrastructure program.

The company's overall compensation methodology for current and new management employees, including current and new executives and senior management, is to target total compensation (base salary, incentive plan values, pension and benefits) at the 50th percentile of total compensation (i.e. salary, target bonus, annualized net present value of long term incentive, benefits, and pension) of the 50/50 blend of public and private sector entities that form our comparator group, which is discussed below. This methodology is consistent with the report of the Agency Review Panel established by the Province in 2007 to review and make recommendations regarding, among other things, executive compensation at five named provincial electricity sector institutions, including Hydro One.

Our compensation program is designed to reward ongoing performance through the base salary component of the program, and longer term and/or project based performance through the short term incentive plan (the "Incentive Plan"). Overall, the program is intended to reward behaviour which will drive corporate performance and productivity in accordance with our corporate strategy.

For 2011, as they were in 2010, Hydro One's compensation practices were applied consistent with the *Public Sector Compensation Restraint to Protect Public Services Act, 2010* (the "Restraint Act") which came into effect on May 18, 2010 and which imposes restraint measures, subject to exceptions contained in the legislation, until March 31, 2012 on compensation plans (including base pay and incentive plan provisions of compensation plans) of non-bargaining employees in the broader public sector, including the NEOs of Hydro One.

The NEOs of Hydro One for 2011 are:

Name	Title
Laura Formusa	President and Chief Executive Officer
Sandy Struthers	Executive Vice President and Chief Financial Officer
Myles D'Arcey	Senior Vice President, Customer Operations and President and Chief Executive Officer Hydro One Remote Communities Inc.
Carmine Marcello	Executive Vice President, Strategy
Peter Gregg	Executive Vice President, Operations

GOVERNANCE

The Human Resources Committee of the Hydro One Board of Directors (the “HRC”) is entirely independent within the meaning of Canadian securities laws. It is responsible for Board oversight of human resources issues including compensation. Its mandate with respect to its advisory functions on executive compensation is to annually review and recommend to the Board for approval:

- all management salary ranges;
- Hydro One’s total compensation practices for all employees;
- any adjustment to the President and Chief Executive Officer’s base salary;
- the aggregate amount of the short term incentive fund;
- the amount of any short term incentive payout to be made to the President and Chief Executive Officer;
- the terms of the performance agreement to be entered into with the President and Chief Executive Officer for the following year;
- the corporate performance measures for Hydro One; and
- Hydro One’s performance against its corporate performance measures.

Also, the HRC annually reviews and approves:

- the amount of any base salary adjustments for the President and Chief Executive Officer’s direct reports, and informs the Board of the Committee’s decision;
- the amount of any short term incentive payouts to be made to the direct reports of the President and Chief Executive Officer, and informs the Board of the Committee’s decision;
- the amount of any adjustments to management base salaries (in the aggregate) and informs the Board of the Committee’s decision; and
- the amount of any management short term incentive results (in aggregate) and informs the Board of the Committee’s decision.

As well, the HRC:

- annually reviews the benefits provided under the pension and benefits plans for active and non-active employees; and
- annually considers the implications of risks associated with Hydro One’s compensation policies and practices.

Composition of the HRC

As at December 31, 2011, the members of our HRC were Douglas E. Speers, Walter Murray, Robert Pace and Gale Rubenstein. Members of the HRC have been selected and appointed to the HRC on the basis of their knowledge, experience and background in executive compensation and risk management related to compensation practices and policies. Each has experience in these areas as senior members of public and private corporations or business entities. Members of the HRC are appointed by the Board of Directors, upon recommendation of the Chair, and management has no role in the selection of the committee members.

Committee Members Relevant and Direct Experience

Douglas E. Speers has been a member of the Board of Directors of Hydro One since November 10, 2005 and has been a member of the HRC since April 5, 2007 when he was also appointed Chair of the HRC. He is fully conversant with the compensation policies and practices of Hydro One. Mr. Speers is the former President and Chief Executive Officer of Emco Corporation, a publicly traded corporation which distributes building materials, and in his capacity had responsibility for all compensation including base pay, long and short term incentives, benefits and pensions. As well, Mr. Speers was the President of Building Products of Canada with responsibility for, among other things, compensation and benefits for a unionized and non-unionized workforce. He was later appointed Chairman of Emco Corporation with continued responsibility in all areas of compensation, and appointed Chair of Building Products of Canada with continued responsibility for compensation and benefits for a unionized and non-unionized workforce. Further Mr. Speers has chaired and sat on various pension committees.

Walter Murray has been a member of the Board of Directors of Hydro One since November 10, 2005 and has been a member of the HRC since December 15, 2005. As well, Mr. Murray is the Chair of our Investment Pension Committee, which has oversight of the Hydro One Pension Plan on behalf of the Board, and is accordingly familiar with all pension matters related to compensation at Hydro One. Mr. Murray was the past Chair of our Audit and Finance Committee and continues to be a member of that committee. Mr. Murray is fully knowledgeable regarding the compensation policies and practices of Hydro One. Mr. Murray was a board member of Ivernia Inc. from 2000 to 2009 and a member of its Human Resources Committee which has responsibility for oversight of its compensation practices.

Robert Pace has been a member of the Board of Directors of Hydro One since March 30, 2007 and has been a member of the HRC since April 5, 2007. As well, Mr. Pace is a member of our Investment Pension Committee, which maintains oversight of the Hydro One Pension Plan and is accordingly familiar with pension matters related to our compensation practices. Mr. Pace is the President and Chief Executive Officer of the Pace Group Ltd., which owns and operates a number of companies in Atlantic Canada and in this role he has responsibility and familiarity with compensation practices for his companies. Additionally, he is a member of the Board of Directors of Canadian National Railway Company and has been the chair of its Human Resources and Compensation Committee for the past four years. Further, Mr. Pace has been a director of High Liner Foods Incorporated for fourteen years and a member of its Human Resources Committee since 2011. Additionally, Mr. Pace attended an executive education session on executive compensation in November 2011 at the Harvard Business School. Mr. Pace is cognizant of compensation policies and practices at Hydro One.

Gale Rubenstein has been a member of the Board of Directors of Hydro One since March 30, 2007 and has been a member of the HRC since December 9, 2010. Ms. Rubenstein is a partner at the law firm of Goodmans LLP and a member of its executive and compensation committees. She is familiar with the compensation practices and policies of Hydro One. Ms. Rubenstein's practice area is in insolvency law and as counsel in such matters she has hands on experience regarding compensation issues and the claims for compensation that have to be determined and approved by the court in cases of insolvency and corporate reorganization transactions.

Compensation Policies and Practices Aligned to Risk Management

The Board of Directors is responsible for reviewing the major risks to the company's business objectives and is also responsible for approving the company's enterprise risk management policy and framework. The HRC, in relation to compensation matters, is charged with considering the implications of risks associated with the company's compensation policies and practices. Hydro One has a disciplined approach to identifying and assessing risk in relation to factors that may adversely affect the company and the HRC takes this into account in determining compensation. This approach and oversight is designed to mitigate excessive risk taking by management.

The following elements of risk management have been built in to our compensation practices:

- we have a formal Enterprise Risk Management Policy and Framework;
- the Board has continual oversight of risk management issues affecting the company;
- the Board annually sets the multi-year strategic plan for Hydro One in which its strategic objectives are clarified and risks considered;
- the strategic objectives form the basis of a corporate scorecard against which corporate performance is measured and incentive compensation is determined;
- the measures and targets in the corporate scorecard are based on objective and industry standard factors with the targets vetted, established and approved by the HRC;
- the overall annual assessment by the HRC of performance against the measures and targets in the corporate scorecard determines the aggregate amount of the short term incentive payout;
- the measures and targets in the corporate scorecard are reviewed and considered by specific Board committees in addition to the HRC during the course of the year to monitor and assess performance throughout the year;
- the Senior Vice President, Internal Audit and Chief Risk Officer audits the achievement of the targets in the corporate scorecard to ensure the targets achieved are accurately represented and reports accordingly to the HRC, prior to the review and assessment by the HRC;
- achievement of the performance targets in the corporate scorecard is based on corporate wide performance and not NEO performance;
- only a portion of the total compensation is based on Incentive Plan payments;
- Incentive Plan payments for the NEOs are at-risk and not guaranteed; performance of the NEOs is reviewed and assessed by the HRC to determine the Incentive Plan payments to the NEOs;

- there are maximum limits on incentive pay and for the NEOs, other than the President and Chief Executive Officer, the maximum payout is 60% of base pay; for the President and Chief Executive Officer the maximum payout is 25% of base pay;
- Hydro One does not grant to management, including the NEOs, any options, warrants or other rights to purchase its stock, including stock appreciation rights;
- there is no area of compensation that encourages senior management to take excessive risks to directly increase their compensation;
- as noted below, the HRC has retained, since 2008, an independent expert to provide it with advice on compensation matters and such advice includes the identification of any risks related to our compensation practices related to management and the NEOs;
- the HRC deliberates, over several meetings, on matters of material importance related to compensation in order to reach an informed decision;
- the HRC holds in camera meetings on a regular basis and in particular does so to reach independent decisions.

Independent Consultant for the HRC

In December 2008, the HRC, in accordance with its powers to obtain independent expert advice, engaged the services of Hugessen Consulting Inc., an independent consulting firm that provides advice to boards and compensation committees on executive compensation, to provide the HRC with advice on the competitiveness and effectiveness of the company's compensation programs, including all elements of management compensation at Hydro One. Hugessen Consulting Inc. attended all the HRC meetings in 2011 and provided its independent views to the HRC and in particular its views on matters of compensation. Additionally, Hugessen Consulting Inc. provided services for the HRC in the design of the corporate scorecard for 2012. Hugessen Consulting Inc. continues to provide its services to the HRC. It does not provide any other compensation advice to Hydro One. For its advice during 2011, Hugessen Consulting Inc. was paid \$170,402.05.

ELEMENTS OF COMPENSATION

Compensation for executive officers consists of a base salary, performance-based pay through the Incentive Plan, pension and health and dental benefits, each of which is described in more detail below. Each of the NEOs, namely, Ms. Formosa, Mr. Struthers, Mr. D'Arcey, Mr. Marcello and Mr. Gregg was entitled under their respective employment agreements to these elements of compensation. Hydro One does not provide its senior management with personal club memberships, car allowances or entertainment accounts. The Province issued a Perquisites Directive, effective June 1, 2011, which applies to Hydro One. The Perquisites Directive provides that, subject to exceptions stated therein, no perquisites are permitted in ministries, classified agencies and prescribed organizations. Hydro One complies with the Perquisites Directive.

The Total Cash Compensation (“TCC”) component of the program is comprised of base salary plus the Incentive Plan. The TCC is set relative to the Total Direct Compensation (“TDC”) of the comparator group (base salary, short term incentive, and long term incentive) in aggregate. For all management employees, the maximum amount payable for the Incentive Plan payment is a percentage of base pay fixed according to the band and salary range level of the employee. For the NEOs, other than the President and Chief Executive Officer, the maximum amount payable for the Incentive Plan payment is 60% of the base salary of the NEO. For all the NEOs, the maximum achievable TCC amount is the base salary and the full award under the Incentive Plan. The value of the Incentive Plan component of TCC reflects short term incentives in the comparator group. The value of base salary tracks at a higher level than those in the comparator group to compensate for the long term compensation component provided by many entities in the comparator group. Hydro One does not have a long term incentive plan.

The HRC approved a comparator group submitted by management with the assistance of management’s external compensation advisors, the Hay Group Limited. The company’s management engaged the services of the Hay Group Limited to provide advice and counsel on compensation matters, including executive compensation. These services are distinct from those provided directly to the HRC by Hugessen Consulting Inc., referred to above. During 2011, the Hay Group Limited was paid \$42,013.12 for its advice and services which included consultations, evaluations and job ratings for management and executive positions.

The comparator group consists of 30 Canadian-based entities (15 public and 15 private). Four of these entities are *not* reportable segments of their reporting parent and therefore financial information was not available. However, these four companies do form part of the Hay compensation information pool. Of the 26 entities in the comparator group with publicly available financial information, approximately 65% are smaller in size when compared to Hydro One, based on both revenues and assets, according to their most recent publicly available annual financial statements.

The list of comparator group companies is as follows:

Public Sector	Private Sector
British Columbia Hydro and Power Authority	ArcelorMittal Dofasco Inc.
Business Development Bank of Canada	Barrick Gold Corporation
Canadian Standards Association/CSA Group	Bruce Power
Canada Mortgage and Housing Corporation	Canadian National Railway Company
Canada Post Corporation	Canadian Pacific Railway
Enersource Hydro Mississauga	Enbridge Gas Distribution Inc.
Farm Credit Canada	Fortis Inc
Government of Ontario	Newfoundland Power Inc.
Ontario Power Authority	Nova Chemicals Corporation
Ontario Power Generation	Nova Scotia Power Inc.
PowerStream Inc.	Siemens Canada Limited
SaskEnergy Incorporated	Suncor Energy Inc.

Sask Power	Ultamar Ltee
Sask Tel	Vale Inco Limited
Toronto Hydro Corporation	Xstrata Nickel Canada
Total 15	Total 15

(1) Base Salary

Base (annual) salary is intended to compensate the NEOs for day-to-day, ongoing performance. The Hydro One Board of Directors determines a range of base compensation for each NEO based on comparisons to comparable roles in the comparator group.

The actual level of base salary, within the approved range for each executive officer, including the NEOs, is determined on the basis of job function and the individual's performance and experience. Prior to the Restraint Act, the President and Chief Executive Officer annually submitted a base salary recommendation to the HRC for each of her direct reports and the HRC would set the base salary of such executives and then reports its decision to the Board of Directors. The HRC would bring a base salary recommendation for the President and Chief Executive Officer to the Board of Directors for approval. Until March 31, 2012, base salary increases are subject to the restraint measures in the Restraint Act. In compliance with the Restraint Act, there were no base salary increases for the NEOs in 2011.

The positioning of the NEO within the range is based on the level of performance relative to the requirements of the position. The Hydro One Board of Directors establishes a base salary increase fund based on market comparisons. Performance is assessed on day-to-day performance in the role, both in terms of results and behaviours, and is often related to the level of experience in the role. Hydro One does not provide across-the-board or economic increases to its NEOs. An NEO's base salary may increase annually, but it may not.

(2) Performance-Based Compensation

Our company does not grant to its executive officers any options, warrants or other rights to purchase its stock, including stock appreciation rights. Performance-based compensation, outside of base salary, is restricted to the Incentive Plan.

Hydro One's Incentive Plan is a mechanism used by the company to drive performance, and is separate and distinct from base salary adjustments. The Incentive Plan is designed to establish a strong correlation between corporate performance, individual performance and at-risk compensation. Hydro One's Incentive Plan provides an opportunity for participants, including the NEOs, to earn an annual cash incentive payment based on two elements. The first element is the achievement of corporate performance targets set by the Board of Directors. The second element is the participant's contributions to these targets.

For the purposes of determining the amount of short term incentive payable to the President and Chief Executive Officer, specific weightings and levels of achievement are established by the HRC and are assigned to each corporate performance measure incorporated in her performance contract as well as to specific qualitative and leadership goals. The assessment of the President and Chief Executive Officer is conducted by the HRC and approved by the Hydro One Board of Directors.

For management employees, the maximum allowable short term incentive is established for each salary band (i.e. range of rates of pay) of management employees and is fixed as a percentage of base pay for that particular band. For each of the NEOs, potential awards range between 0% and a maximum of 60% of base salary. For the year ended December 31, 2011, the potential award ranges for the NEOs were as follows: between 0% and 25% of base salary for Ms. Formusa, and between 0% and 60% of base salary for each of Mr. Struthers, Mr. D'Arcey, Mr. Marcello and Mr. Gregg. The range for Ms. Formusa was set by the HRC and approved by the Board in 2007. The range for the NEOs other than the President and Chief Executive Officer was established by the HRC and approved by the Board and has been in place since 2006. These ranges for NEOs did not change from 2010 to 2011.

There are two components to performance-based compensation for NEOs other than the President and Chief Executive Officer: fund determination and fund allocation. These components will be described separately.

Fund Determination: The maximum percentage for funding is at the discretion of the Hydro One Board of Directors, based on a recommendation by the HRC. The funds available for the NEOs (other than the President and Chief Executive Officer) are a percentage of the total payout which would be payable assuming each individual earned his or her maximum allowable short term incentive. In 2011, the maximum percentage of funds available for the NEOs was set at 75% of this total potential payout. This determination was made by the HRC, and recommended to, and approved by, the Board of Directors, by measuring the company's performance at the end of the year against various corporate performance targets and measures set at the beginning of the year.

Fund Allocation: The fund is allocated among individual executives on the basis of performance. It is not an across the board allocation. NEOs are assessed against their performance agreement and against the other direct reports of the President and Chief Executive Officer, based on objective and subjective assessments. These assessments of the NEOs, other than the President and Chief Executive Officer and other than Mr. D'Arcey, are conducted by the President and Chief Executive Officer, and approved by the HRC. The assessment of Mr. D'Arcey is conducted by the Executive Vice President, Operations and approved by the President and Chief Executive Officer. No direct report is allowed to receive above their maximum allowable short term incentive. A further discussion on the evaluation of performance of the NEOs is set out below in the section dealing with individual performance.

(a) Corporate Performance Measures and Targets

The HRC, together with input from senior management, develops Hydro One's corporate performance measures and targets annually at the end of each year for the following year through the use of a balanced scorecard. A balanced scorecard is designed to measure corporate performance broadly, covering all key aspects of corporate performance. Measures included in the scorecard are designed to ensure that the corporate strategy is achieved.

In the fall of each year, Hydro One's management identifies the key measures and targets which it believes will drive corporate performance during the course of the following year and presents these recommended measures and targets to the HRC. For 2011, the corporate performance measures were tied to Hydro One's corporate strategy which was updated in 2011. See "General Development of the Business - Our Strategy" for additional information. Management and the

HRC reviewed, considered and assessed the measures and targets to ensure they covered all key aspects of corporate performance and were robust enough to drive superior performance and corporate strategy implementation. The HRC then recommended the measures and targets to the full Board of Directors for approval. These measures and targets are based on Hydro One's key strategic goals in the areas of safety, customer satisfaction, continuous innovation, reliable transmission and distribution, protecting the environment, employee engagement, shareholder value and productivity.

The following table sets out Hydro One's corporate performance measures for 2011, which were aligned to its strategic objectives and the targets for each of those measures. In 2011, the Board of Directors determined that Hydro One met or exceeded 14 of 17 targets. The context of those targets is described in more detail under each strategic objective heading below.

Strategic Objective	Performance Measure	Year-End		
			Actual	Target
Injury-free Workplace	Medical Attention [†]	△	3.7	2.2
	(# of medical attentions per 200,000 hours worked)			
Satisfying our Customers	Transmission Customer Satisfaction	△	85	89
	(% satisfied / Results available in May & October)			
Continuous Innovation	Distribution Customer Satisfaction	△	83	85
	(% satisfied)			
Reliable Transmission and Distribution	Smart Grid Initiatives	★	100	90
	– Smart Meters TOU Billed & Green Grid Enablers			
Protecting Environment	(% of milestone met / Results available quarterly)			
	Transmission Frequency of Unplanned Customer Interruptions on 115/230kV Network System per delivery point ^Φ	★	0.21	0.25
Employee Engagement	Transmission Duration of Unplanned Customer Interruptions on 115/230kV Network System (minutes/delivery point) ^Φ	★	8.9	15.0
	Distribution Duration of Customer Interruptions (hours per customer)	△	6.9	6.8
Shareholder Value	Long Term Energy Plan and Bruce to Milton Project	★	100	90
	(% of milestone met)			
Achieving Productivity Improvements and	Greenhouse Gas Reduction (# of metric tonnes)	★	3,555	2,736
	Fleet/Facilities/SF6	★	100	90
Shareholder Value	Conservation & Demand Management	★	100	90
	(% of milestone met)			
Shareholder Value	Employee Survey (Grand Mean Score)	★	3.94	3.79
	Net Income After Tax ^{* +}	●	641	613
Shareholder Value	(\$M)	●	A	A
	Credit Rating (Long-Term Debt Rating Category) ⁺	●	4.9	5.0
Shareholder Value	Transmission Unit Cost [*]	●	4.9	5.0
	(% Sustaining Capital and O&M per Asset)			

Strategic Objective	Performance Measure	Year-End	
		Actual	Target
Cost-Effectiveness	Distribution Unit Cost * (Capital and O&M costs per km of line) \$'000/km	● 6.6	6.8
	Collaborative Planning Index (%)	★ 93	87
	Cornerstone Saving (\$millions)	★ 41.3	38.5
Legend	★ Better than plan ($\geq 5\%$)	● On Plan	△ Below Plan

† Subset of WSIB reportable Injuries.- for Networks only and does not include performance of the subsidiaries

⌀ All multi-circuit supplied delivery points.

* +/-5% is considered on target.

+ Results are for Hydro One Inc. which includes all subsidiaries.

The 2011 scorecard is not weighted. Each measure is key to driving corporate performance, and all of the measures are interrelated. In terms of assessing performance, the HRC is required to exercise judgment in weighing the results for each measure and determining whether overall corporate performance, as reflected through scorecard performance, is met. If, on balance, scorecard performance is met or exceeded, the short term incentive fund may be funded to a percentage of the maximum short term incentive payout, up to 100%, based on the recommendation of the HRC, but subject to the ultimate discretion of the Board of Directors. If, on balance, scorecard performance is not met, the HRC will determine and recommend a funding level, also subject to the ultimate discretion of the Board of Directors. For 2011, the Board of Directors took an approach consistent with past practice in which the funding level was set at 75% of the maximum short term incentive fund if on balance the targets were met or exceeded. Taking past practice into account, funding up to the 75% level is consistent with the provisions of the Restraint Act. In the event that if on balance the targets were not met, the Board of Directors retained the discretion to reduce the percentage of the short term incentive fund. In 2011, the Board of Directors decided that on balance the targets were met and in the exercise of its discretion, the Board of Directors determined the funding level to be 75% of the maximum short term incentive fund.

1. Safety: Injury Free Workplace

Safety is the primary focus of the company and its first key strategic objective. The safety of our employees is paramount. For 2011, Hydro One established medical attentions, that is, injuries that require treatment by a medical practitioner (beyond first aid), as the performance measure for this strategic objective. The medical attentions measure reflects incidents that are reported to the Workplace Safety Insurance Board and is calculated by the number of attentions per 200,000 hours worked. In 2011, Hydro One set a target of no higher than 2.2 incidents per 200,000 hours worked. In an effort to achieve this target, Hydro One engaged in a number of activities such as, among other things, continued emphasis on improving health and safety through face-to-face sessions, continuation of its Journey to Zero initiative, better monitoring of mandatory skills and safety training, enhanced driver training/evaluation program, and field coaching to increase the expectations from supervisors and staff. The number of incidents in 2011 increased and as a result Hydro One did not meet this target.

2. Customer Satisfaction

Customer satisfaction measures the degree to which our transmission and distribution customers are satisfied with the service they receive from our company. Corporate reputation is also a key influencer in customer satisfaction. Hydro One continues to focus on improving its reputation. Customer satisfaction is measured on the results of various customer surveys conducted on Hydro One's behalf by independent third parties. In 2011, for transmission customers we targeted a customer satisfaction rate of 89% and did not meet this target. For our distribution customers, we targeted a satisfaction rate of 85%, but did not meet this target.

Despite these results, Hydro One was honoured by the E Source Review as ranking third in Canada among electric and gas utilities in delivering positive customer experience through its automated phone system - interactive voice response system. Additionally, Hydro One received the Canadian Electricity Association's Sustainable Electricity Social Responsibility Award in recognition of its leadership in engaging its stakeholders. One of the projects recognized by this award is Hydro One's outreach at fairs across the province to deliver the "Understanding Your Power" event to customers and stakeholders.

3. Continuous Innovation

We are committed to identifying and providing innovative solutions that will improve the reliability and efficiency of electricity delivery and allow our customers more capability to manage their power costs. Billing customers on TOU rates is the last step in the implementation of the Smart Meter project. We established a milestone of 1.05 million meters consuming power on TOU rates for 2011. The Green Grid Enablers are an integral part of meeting the Green Energy Act (GEA) and Hydro One's strategy towards embracing innovation. Our target is a percentage completion of a number of milestones for the combined Smart Meters TOU Billed and Green Grid Enablers which are projects designed to meet the objectives of the Green Energy Act. Our target was to complete 90% of all milestones established for all these initiatives by year end. For 2011, we exceeded our target.

We were honoured and recognized by two awards in 2011. We received the Apex Award, given by the Utilities Telecom Council, in recognition of how our communications systems demonstrate excellence, innovation and service to the communities we serve and in recognition of the installation of six WiMax base stations to provide wireless communications for testing the smart grid applications. As well, we received the Excellence in Project Management Award, given by Utilimetrics, in further recognition of our smart meter deployment and conversion of customers to TOU billing.

4. Reliability of Transmission and Distribution

Hydro One aims to build and retain public confidence and trust in its operations, as stewards of Ontario's electricity grid. In 2011, Hydro One continued its focus on this strategic priority by investing in the key assets of the electricity delivery system and by operating the existing system for customers in a safe, reliable and efficient fashion. Transmission reliability is measured through the frequency and duration of unplanned customer interruptions. Distribution reliability is measured through the duration of customer interruptions. The results of Hydro One's performance are compared with other large sized participants of the Canadian Electricity Association ("CEA"). Reliability is influenced by weather patterns and accordingly, to achieve

results, Hydro One requires good performance from both its transmission and distribution systems. Hydro One is conscious that businesses of all sizes require reliable service to allow them to deliver their products and services and that customers' expectations are for a reasonably limited duration of interruption.

With respect to transmission, in 2011, Hydro One targeted 0.25 interruptions per delivery point for its frequency of unplanned interruptions. The actual year-end frequency of unplanned customer interruptions was 0.21. We more than met the target.

For duration of unplanned customer interruptions on the transmission side, the target was 15 minutes per delivery point. The duration of unplanned customer interruptions at year-end was 8.9 minutes. We more than met the target.

On the distribution side, the target for 2011 for the duration of customer interruptions was set at 6.8 hours per customer. Due to a number of storms in December 2011 interrupting a large number of customers over several days, the duration of customer interruptions over the year was negatively impacted. As a result, the duration of interruptions was 6.9 hours, or 0.1 hours higher than target; Hydro One did not meet its target.

5. *Protecting the Environment*

Hydro One's initiatives to protect the environment are aligned with the *Green Energy Act* and show our commitment to the delivery of renewable clean energy. Hydro One developed three key performance measures for 2011: (i) LTEP and the Bruce to Milton project; (ii) greenhouse gas reduction and (iii) CDM.

The Province's LTEP released in 2010 identifies 5 priority projects to be completed by 2018 that will ensure that the growing mix of renewable generation can be reliably transmitted across the province. Under the LTEP, Hydro One is to develop three of these projects. These three priority projects and our continued work on the Bruce to Milton project align with our commitments to protect the environment and support the *Green Energy Act*. For the LTEP, Hydro One targeted completion of milestones leading to the successful completion of the development phases of the three projects. Regarding the Bruce to Milton project, Hydro One targeted a 90% completion of critical milestones by selected dates within 2011. We exceeded our target with respect to the LTEP projects and the Bruce to Milton project for 2011.

With respect to greenhouse gas reduction, Hydro One established a target of 2,736 metric tonnes of greenhouse gas removed through its initiatives related to its (a) vehicle fleet program (150 tonnes), (b) sulphur hexafluoride gas (SF₆) (2,536 tonnes), and (c) facilities electricity (50 tonnes). Hydro One achieved an aggregate of 3,555 metric tonnes of greenhouse gas removed from these initiatives, thus exceeding its target.

Regarding CDM, Hydro One is required to comply with the OEB CDM Code and achieve targets established for Hydro One during a period of 2011-2014. For 2011, Hydro One established a corporate plan to achieve 90% of the milestones it set for those programs for 2011. Hydro One exceeded its target for 2011 by completely meeting all milestones.

6. Employee Engagement

Hydro One's greatest assets are its employees. Hydro One continues to focus effort, specifically in employee and management development activities, on increasing employee engagement throughout the company as an engaged workforce is one in which employees embrace the corporate values of safety, stewardship, excellence and innovation. The process of measuring and improving such engagement began in 2008 by means of an employee engagement survey administered by an independent third party expert and the target is to improve the grand mean score year over year. The response rate in 2011 was the largest received to date, with an 86% participation rate. The target of improving the grand mean score to 3.79 (out of 5) in 2011 from the actual result of 3.70 in 2010 was achieved as we exceeded our target with a score of 3.94.

7. Shareholder Value

Achievement of strong financial performance is measured by our two performance measures of net income after tax and a strong credit rating. Our targets were \$613 million net income after tax and an "A" category credit rating. Net income for 2011 was \$641 million; we met our target. In relation to our credit rating, Hydro One's long term credit ratings provided by Standard & Poor's, Moody's and DBRS met the targeted "A" rating category. Maintaining an "A" category credit rating allows us to have access to long-term debt markets on a cost-effective basis, which is even more critical in the current financial market environment and given our capital requirements over the medium term.

8. Productivity

One of our strategic objectives is to be productive through efficiency improvements and effective management of costs. The measures for this objective for 2011 were: transmission unit cost, distribution unit cost, Collaborative Planning Index and Cornerstone savings.

To meet our goals regarding transmission unit costs and distribution unit costs, Hydro One benchmarked itself against electricity industry wide measures of productivity. The two most comparable benchmark measures are (a) transmission unit cost (sustaining capital and OM&A per asset) on a percentage basis (i.e. cost per asset value for the transmission business) and (b) distribution unit cost (capital and OM&A per kilometre of line) (i.e. cost per line length for the distribution business) and these were set as our performance measures. Our objective with our ongoing work and investment program is to maintain and improve our assets such that delivery reliability for our customers is maintained or improved and to be productive in how we do that work. To benchmark our performance and monitor our productivity year over year we set cost targets which are measured within a +/- 5% range. Our transmission unit cost target was set at 5% and Hydro One met this target. Regarding our distribution unit cost, our cost target was set at \$6,800 per kilometre of line and Hydro One also met this target.

The Collaborative Planning Index is a measure of the effective workflow between lines of business and the resulting efficiencies enabling field crew productivity. The Collaborative Planning Index is based on the average of three metrics: release of work (which is the release of funds at the program and project level for work defined and agreed to by the operations groups), planning index (which is the percent measure of the total number of material orders entered into the system divided in accordance with lead times agreed to by the stakeholders) and order fill rate (which is the percent measure of the total number of the material orders divided into the

number of line orders that have been delivered to the right location at the right time). For 2011, we set the target for the average of three metrics at 87% and we exceeded this target.

Cornerstone is our phased replacement of key enterprise information technology systems. Savings from this initiative are derived by looking at a wide range of processes to identify savings across the various lines of businesses. Our target for 2011 was \$38.5 million in savings and we achieved \$41.3 million in savings through strategic sourcing of materials, reduction in employee headcount, and reduction in the number of information technology applications and their attendant support costs thereby exceeding this target.

Overall Performance for 2011

For 2011, the HRC determined that of the 17 targets, 9 has been exceeded, 5 were met and 3 were not met and that, on balance, the targets had been met and recommended the payout funding at **75%** of the maximum short term incentive payout. In considering the 2011 results, the HRC noted that while the safety target had been missed, there has been no decrease in the reporting of medical attentions, there were no systemic issues and management continues to focus on improvements in management systems and on prevention. The HRC also determined that the Distribution Duration of Customer Interruptions was met as the Company had been on or better than target for the year and had narrowly missed the target by 0.1/hour due to severe storms in the month of December. The HRC also noted the Company's concerted efforts to address customer satisfaction and its continuing attention to improving this measure. With respect to the remaining measures, the HRC found the Company had performed very well, particularly regarding the progress made on the Bruce to Milton high-voltage transmission project and the significant improvement in employee engagement. The Board of Directors considered the HRC's recommendation and decided that, on balance, the targets had been met and approved the payout funding at **75%** of the maximum short term incentive payout. Accordingly, the funding at **75%** of the maximum short term incentive payout was the available amount for distribution to all management employees, including the NEOs.

(b) Individual Performance

The second component of determining the amount of short term incentive payments to be made to NEOs pursuant to the Incentive Plan is their individual performance. Individual target performance criteria are outlined in individual performance agreements which include both broad corporate and individual specific targets. NEOs are expected to align their efforts with and advance the Corporate Performance Measures and Targets discussed above. The NEOs were required to demonstrate their commitment to the successful implementation of the "Journey to Zero" initiatives designed to achieve world class health and safety at Hydro One over the foreseeable future. In addition, the NEOs, as organizational leaders are held to certain defined accountabilities, pursuant to an enhanced managerial framework for Hydro One called "Craft of Management". Performance agreements are entered into annually between the President and Chief Executive Officer and her direct reports. The Board of Directors, in turn, annually approves the performance agreement entered into between the President and Chief Executive Officer and the Chair of the Board.

Potential awards for NEOs are expressed as a percentage of base salary as described above.

The potential award for each NEO was based on his or her relative achievement of specific individual performance targets. As noted earlier, these targets may be objective, numeric-based targets or more subjective targets. These targets are linked to some or all of the corporate performance measures, to measures related to the NEO's business unit and were designed to enable our company to promote and achieve its strategic plan. The evaluation of performance against the targets is important. Hydro One does not take a mechanistic approach to assessment. Each NEO is assessed objectively against his/her specific individual targets. Once this assessment has been completed, a second assessment comparing relative achievement across the NEOs is also conducted. This approach requires judgment on the part of the President and Chief Executive Officer and HRC with respect to the NEOs other than the President and Chief Executive Officer and the HRC with respect to the President and Chief Executive Officer, but provides a better assessment of performance since it considers both absolute performance (against a set of targets) and relative performance against the other NEOs (other than the President and Chief Executive Officer). Using this approach means an NEO could meet all of his/her targets but receive less than his/her incentive maximum if other NEOs performed better against their targets.

Ms. Formusa's targets were weighted and comprised both quantitative and qualitative targets. The quantitative factors (overall total 70%) were, with specific sub-weightings: financial (25%), transmission and distribution reliability and customer satisfaction (15%), employee, safety and environment (15%), and continuous innovation and productivity (15%). With respect to these quantitative targets, they were the same as and tied to achieving the corporate performance measures and targets described above. The qualitative factors (30%), each carrying a sub-weighting, were: strategic planning and key priorities (7.5%), leadership and culture (7.5%), relationship management - Board and shareholder (7.5%), and relationship management - other stakeholders (7.5%).

Mr. Struthers, as Executive Vice President and Chief Financial Officer responsible for Corporate Finance, Human Resources, Labour Relations and Regulatory Affairs, had targets with a number of finance components including moving financial reporting to US GAAP; obtaining all required approvals for doing so and amending all required filings to reflect US GAAP; managing towards meeting the net income target; obtaining capital funding in a cost effective manner; and providing, supporting and completing the 2012 business plan. As well, Mr. Struthers targets included the successful collective agreement negotiations with the company's unionized workforces. Other key targets included completion of the rollout of the Craft of Management to certain band levels of employees within his reporting group, supporting the improvement in the employee engagement scores, and completing the business continuity plans for each functional area for which he is responsible. Additionally, Mr. Struthers had targets to enhance relations with stakeholders and industry counterparts, develop staff and enhance Hydro One's reputation through presentations at external conferences.

Mr. D'Arcey, as Senior Vice President Customer Operations and President and Chief Executive Officer of Hydro One Remote Communities Inc. was assigned targets focused on the areas of safety, productivity and efficiencies, customer satisfaction, employee engagement, distribution reliability, succession planning, migration of customers to TOU billing under the smart meter program, delivery of and meeting the 2011 Hydro One Remote Communities Inc. scorecard targets, distribution generation processes incorporated into line of business work process to deliver timely distribution generation connections, oversee and guide the Customer Information

System (part of the Cornerstone initiative) replacement program as sponsor, improve distribution reliability through completion of defined work programs such as Forestry, defect corrections and asset condition assessments and continued work on the environmental programs to address environmental issues.

Mr. Marcello, as Executive Vice President, Strategy, responsible for Asset Management, Business Performance, Corporate Affairs, First Nations and Metis Relations, Hydro One Brampton, Information Solutions (information technology), Strategy Alignment and Transmission Projects Development, was assigned targets which included strategic planning and key priorities (related to the strategy objectives of employee engagement, productivity metrics, continuous improvement, customers, distribution strategy, competitive transmission, and corporate strategy); leadership and culture (related to an engaged workforce through Journey to Zero, Craft of Management and the engagement survey action plans, completing the process to develop the 2012 corporate scorecard, enhancing the effectiveness of the executive team, and enhancing succession planning); relationship management – board and shareholder (related to improving communications with management and the board through the development of meeting agendas tied to the corporate strategic plan and a dashboard to illustrate and monitor key strategic metrics); relationship management – other stakeholders (related to enhancing Hydro One's reputation through external communications, maintenance of optimum relations with government officials and industry agencies, enhancing relationships with industry counterparts, and enhancing stakeholders understanding of Hydro One's plans); and execution (related to major project delivery, productivity and establishment of processes to manage and control investments). Additionally, Mr. Marcello was involved in the OEB competitive transmission bid process related to the East-West Tie project, distribution rationalization process with respect to local distribution companies and took over accountability for Hydro One Brampton.

Mr. Gregg, as Executive Vice President, Operations responsible for Customer Operations, Engineering Project Delivery, Facilities and Real Estate, Grid Operations, Health Safety and Environment, Organizational Alignment and Supply Chain and Shared Services, was given key objectives with respect to leadership and culture (related to improving the overall grand mean score for the employee engagement survey, driving a culture of monthly work accomplishment reporting with a focus on continuous improvement and productivity); productivity (related to realignment of key accountabilities with the management structure of the Operations Group to improve decision making, increase efficiency and drive productivity initiatives); other operational metrics (related to improving customer satisfaction levels, completing planned work programs to improve transmission and distribution reliability, and ensuring the Bruce to Milton project is constructed on time and on budget).

In 2011, all NEOs substantially met all of their specific individual performance targets based on an assessment of their respective performance and their performance compared to other executives. More specifically, the HRC determined that each of Mr. Struthers, Mr. Marcello and Mr. Gregg had performed very well, and worked particularly well as a team with the CEO to deliver the results achieved in 2011. In this context, the HRC decided to award each of these NEOs the same short term incentive in the amount of \$177,000. The same general reasoning applied to the decision to pay the President and Chief Executive Officer the same short term incentive amount as these NEOs.

The determination of Incentive Plan amounts for the NEOs is independent from the assessment of base salary adjustments. However, the final dollar amount of an annual Incentive Plan payment is impacted by any changes to base salary since it is a percentage of base salary.

(3) Benefits

In addition to the Base Salary and Incentive Plan compensation, as part of their compensation package, the NEOs also participate in the Hydro One registered pension plan and supplementary pension plan and participate in a flexible benefits plan, which is available to all other management employees. The flexible benefits plan provides various benefits, including life insurance, long term disability benefits, accident insurance, vacation and extended health care benefits. Hydro One provides to each executive and management employee certain core benefits, which include basic life insurance, accidental insurance, extended health benefits, out of country medical, dental, sick leave and long term disability, pension and basic vacation. The flexible benefit plan provides for credits for life insurance and vacation calculated each plan year on the individual's base annual earnings in effect at the time of enrolment in the plan. Those flexible benefit plan credits may then be allocated by each executive and management employee to purchase additional life insurance, up to allowed additional vacation days, and a health care account. Unallocated credits are paid out at year end, subject to withholding tax, to the employee.

Benefits provided to NEOs, other than Mr. Gregg, are the same as those provided to all other management employees and could be higher or lower than bargaining unit represented staff, depending on the specific benefit. Benefits are relatively independent of base salary and Incentive Plan payments, although some are a percentage of base pay. Many health-related benefits are a flat rate and not related to base salary or Incentive Plan levels.

Pension benefits for NEOs, other than Mr. Gregg, are identical to those of all other executive and management staff in our company with the same start date, and are calculated in a similar manner identical to all employees in our company. See "Pension Plan Benefits" below.

Role of NEOs in Determining Executive Compensation

An NEO does not play any part in determining his or her own compensation. The Executive Vice President and Chief Financial Officer, working with the Vice President, Human Resources and Hay Group Limited, is responsible for providing recommendations regarding compensation (other than that of the Executive Vice President and Chief Financial Officer) to the HRC consistent with the Board approved compensation strategy. The HRC must then review, discuss, and ultimately approve the base salary, Incentive Plan payment and benefits for all the NEOs (other than the President and Chief Executive Officer) based on a recommendation by the President and Chief Executive Officer. With respect to the compensation payable to the President and Chief Executive Officer, the HRC reviews, discusses and makes a recommendation to the Board of Directors, who must consider, discuss and ultimately approve the final compensation level for the President and Chief Executive Officer. In 2011, in addition to the above recommendations, the HRC and the Board of Directors considered the requirements of the Restraint Act in determining the base salary and Incentive Plan payments for all the NEOs for 2011. Base salary for the NEOs did not increase in 2011; nor were the salaries adjusted in 2011 to reflect the increased responsibilities for each of the three Executive Vice President positions.

SUMMARY COMPENSATION TABLE

The following table summarizes the compensation paid to each of the Chief Executive Officer, Chief Financial Officer and to each of the three other most highly paid officers in 2011, 2010 and 2009.

Name and Principal Position	Year	Salary (\$)	Non-equity incentive plan compensation (\$)		Total Direct Compensation (\$)	Pension Value ⁵ (\$)	All Other Compensation (\$)	Total Compensation (\$)
			Annual incentive plans¹	Long-term incentive plans				
L. Formusa President & CEO	2011	\$735,875	\$177,000	\$0	\$912,875	\$42,000	\$0	\$954,875
	2010	\$735,875	\$157,477	\$0	\$893,352	\$58,000	\$0	\$951,352
	2009	\$735,875	\$147,658	\$0	\$883,533	\$75,000	\$0	\$958,533
S. Struthers ² Executive Vice President and CFO	2011	\$325,000	\$177,000	\$0	\$502,000	\$36,000	\$0	\$538,000
	2010	\$325,000	\$178,750	\$0	\$503,750	\$60,000	\$0	\$563,750
	2009	\$312,632	\$140,000	\$0	\$452,632	\$195,000	\$0	\$647,632
M. D'Arcey Senior Vice President, Customer Operations	2011	\$339,010	\$150,000	\$0	\$489,010	(\$37,000)	\$0	\$452,010
	2010	\$339,010	\$154,000	\$0	\$493,010	(\$2,000)	\$0	\$491,010
	2009	\$339,009	\$152,250	\$0	\$481,259	\$36,000	\$0	\$527,259
C. Marcello ³ Executive Vice President Strategy	2011	\$300,000	\$177,000	\$0	\$477,000	(\$9,000)	\$0	\$468,000
	2010	\$300,000	\$165,000	\$0	\$465,000	\$51,000	\$0	\$516,000
	2009	\$291,022	\$156,000	\$0	\$447,022	\$232,000	\$0	\$679,022
Peter Gregg ⁴ Executive Vice President Operations	2011	\$295,000	\$177,000	\$0	\$457,250	\$34,000	\$0	\$506,000
	2010	\$295,000	\$162,250	\$0	\$457,250	\$35,000	\$0	\$492,250
	2009	\$287,089	\$157,000	\$0	\$444,089	\$29,000	\$0	\$473,089

¹ Information in the Summary Compensation Table is based on the year the incentive was earned. The incentive is generally earned in one year and paid in the following year. Therefore, the information provided in the Summary Compensation Table above differs from that published under the Public Sector Salary Disclosure Act (Ontario).

² In 2008, Mr. Struthers was the Company's Chief Information Officer ("CIO") and his base salary and incentive plan was in accordance the compensation plan for his management band and salary level for that year. Mr. Struthers became the CFO effective February 12, 2009, upon the resignation of B. Summers, the former CFO. For 2009, Mr. Struthers was compensated for two months in accordance with his compensation plan as CIO and for the balance of the year in accordance with his compensation provisions as CFO, which provided Mr. Struthers with an annualized base salary of \$325,000 which remained unchanged in 2011. Mr. Struthers became an Executive Vice President and CFO effective November 1, 2010. In his new role, Mr. Struthers continued with his responsibilities for Corporate Finance and has added responsibilities for Human Resources, Labour Relations and Regulatory Affairs. Base salary for Mr. Struthers was not adjusted in 2011 to reflect his increased responsibilities.

³ In 2008, Mr. Marcello was the Company's Vice President of Corporate Projects and his base salary and incentive plan was in accordance the compensation plan for his management band and salary level. Mr. Marcello was appointed on March 9, 2009 as Senior Vice President – Asset Management. For 2009, Mr. Marcello was compensated for three months in accordance with his compensation plan as Vice President Corporate Projects and for the balance of the year in accordance with his compensation provisions as Senior Vice President – Asset Management, which provided Mr. Marcello with an annualized base salary of \$300,000 which remained unchanged in 2010. On November 1, 2010, he was appointed Executive Vice President Strategy and continues to retain his responsibilities for Asset Management. He has additional responsibilities for Business Performance, Corporate Affairs, First Nations and Metis Relations, Hydro One Brampton, Information Solutions Division, Strategy Alignment, and Transmission Projects Development. Base salary for Mr. Marcello was not increased in 2011 to reflect his increased responsibilities.

⁴ Mr. Gregg was formerly the Senior Vice President, Corporate and Regulatory Affairs until November 1, 2010 when he was appointed Executive Vice President Operations. In 2009, Mr. Gregg was given added responsibilities and an expanded role. As a result of these added responsibilities Mr. Gregg's salary was increased and his base salary for 2009 reflects four months at his previous level and eight months at the higher level. At the end of 2009, Mr. Gregg's annualized base salary was \$295,000 which remained unchanged in 2010. In his role as Executive Vice President Operations, Mr. Gregg is accountable for Customer Operations, Engineering and Project Delivery, Facilities and Real Estate, Grid Operations, Health Safety and Environment, Organizational Alignment, and Supply Chain and Shared Services. Base salary for Mr. Gregg was not increased in 2011 to reflect his increased responsibilities.

⁵ The pension value includes a combination of annual current service cost as well as the past service impact of other compensating amounts as described in footnotes 2 and 3 to the defined benefit pension plan table in the next section.

None of Ms. Formusa, Mr. Struthers, Mr. D'Arcey, Mr. Marcello or Mr. Gregg are entitled to other benefits or perquisites in the aggregate amount that exceeds \$50,000 or 10% of his or her annual salary.

Ms. Formusa does not receive any additional compensation for her services as a director of Hydro One.

Pension Plan Benefits

Defined Benefit Pension Plan

Hydro One provides a defined benefit pension plan to its employees. Each of the NEOs participates in the Hydro One Pension Plan (consisting of the Hydro One registered pension plan and the supplementary pension plan). The benefits for these individuals are calculated in a consistent manner with all other Hydro One employees, as described below.

For each year of credited service under the Hydro One Pension Plan, to a maximum of 35 years, the benefit provided for each of the employees who participate in the plan is equal to 2% of the member's average base annual earnings during the 36 consecutive months (60 consecutive months for management employees hired on or after January 1, 2004 and for employees represented by the Society of Energy Professionals hired on or after November 17, 2005) when his or her base annual earnings were highest. Base annual earnings are comprised of the member's salary and 50% of his or her short term incentive, if applicable.

The approximate projected credited years of service that each NEO will have if he or she works until the age of 65 is as follows: Ms. Formosa – 35 years; Mr. Struthers – 24 years; Mr. D'Arcey – 35 years; Mr. Marcello 35 years and Mr. Gregg 28 years. This pension is reduced by 0.625% of the member's average base annual earnings up to the year's maximum pensionable earnings during the 36 consecutive months (60 consecutive months for management employees hired after January 1, 2004 and for employees represented by the Society of Energy Professionals who were hired after November 17, 2005) when his or her base earnings were highest (the reduction is 0.500% for employees represented by the Society of Energy Professionals who were hired prior to November 17, 2005 and for all employees represented by the Power Workers' Union). The reduction is intended to offset Canada Pension Plan ("CPP") benefits.

The plan terms also include a bridge pension which is payable from the date of retirement to age 65 for all members except for management employees hired on or after January 1, 2004 and employees represented by the Society of Energy Professionals hired on or after November 17, 2005. The Hydro One Pension Plan provides for early retirement with an unreduced pension at the earlier of age 65 and the attainment of years of age plus continuous employment totalling 82 or more (years of age plus credited service totalling 85 for management employees hired on or after January 1, 2004 and for employees represented by the Society of Energy Professionals hired on or after November 17, 2005). A plan member who is not eligible for an unreduced pension can retire with a reduced pension any time after attaining age 55.

Pension benefits payable to pensioners, beneficiaries and terminated employees with deferred pensions are increased annually effective January 1 of each year equal to 100% of the increase in the Ontario consumer price index for the 12 month period ending in June of the previous year (75% for management employees hired on or after January 1, 2004 and for employees represented by the Society of Energy Professionals hired on or after November 17, 2005). The normal form of pension for a member who does not have a spouse at retirement is a pension payable for life and guaranteed for five years, payable to an estate if not paid to the retiree. The normal form of pension for a member who has a spouse at retirement is a pension payable for the life of the member, and continuing after the member's death to his or her spouse at the rate of 66 2/3% of the amount the member was receiving.

Benefits payable under Hydro One's registered pension plan, similar to other entities, are restricted by the *Income Tax Act* (Canada). This limit on benefits affects members whose average annual earnings exceed approximately \$143,000 in 2011. Participants whose pensions would otherwise be restricted by the *Income Tax Act* (Canada) participate in an unregistered supplementary pension plan that provides benefits equal to the difference between the *Income Tax Act* (Canada) maximum pension benefits and the benefits determined in accordance with the formula set out in Hydro One's registered pension plan. The supplementary pension plan is unfunded and the additional retirement income is paid from general revenues. Hydro One's obligations to participants under the supplementary pension plan are secured by a letter of credit.

The table below shows the following information for each NEO participating in the company's defined benefit pension arrangements:

- Years of credited service as at December 31, 2011 and as at the normal retirement age of 65;
- Estimated annual benefit accrued, or earned, for service up to December 31, 2011 and up to the normal retirement age of 65; and
- A reconciliation of the accrued obligation from December 31, 2010 to December 31, 2011. The accrued obligations reflect the impact of the annual bonus earned in the year even though it is paid in the following year.

Name	Number of years credited service at year end (#)	Annual benefits payable (\$)		Accrued obligation at start of year ¹ (\$)	Compensatory change (\$)		Non-compensatory change ⁴ (\$)	Accrued obligation at year end ⁵ (\$)
		At year end	At age 65		Service Cost ²	Other ³		
L. Formusa	30.9 yrs	\$495,000	\$560,400	\$7,636,000	\$221,000	(\$179,000)	\$650,000	\$8,328,000
S. Struthers	11.9 yrs	\$88,800	\$178,800	\$1,045,000	\$76,000	(\$40,000)	\$212,000	\$1,293,000
M. D'Arcey	33.2 yrs	\$263,300	\$277,800	\$4,218,000	\$105,000	(\$142,000)	\$451,000	\$4,632,000
C. Marcello	24.1 yrs	\$169,700	\$246,600	\$2,396,000	\$84,000	(\$93,000)	\$458,000	\$2,845,000
P. Gregg	7.5 yrs	\$49,600	\$185,700	\$481,000	\$54,000	(\$20,000)	\$136,000	\$651,000

¹ The accrued obligation is the value of the projected pension earned for service to December 31, 2010. The values have been determined using the same actuarial assumptions used for determining the pension plan obligations at December 31, 2010 as disclosed in the notes to the 2010 consolidated financial statements, based on the actual earnings for 2010 and adjusted to reflect expected increases in pensionable earnings.

² The values shown under the column headed Service Cost under Compensatory Change is the value of the projected pension earned for service in the current fiscal year (reduced by the NEOs own contributions).

³ The values shown under the column headed Other under Compensatory Change is the value of the increase or decrease in the accrued obligation that relates to service prior to the current fiscal year due to the differences between actual compensation for the year and the actuarial assumption for the year assumed at the end of the prior year.

⁴ The values shown under the column headed Non-Compensatory Change include the impact of amounts attributable to interest accruing on the beginning-of-year obligation, changes in the actuarial assumptions, the NEOs own contributions and any other experience gains and losses.

⁵ The accrued obligation is the value of the projected pension earned for service to December 31, 2011. The values have been determined using the same actuarial assumptions used for determining the pension plan obligations at December 31, 2011 as disclosed in the notes to the 2011 consolidated financial statements, based on the actual earnings for 2011 and adjusted to reflect expected increases in pensionable earnings.

Notes:

- All members are currently vested in their pension entitlements earned to December 31, 2011.
- In accordance with Canadian generally accepted accounting principles, the amounts above make no allowance for the different tax treatment of the portion of pension not paid from the registered or qualified pension plans.
- All amounts shown above are estimated based on assumptions and represent contractual entitlements that may change over time.
- The method and assumptions used to determine estimated amounts will not be identical to the method and assumptions used by other issuers and, as a result, the figures may not be directly comparable to other issuers.

Termination and Change of Control Benefits

Each of Ms. Formusa, Mr. Struthers, Mr. D'Arcey, Mr. Marcello and Mr. Gregg is a party to an employment agreement with Hydro One governing the terms of their employment. None of the NEOs have any rights or receive benefits on a change of control of the company. With respect to Ms. Formusa, Mr. Struthers, Mr. D'Arcey, Mr. Marcello and Mr. Gregg, if their employment is terminated by Hydro One without cause, each of Ms. Formusa, Mr. Struthers, Mr. D'Arcey, Mr. Marcello and Mr. Gregg is entitled to receive an amount equal to her or his base salary at the date of termination in equal monthly instalments for a period of 24 months (18 months in the case of Mr. Gregg) and to receive benefits over the same period (including Incentive Plan payments equal to the average of the three previous Incentive Plan payments). Each of Ms. Formusa, Mr. Struthers, Mr. D'Arcey, Mr. Marcello and Mr. Gregg would continue to earn credited service under the Hydro One Pension Plan during such 24-month period (18-month period in the case of Mr. Gregg). Continuation of benefits will also continue until expiry of the severance period. The amount of salary and incentive plan benefits expected to be paid if Ms. Formusa, Mr. Struthers, Mr. D'Arcey, Mr. Marcello and Mr. Gregg were terminated on December 31, 2011 is summarized in the following table.

Name	Base Salary	3 year average Incentive Payment	Total Payment
L. Formusa	\$1,471,750	\$317,006	\$1,788,756
S. Struthers	\$650,000	\$263,833	\$913,833
M. D’Arcey	\$678,020	\$320,833	\$998,853
C. Marcello	\$600,000	\$278,666	\$878,666
P. Gregg	\$442,500	\$240,099	\$682,599

The following information summarizes the amount by which each NEO’s annual pension would increase due to inclusion of such 24-months (18 months in the case of Mr. Gregg) of additional credited service and any corresponding increase in average annual earnings calculated at the end of such 24-month period (18 months in the case of Mr. Gregg).

Ms. Formusa’s annual pension accrued at December 31, 2011 would be expected to increase by \$31,600.

Mr. Struthers’s annual pension accrued at December 31, 2011 would be expected to increase by \$18,000.

Mr. D’Arcey’s annual pension accrued at December 31, 2011 would be expected to increase by \$12,800.

Mr. Marcello’s annual pension accrued at December 31, 2011 would be expected to increase by \$17,500.

Mr. Gregg’s annual pension accrued at December 31, 2011 would be expected to increase by \$14,000.

The payment levels have been determined based on standard factors considered in termination situations, such as age, length of service, proximity to retirement and job level.

Ms. Formusa, Mr. Struthers, Mr. D’Arcey, Mr. Marcello and Mr. Gregg are not entitled to receive any payment in the event of termination for cause or voluntary termination.

Upon retirement, all NEOs are entitled to benefits, which include core health and dental coverage and life insurance applicable to all management employees employed at Hydro One. These benefits are identical to the retirement benefits provided to other management employees in the company. No benefits are provided in the event of a termination of employment for any other reason in the NEO’s employment contract.

For the NEOs, there are no significant conditions or obligations that apply to receiving any of these benefits or payments other than a standard company confidentiality agreement.

Director Compensation

The by-laws of Hydro One provide that directors may receive reasonable remuneration for their services, commensurate with their duties, together with reimbursement for all reasonable expenses incurred in fulfilment of their duties, including travel expenses. The amount of such

remuneration is determined by the Board of Directors from time to time. The following remuneration is currently paid to directors:

Retainer for directors	\$25,000 per annum
Retainer for Committee Chairs	\$3,000 per annum
Participation in Board and Committee Meetings	\$900 per meeting

The fees are reviewed periodically but have not been revised since 2001. The President and Chief Executive Officer is not entitled to these fees. Directors who travel large distances to attend Board and Committee meetings also receive an allowance of \$900 for each meeting or series of meetings. Directors are also reimbursed for travel and other expenses incurred for attendance at Board and Committee meetings. Directors' fees, less statutory deductions, are paid quarterly by direct deposit or cheque as requested.

Mr. James Arnett was appointed Chair of the Board of Directors on March 31, 2008. The Chair receives annual remuneration of \$150,000 per annum and does not receive any additional fees for serving as a director.

The following table summarizes the compensation paid in 2011 to the directors of Hydro One.

DIRECTOR COMPENSATION TABLE

Name	Fees Earned	All other compensation¹	Total
James Arnett Chair	\$150,000.00	\$0	\$150,000.00
Sami Bébawi	\$37,600.00	\$5,400.00	\$43,000.00
Kathryn Bouey	\$53,200.00	\$0	\$53,200.00
George Cooke	\$52,900.00	\$0	\$52,900.00
Janet Holder	\$50,200.00	\$0	\$50,200.00
Don MacKinnon	\$45,100.00	\$0	\$45,100.00
Michael Mueller	\$54,100.00	\$7,200.00	\$61,300.00
Walter Murray	\$58,600.00	\$12,600.00	\$71,200.00

Name	Fees Earned	All other compensation¹	Total
Robert Pace	\$60,400.00	\$8,100.00	\$68,500.00
Gale Rubenstein	\$58,600.00	\$0	\$58,600.00
Douglas Speers	\$56,800.00	\$9,900	\$66,700.00
TOTAL	\$677,500.00	\$43,200.00	\$720,700.00

1. All other compensation is the cumulative travel allowance, described above, for attendance at meetings or series of meetings.

APPOINTMENT OF AUDITOR

On December 13, 2007, the board of directors recommended to our sole shareholder that KPMG LLP be appointed as the auditor of our company for the fiscal year ended December 31, 2008. This appointment was confirmed by our sole shareholder on December 19, 2007. In 2011, KPMG LLP was re-appointed as the auditor of our company for the fiscal year ended December 31, 2011.

AUDIT AND FINANCE COMMITTEE INFORMATION

The Audit and Finance Committee's Charter

Our Audit and Finance Committee's mandate is attached hereto as Appendix "A", which Appendix is hereby incorporated by reference. The Audit and Finance Committee mandate was last reviewed on December 8, 2011.

Composition of the Audit and Finance Committee

As at December 31, 2011, the members of our Audit and Finance Committee were Michael Mueller (Chair), Kathryn Bouey, George Cooke and Walter Murray. All members are independent, and all members are financially literate as such terms are defined under applicable Canadian securities legislation.

Relevant Education and Experience

In addition to each member's general business experience, the education and experience of each Audit and Finance Committee member who was serving as a member of the Audit and Finance Committee on December 31, 2011 that is relevant to the performance of his or her responsibilities as an Audit and Finance Committee member is described below.

Mr. Mueller is a former Global Leader of PricewaterhouseCoopers' (PwC) Private Company Services/Middle Market Practice and a former member of PwC's Global Audit Leadership Team, Global Advisory Leadership Team and the Global Markets Council. From 1996 to 2005, Mr. Mueller held the position of COO and National Managing Partner of PwC Canada. Mr. Mueller is a Chartered Accountant, and a Chartered Business Valuator. Until 2009, he was a Certified Insolvency Practitioner. Since July 2010, Mr. Mueller is a Director and Chair of the Audit and Finance Committee for SMART Technologies Inc.

Ms. Bouey is President of TBG Strategic Services Inc., a management consulting firm. From 2001 to 2005, Ms. Bouey was the Deputy Minister of the Management Board Secretariat, Province of Ontario and previously held other senior management positions with the Province, including: Deputy Minister of Intergovernmental Affairs (1999-2001); and Assistant Deputy Minister, Corporate Services Group, Ministry of Health and Long-Term Care (1997-1999). Previously, she held the position of Chair of the Ontario Civil Service Commission and has served on the boards of the Canadian Comprehensive Auditing Foundation, Ontario Power Generation, the Ontario Financing Authority, the Ontario Pension Board and Sheridan College of Technology and Applied Learning. Ms. Bouey obtained a Master of Arts (Economics) from Carleton University in 1981 and was certified by the Institute of Corporate Directors in 2006. She also completed the Rotman/Institute of Corporate Directors course on Financial Literacy for Directors and Executives in 2005.

Mr. Cooke was appointed the President and CEO, The Dominion of Canada General Insurance Company ("The Dominion"), in 1992. Prior to his appointment with The Dominion, Mr. Cooke was Vice President (Ontario Division), S.A. Murray Consulting Inc. (a government relations consulting firm) between 1990 and 1992. His previous experience also includes Special Advisor, Policy to the Ontario Deputy Premier and Treasurer (1989-1990), General Manager, Ontario Automobile Insurance Board (1988-1989), and positions with the OEB (1980-1988). Mr. Cooke was a member of the Board of Directors of Atomic Energy Canada Limited (1995 to 1999) and a member of the Audit Committee. He obtained a Bachelor of Arts degree (Hons.) in Political Studies (1975) and a Masters of Business Administration degree (1977) from Queen's University, Kingston, Ontario. He also holds an Honorary Doctor of Laws degree (1999) from Assumption University in Windsor. He is currently a member of the board of directors of: The Dominion of Canada General Insurance Company, E-L Financial Corporation Limited, Insurance Bureau of Canada, and the Property & Casualty Insurance Compensation Corporation.

Mr. Murray is the former Vice-Chairman and member of the Executive Committee of RBC Capital Markets, an international corporate and investment bank. His 38 year career at the RBC Royal Bank included Senior Executive Investment Banking responsibility, Executive head of corporate banking activities for Canada and Regional Executive for RBC's Midwestern USA Corporate Banking operations. Mr. Murray is a former director of Ivernia Inc.'s Board of Directors and past Chair of its audit committee. Mr. Murray holds a Bachelor of Commerce degree from Concordia University majoring in Accounting and Business Administration. He is also a graduate of the Executive Development Program at the Tuck School of Business, Dartmouth College, New Hampshire.

Audit and Finance Committee Oversight

There have been no recommendations of our Audit and Finance Committee to nominate or compensate an external auditor which have not been adopted by our Board of Directors.

Pre-Approval Policies and Procedures

In accordance with the provisions of its mandate, the Audit and Finance Committee ratifies all non-audit services, as pre-approved by the Committee Chair, to be provided to our company by its external auditor.

External Auditor Service Fees

(a) Audit Fees

The audit fees to be billed by KPMG LLP for fiscal 2011 are estimated to be approximately \$695,000. The audit fees billed by KPMG LLP for fiscal 2010 were \$881,092.

(b) Audit-Related Fees

The total audit-related fees billed by KPMG LLP for fiscal 2011 are estimated to be approximately \$292,000. The total audit related fees billed by KPMG LLP for fiscal 2010 were \$167,122. The nature of services rendered in both years were: audit of the Hydro One Pension Plan, audit of the Hydro One Employees' and Pensioners' Charity Trust, French translations and executive expense reviews.

(c) Tax Fees

There were no tax fees billed by KPMG LLP for fiscal 2010 or fiscal 2011 as KPMG LLP did not provide any professional services in respect of tax compliance, tax advice or tax planning.

(d) All Other Fees

There were no other fees billed by KPMG LLP for fiscal 2010 or fiscal 2011.

CORPORATE GOVERNANCE DISCLOSURE

Board of Directors

The Board of Directors of our company (the "Board") has undertaken an independence assessment and determined that, except as noted below, all of Hydro One's current directors are "independent" within the meaning of the rules adopted by the Canadian Securities Administrators (the "CSA"). Ms. Laura Formosa, who is the President and Chief Executive Officer of our company and a member of the Board of Directors, is not independent as she is an executive officer of our company. In addition, Mr. James Arnett, the Chair of our Board of

Directors, is also not considered independent as he acts as our Chair and accordingly is considered an executive officer of our company.

The Board has separated the roles of Chair and Chief Executive Officer. The prime responsibility of the Chair of the Board of Directors is to provide leadership to the Board and to enhance Board effectiveness. The Chair, as the presiding member of the Board, also ensures that the relationships between the Board, management, the shareholder and other stakeholders are effective, efficient and further the best interests of our company. The Chair also encourages input and significant participation of independent directors in the leadership of our company.

Directors hold regularly scheduled meetings at which members of management are not in attendance. During 2011, nine such sessions without management were held at Board of Directors' meetings. Each Committee of the Board also holds regular in camera sessions without management present. As well, the Audit and Finance Committee regularly holds such sessions with the external auditors and with the internal auditor. The Chair of the Audit and Finance Committee meets four times a year with the internal auditor. These sessions encourage open and candid discussion among the directors including amongst independent directors.

Summary of Attendance of Directors

The following table summarises the attendance of individual directors at meetings of the Board of Directors held for the 12-month period ending December 31, 2011.

Director	Board Meetings Attended
James Arnett	13 of 13
Sami Bébawi	10 of 13
Kathryn Bouey	13 of 13
George Cooke	13 of 13
Janet Holder	13 of 13
Laura Formusa	13 of 13
Don MacKinnon ¹	10 of 11
Michael Mueller	13 of 13
Walter Murray	13 of 13
Robert Pace	13 of 13
Gale Rubenstein	13 of 13
Douglas Speers	12 of 13

- (1) Mr. MacKinnon was not in attendance at two meetings of the Board of Directors because these meetings solely addressed labour relations matters and, as President of the PWU, there was a conflict of interest.

Directors' Board Memberships in Other Reporting Issuers

Director	Reporting Issuer
Robert Pace	Canadian National Railway Company, High Liner Foods Incorporated
George Cooke	E-L Financial Corporation Limited
Laura Formusa	DHX Media Ltd.
Michael Mueller	Smart Technologies Inc.

Board Mandate

The Board is responsible for the stewardship of our company and the supervision of management of the business and affairs of our company. The Board's accountabilities and responsibilities include development of our company's approach to corporate governance, the adoption of a strategic plan and oversight of risk management, as well as oversight of the company's pension plan. The Board has adopted a written mandate, the text of which is set out as Appendix "B" and which is hereby incorporated by reference.

Position Descriptions

The Board has adopted formal position descriptions for the Chair of the Board and the Board Committee Chairs. The position descriptions of each Committee Chair are set out in the Committees' mandates. In general, Committee Chairs are responsible for the leadership of their Committee as well as reporting to the Board on behalf of the Committee. The Board of Directors has also adopted a position description for the President and Chief Executive Officer, which sets out the key roles and responsibilities for that position.

Committees of the Board of Directors

The Board has established seven standing committees of the Board and delegates certain of its enumerated responsibilities to each of the Committees. Notwithstanding this delegation, the Board retains its oversight function and ultimate responsibility for all matters delegated to committees.

The seven standing committees of the Board are the Audit and Finance Committee, the Business Transformation Committee, the Corporate Governance Committee, the Health, Safety and Environment Committee, the Human Resources Committee, the Investment-Pension Committee, and the Regulatory and Public Policy Committee. The roles and responsibilities of each Committee are set out in formal written mandates. These mandates are reviewed at least annually to ensure that they reflect best practices as well as applicable regulatory requirements. In 2010, the Committee structure was revised to support the efficient operation of the committees and the Board's oversight of the business of the company. A brief summary of each of the Committees' responsibilities follows.

Audit and Finance Committee

The Audit and Finance Committee is composed entirely of independent directors or directors who are exempt from such independence requirements as required by the CSA rules (for more information, see the mandate of the Audit and Finance Committee which is attached and the discussion concerning the composition of the Audit and Finance Committee above). The Audit and Finance Committee oversees the integrity of accounting policies and financial reporting, internal controls, internal audit, financial risk exposures, financial compliance and ethics policies. In 2011, the mandate of the Audit and Finance Committee was amended to reflect that oversight responsibility for corporate risk management resides with the Board of Directors.

Business Transformation Committee

The Business Transformation Committee is composed entirely of independent directors and was first established as an ad hoc advisory Committee of the Board specifically to assist the Board in its oversight responsibility on matters related to our company's Cornerstone project.

In May 2009, the Committee's mandate was amended to include oversight responsibility for all matters related to the "ADS and Continuous Innovation Strategy". In 2010, the Committee's mandate was further amended to include oversight responsibility for all matters related to the planning, development and implementation of major transmission system or distribution projects including the projects described in the Corporation's Green Energy Implementation Plan.

Corporate Governance Committee

The Corporate Governance Committee is composed entirely of independent directors with the exception of Mr. Arnett. The Corporate Governance Committee acts as the nominating committee of the Board and recommends director candidates, committee assignments, director compensation, and corporate governance policy for committees and the board as a whole. The Corporate Governance Committee reviews the general and specific criteria applicable to candidates to be considered for nomination to the Board. The objective of this review is to maintain the composition of the Board in a way that provides the best mix of skills and experience to guide the long-term strategy and ongoing business operations of our company. In addition, the Corporate Governance Committee leads an annual evaluation of the Board and makes recommendations on modifications of the evaluation process.

Health, Safety and Environment Committee

The Health, Safety and Environment Committee advises the Board on health, safety and environment policies and standards, oversees compliance with health, safety and environment regulations at our company, and reviews and reports to the Board on our company's emergency preparedness.

Human Resources Committee

The Human Resources Committee (the "HR Committee") is composed entirely of independent directors. The HR Committee recommends compensation policy for senior managers, leads the performance review of the President and Chief Executive Officer, and recommends bargaining strategy with respect to the unions. In this regard, the Committee also reviews succession

planning and the recommendations for the appointment of persons to senior executive positions. In 2011, the Hay Group reviewed and provided advice on management compensation. The HR Committee also engaged Hugessen Consulting Inc. to advise the Committee and the Board on the competitiveness and effectiveness of the company's compensation programs. For additional information relating to the compensation of our company's senior executives, see "Statement of Executive Compensation."

Investment-Pension Committee

The Investment-Pension Committee's primary function is to assist the Board of Directors in fulfilling its oversight responsibilities in all matters related to the Hydro One Pension Plan including the Hydro One Pension Fund.

Regulatory and Public Policy Committee

The Regulatory and Public Policy Committee monitors our company's compliance with regulatory requirements and related risk, reviews related policies and generally oversees processes and procedures related to regulatory compliance at our company. The Regulatory and Public Policy Committee also advises the Board on public policy matters and corporate social responsibility issues.

Orientation and Continuing Education

Hydro One's "The Director Orientation and Continuing Education Program" was established in accordance with the principles set out in the *Business Corporations Act* (Ontario), National Policy 58-201: *Corporate Governance Guidelines*, the mandate of the Board and the mandates of the Corporate Governance and Audit and Finance Committees. The Director Orientation and Continuing Education Program consists of two elements: the New Director Orientation Program and the Continuing Director Education Program. The New Director Orientation Program consists of a Hydro One Directors' Guide, which is given to all new directors upon joining the Board to provide them with an overview of the key organizational, financial, regulatory, and operational aspects of our company. The Directors Guide also contains information on the structure of the Board and its committees, committee mandates and general information on a director's obligations. In addition, new directors receive orientation sessions with the Chair, the President and Chief Executive Officer and members of the senior management team as well as tours of our company's facilities. The orientation sessions familiarize directors with Hydro One's strategic plans, its significant financial, accounting and risk management issues, its compliance programs, its Pension Plan and the directors' obligations as plan fiduciaries, and its Code of Business Conduct.

The Continuing Director Education Program includes, on an ongoing basis, as part of regular Board meetings, information briefings, presentations and updates from senior management on relevant topics related to our company's business. These information items are either suggested by management or may be requested by members of the Board. As well, directors receive information from management in response to any actions arising at a board meeting or otherwise. The Continuing Director Education Program also includes articles and other information from relevant publications, which are forwarded to directors, visits to Hydro One facilities, and,

attendance at industry events and conferences and seminars which are relevant external education opportunities or general courses of interest.

Ethical Business Conduct

The Board has adopted a written Code of Business Conduct (the “Code”). The Code sets out a comprehensive set of principles and expectations relating to ethical conduct, conflicts of interest and compliance with laws. The Code is part of Hydro One’s internal control framework and applies to all of Hydro One’s directors, officers and employees. The Code also applies to Hydro One’s agents, consultants, contractors and business partners, to the extent feasible. The Code is posted on the corporate intranet site and on the external corporate website at www.HydroOne.com.

Our company has a Corporate Ethics Officer who is accountable for making sure that the appropriate actions are taken to investigate and resolve known or suspected violations of the Code, and for ensuring the tracking and reporting of all violations. The Board monitors compliance with the Code through the Human Resources Committee and the Audit and Finance Committee, to whom the Corporate Ethics Officer reports. The President and Chief Executive Officer is ultimately responsible for our company’s compliance with the Code. Further, the Board of Directors abides by a conflict of interest policy which requires directors to exercise independent judgment when considering transactions and contracts in respect of which a director has a material interest.

In 2008, the Code was updated to reflect changes in Hydro One’s organizational structure, corporate accountabilities, and the Company’s business strategy. The revised Code reflects current best governance and ethics practices, including the introduction of a third-party hotline for the anonymous reporting of any accounting, internal accounting controls or auditing matters. The document can be found at: <http://www.hydroone.com/Careers/Pages/CodeofConduct.aspx>.

Board, Committee and Director Assessments

A process is in place for evaluating the effectiveness of the Board and its Committees. The process consists of a long-form and short-form evaluation process. The long-form Board evaluation process consists of three written questionnaires: Board, Individual Director, and Committee Assessments of the Board. The Board Assessment addresses the areas of board responsibility, operation and effectiveness. The Individual Director Assessment allows each director to identify areas for improved individual development and performance. The Committee Assessment addresses areas of committee operations and allows each Committee member to identify areas for improved performance.

In alternate years, a short-form Board evaluation process consisting of a one-page questionnaire in which Board members provide comments on any issues that may be of concern to them, is completed.

In addition to the written questionnaires, the Chair of the Board also meets annually with each director about individual performance and the effectiveness of the Board and Committees.

The responses to each questionnaire are compiled in summary reports, which are reviewed by the Corporate Governance Committee to determine what, if any, actions may need to be taken. The Chair of the Corporate Governance Committee provides a report on the summary reports to the Board.

APPENDIX “A”

AUDIT AND FINANCE COMMITTEE

MANDATE

1. Pursuant to By-Law No. 1 of Hydro One Inc. (the “Corporation”), a committee of the directors to be known as the “Audit and Finance Committee” (hereinafter referred to as the “Committee”) is hereby established.
2. The Committee shall be composed of a minimum of four directors, and have membership attributes consistent with applicable requirements under the *Securities Act* (Ontario) and regulations there under including:
 - **Independence.** The Committee shall be comprised of directors who shall meet the independence and audit committee composition requirements set forth by applicable securities regulatory authorities, or any governmental or regulatory body exercising authority over the Corporation, as in effect from time to time. A member cannot accept consulting, advisory or compensatory fees, other than compensation for directors’ fees and expenses, from the Corporation.
 - **Financial Literacy.** All members are to be financially literate (or shall become financially literate within a reasonable period of time after appointment to the Committee). A member is financially literate if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the Corporation’s financial statements.
3. The members of the Committee shall be appointed or re-appointed at the Organizational Meeting of the Board of Directors (the “Board”) immediately following each annual meeting of the Shareholder of the Corporation. Each member of the Committee shall continue to be a member thereof until his or her successor is appointed, unless such member shall resign or be removed by the Board or shall cease to be a director of the Corporation. Where a vacancy occurs at any time in the membership of the Committee, it may be filled by the Board and shall be filled by the Board if the membership of the Committee is less than four directors as a result of the vacancy. Whenever there is a vacancy on the Committee, the remaining members may exercise all of the powers of the Committee as long as a quorum remains in office.
4. The Board or, in the event of its failure to do so, the members of the Committee, shall appoint a Chair from amongst their number. If the Chair of the Committee is not present at any meeting of the Committee, the Chair of the meeting shall be chosen by the Committee from among the members present. The Committee Chair shall be responsible for the leadership of the Committee, including the preparation of the agenda, presiding over meetings and determining Committee assignments. The Chair presiding at any meeting of the Committee shall have a casting vote in case of deadlock. The Committee shall also appoint a Secretary who need not be a director.

5. The time and place of meetings of the Committee and the procedure at such meetings shall be determined from time to time by the members thereof provided that:
 - (a) a quorum for meetings shall be three members, present in person or by telephone or other telecommunication device that permit all persons participating in the meeting to speak and hear each other;
 - (b) the Committee shall meet at least quarterly; and
 - (c) notice of the time and place of every meeting shall be given in writing by facsimile communication or electronic mail to each member of the Committee, the internal auditors and the external auditors of the Corporation at least 24 hours prior to the time fixed for such meeting, provided, however, that a member may in any manner waive a notice of a meeting; and attendance of a member at a meeting is a waiver of notice of the meeting, except where a member attends a meeting for the express purpose of objecting to the transaction of any business on the grounds that the meeting is not lawfully called. The Committee may request the external auditors to attend a meeting or meetings of the Committee, the expense of which shall be paid by the Corporation and included within the external auditors' annual fee. A meeting of the Committee may be called by the Secretary of the Committee on the direction of the Chair or Chief Executive Officer of the Corporation, by any member of the Committee, the external auditors or internal auditors. Notwithstanding the provisions of this paragraph, the Committee shall at all times have the right to determine who shall and shall not be present at any part of the meeting of the Committee.
6. The Committee Chair is responsible for reporting to the Board on behalf of the Committee on matters considered by the Committee, its activities and compliance with this mandate.
7. For purposes of this Section, the term "Corporation" shall include Hydro One Inc. and its subsidiary entities, as defined by Multilateral Instrument 52-110 Audit Committees.

The Committee shall:

- (1) in connection with its advisory functions:
 - (a) review the internal audit procedures of the Corporation and advise the Board on its auditing practices and procedures and obtain adequate assurance that internal controls are adequate;
 - (b) meet separately with the external auditors and internal auditors;
 - (c) recommend to the Board and shareholder the retention and, if appropriate, the removal of external auditors, evaluating and remunerating them, and monitoring their qualifications, performance and independence;
 - (d) review periodically, reports on the nature and extent of compliance with requirements regarding statutory deductions and remittances, including

deductions and remittances under the *Income Tax Act* (Canada), the *Excise Tax Act* (Canada) and the *Unemployment Insurance Act* (Canada), the nature and extent of non-compliance together with the reasons therefore and the plan and timetable to correct deficiencies and report to the Board on the status of such matters;

- (e) review and reassess the Committee's mandate at least annually and report to the Board results of the review, including any recommended changes to the mandate;
- (f) the Committee shall meet with management to review and assess the process and systems in place for the review of public disclosure documents that contain audited and unaudited financial information and their effectiveness;
- (g) describe in the annual information form all information about the Committee as required by applicable securities regulatory authorities; and
- (h) review and assess with management and recommend to the Board for approval any material transaction, contract or other matter involving the Corporation and a shareholder, or other person, which owns directly or indirectly voting securities of the Corporation. For this purpose, "material" means any transaction, contract or matter that significantly affects, or would reasonably be expected to have a significant effect on, the financial position of the Corporation or the market price or value of its securities.

(2) In connection with the exercise of its powers:

- (a) review and recommend to the Board for approval:
 - (i) the audited annual financial statements of the Corporation, the annual management discussion and analysis ("MD&A") and any required annual MD&A supplement and related press releases before the Corporation publicly discloses this information;
 - (ii) the Corporation's interim (quarterly) financial statements, interim MD&A and any required interim MD&A supplement and related press releases before the Corporation publicly discloses this information, unless the Board delegates to the Committee such approval authority as provided in paragraph (b) below;
 - (iii) all financial statements in prospectuses and other offering memoranda, and financial statements required by securities regulatory authorities;
 - (iv) the annual information form of the Corporation and any other similar disclosure required to be filed by securities regulatory

authorities;

- (v) any prospectus, offering memorandum of the Corporation, or any amendments thereto. For the purpose of this mandate, reference to “prospectus” includes a preliminary prospectus, a prospectus, or an amendment thereto, but excludes a pricing supplement;
 - (vi) the annual financing plans and objectives of the Corporation including, foreign currency risk and interest rate risk strategies; and
 - (vii) the Corporation’s annual Budget and Outlook, and annual Business Plan, and any amendments thereof.
- (b) subject to the authority delegated by the Board, review and approve the Corporation’s interim financial statements, interim MD&A and any interim MD&A supplement, and review and approve the related press releases;
 - (c) discuss with the external auditors results of their review of the interim financial statements and interim MD&A, including any matters external auditors may raise with audit committees under generally accepted accounting principles and auditing standards in compliance with applicable securities laws and regulations;
 - (d) review the issuance under a shelf prospectus of the Corporation of debentures, notes and/or other unsecured and secured evidences of indebtedness of the Corporation, in accordance with the authority delegated by the Board and the filing with securities regulatory authorities of any prospectus supplement relating thereto;
 - (e) review and oversee the audit plans of the internal auditors and review, pre-approve and directly be responsible for overseeing the work of the external auditors of the Corporation engaged for the purpose of preparing or issuing an auditor’s report or performing other audit, review or attest services for the Corporation, including the resolution of any disagreements between management and the external auditors regarding financial reporting. The Committee has the authority to communicate directly with the internal and external auditors.

The Committee shall also review the degree of co-ordination between the audit plans of the internal auditors and the external auditors and will inquire as to the extent the planned audit scope can be relied upon to detect weaknesses in internal control, fraud or other illegal acts. Any significant recommendations made by the auditors for the strengthening of internal controls will be reviewed;

- (f) pre-approve all audit and non-audit services to be provided to the Corporation by its external auditors. In connection with non-audit services, the Committee shall adopt specific policies and procedures for the engagement of non-audit services ensuring that the non-audit service is not prohibited or restricted by securities regulatory authorities. The Committee may also delegate to one or more of its members the authority to pre-approve audit and non-audit services, in which event the pre-approval of audit and non-audit services by any such member must be presented to and ratified by the Committee at its first scheduled meeting following such pre-approval;
- (g) review the internal control procedures and management's annual internal control report to ensure compliance with the law and avoidance of conflicts of interest including, without limitation, a review of policies and practices concerning officers' expenses and perquisites, including the use of the Corporation's assets;
- (h) review the duties and responsibilities of internal audit staff respecting controls, procedures and accounting practices of the Corporation;
- (i) review management programs and policies regarding the adequacy and effectiveness of internal controls over the accounting and financial reporting systems within the Corporation and, in particular, the Committee will review management's response to the internal control recommendations of the internal and external auditors;
- (j) receive and review regular reports from the internal and external auditors on the appropriateness of the Corporation's significant accounting and disclosure policies and practices and changes thereto, including any areas of management judgment and estimates that have a material effect upon the financial statements, alternative accounting treatments and their ramifications, disagreements between management and the internal and external auditors and include in the review a discussion with the external auditors of the quality, not just acceptability, of accounting principles, the reasonableness of significant judgments, and the clarity and completeness of disclosure;
- (k) review with management, the external auditors and, if necessary, with legal counsel, any litigation, claim or other contingency, including tax assessments, that could have a material effect upon the financial position or operating results of the Corporation, and the manner in which these matters have been disclosed in the financial statements;
- (l) review, at least annually, the Corporation's corporate insurance program;
- (m) annually discuss with external auditors and report to the Board the auditors' independence from management and the Corporation, and in connection, request their written confirmation of independence and

disclosure of relationships they have with the Corporation that may be thought to bear on independence, including non-audit related services and fees and their impact;

- (n) review the minutes of any audit committee meetings of subsidiary entities of the Corporation and any significant issues and auditor recommendations concerning such subsidiary entities;
 - (o) review the basis and amount of the external auditor's fees in light of the number and nature of reports issued by the auditors, the quality of the internal controls, the size, complexity and financial condition of the Corporation and the extent of internal audit and other support provided by the Corporation to the external auditors and review all other non-audit fees of the auditors or other accounting firms;
 - (p) review management's retention of consulting and professional services, including external legal services, on an annual basis;
 - (q) review and appropriately address any complaints regarding accounting, internal accounting controls, or auditing matters received since the Committee's last meeting, including complaints confidentially submitted by those wishing to remain anonymous; and
 - (r) receive and review any reports of evidence of a material violation of securities laws or breaches of fiduciary duty tabled by the Corporation's legal counsel as a result of an inappropriate response from management.
- (3) review and approve the Corporation's hiring policies regarding partners, employees and former partners and employees of the current and former external auditor of the Corporation.
- (4) review, at least on an annual basis:
- (a) for information purposes:
 - (i) overall financing of risk, including the purchase of insurance;
 - (ii) loss prevention policies and insurance risk management programs;
 - (b) and recommend to the Board for approval financial risk management strategies, including foreign currency and interest rate risk strategies.
- (5) With respect to the Corporation's Pension Plan and Fund, review and recommend to the Board for approval the Hydro One Pension Plan and Fund Annual Report and Audited Financial Statements and those of each of its subsidiary investment corporations.

8. The Committee is responsible for monitoring the Strategic Objectives contained in the annual Corporate Scorecard applicable to it, as determined from time-to-time by the Corporate Governance Committee of the Board.
9. In instances where members of the Committee believe that in order to properly discharge their fiduciary obligations to the Corporation it is necessary to obtain the advice of independent counsel and other expert advisers, the Committee shall have authority to engage and compensate the appropriate experts. The Board shall be kept apprised of both the selection of the experts and the expert's findings through the Committee's regular reports to the Board.

APPENDIX “B”

HYDRO ONE INC. BOARD OF DIRECTORS

MANDATE

DUTIES OF THE BOARD OF DIRECTORS

1. The Board of Directors of Hydro One Inc. (the “Board”) is responsible for the stewardship of, and has the duty to supervise the management of, the business and affairs of the Corporation including its Subsidiaries, as defined in the *Business Corporations Act* (Ontario).
2. The Board is elected by the sole Shareholder, the Province of Ontario, as represented by the Minister of Energy and Infrastructure (the “Shareholder”). The Board is responsible for seeking and recommending suitable Board candidates to the Shareholder.

ACCOUNTABILITIES AND RESPONSIBILITIES

The Board shall have the accountabilities and responsibilities set out below. In addition, the Board shall perform such duties as may be required under, and act in accordance with the *Business Corporations Act* (Ontario), the Corporation’s by-laws, the Memorandum of Agreement with the Shareholder, dated March 27, 2008 (the “Shareholder Agreement”), as may be amended from time to time, and all applicable laws.

1. Corporate Governance

- a. The Board is responsible for developing the Corporation’s approach to corporate governance, including developing appropriate policies and procedures and delegating such other matters as it sees fit to the Corporate Governance Committee for its review and consideration.
- b. The Board is responsible for the Corporation’s approach to its governance relationship with its sole Shareholder.

2. Strategic Planning

The Board is responsible for:

- a. adopting a strategic planning process and approving, on at least an annual basis, a strategic plan which lays out the strategic direction of the Corporation in the context of the opportunities and risks of the business and the business and commercial environment in which it operates;
- b. reviewing and approving the business, financial, strategic and other plans proposed by management to enable the Corporation to execute its strategy;
- c. adopting processes for monitoring the Corporation’s progress toward its strategic and operational goals, and to revising and altering its directions to management in light of changing circumstances affecting the Corporation;
- d. taking action when corporate performance falls short of its performance targets or other special circumstances warrant;

- e. approving the audited financial statements, interim financial statements and the notes and management's discussion and analysis accompanying such financial statements and the Corporation's Annual Information Form;
- f. reviewing and approving material transactions outside the ordinary course of business, subject to the Shareholder Agreement; and
- g. overseeing the Corporation's Pension Plan and Fund.

3. **Risk Management**

The Board is responsible for:

- a. identifying the principal risks of the Corporation's business and ensuring the implementation of appropriate systems to effectively monitor and manage such risks with a view to the long-term viability of the Corporation;
- b. reviewing the major risks to the Corporation's business objectives (Corporate Risk Profile);
- c. reviewing the risk retention philosophy and risk tolerance guidelines;
- d. reviewing and approving the Corporation's enterprise risk management policy and framework;
- e. overseeing the integrity of the Corporation's internal control and management information systems;
- f. approving and monitoring compliance with, all significant policies and procedures by which the Corporation is operated; and
- g. approving policies and procedures designed to ensure that the Corporation operates at all times within applicable laws and regulations.

4. **Human Resources Management**

- a. The Board is responsible for approving the appointment of the President and CEO. The Board is also responsible for approving the compensation of the President and CEO and the performance agreement of the President and CEO following a review of the recommendations of the Human Resources Committee.
- b. The Board will, to the extent feasible, satisfy itself as to the integrity of the President and CEO and other executive officers, and that the President and CEO and other executive officers create a culture of integrity throughout the organization.
- c. The Board is responsible for ensuring that succession planning programs are in place, including programs to train, develop, monitor and retain senior management, including the President and CEO.

5. **Communications and Reporting**

- a. The Board is responsible for approving and revising from time to time, a disclosure policy to address accurate and timely communications with the Shareholder, bondholders, employees, financial analysts, governments and regulatory authorities, the media and the public.
- b. The Board is responsible for overseeing the Corporation's reporting to the Shareholder, responses to requests for information and other reporting obligations as set out in the Shareholder Agreement, and for ensuring open and transparent communication with the Shareholder.

6. Board Meetings and Materials

- a. The Chair, in consultation with the President and CEO and the General Counsel and Secretary, shall develop the agenda for each Board meeting.
- b. Meeting materials shall be provided to directors before each Board meeting in sufficient time to ensure adequate opportunity for review.
- c. Independent directors (as defined under applicable securities legislation) shall hold regularly scheduled meetings at which non-independent directors including members of management are not present.

7. Committees of the Board

- a. The Board discharges its responsibilities both directly and through its committees: the Audit and Finance Committee, the Business Transformation Committee, the Corporate Governance Committee, the Human Resources Committee, the Health, Safety and Environment Committee, the Investment-Pension Committee and the Regulatory and Public Policy Committee. In addition to these standing Committees, the Board may from time to time appoint ad hoc Committees to address certain issues of a more short-term nature.
- b. The Board is responsible for approving the mandates for each Board Committee.
- c. To facilitate communication between the Board and each Board Committee, each Committee Chair is responsible for providing a report to the Board on material matters considered by the Committee at the first Board meeting after the Committee's meeting.

DIRECTOR DEVELOPMENT AND EVALUATION

1. Each new director shall participate in Hydro One's Director Education Program and any continuing director development programs.
2. Annually, with the assistance of the Corporate Governance Committee, the Board shall evaluate and review the performance of the Board, each of its Committees, each of the directors and the adequacy of this mandate.